TBS

Briefing Note

Office of the Treasury Board
Office of the Provincial Controller Division
Program Expenditure Management Division

Debt Financing the Global Adjustment: Preliminary Accounting and Fiscal Analysis

Issue:

The Ministry of Energy is exploring an electricity rate mitigation option in which the billing impact of the Global Adjustment (GA) on ratepayers would be reprofiled to be lower in the immediate term and spread out over a longer timeframe. The incremental cost of the initiative associated with debt financing would be borne through future rates.

Current Status:

The Ministry of Energy has requested comments from the Ministry of Finance and Treasury Board Secretariat.

Background:

The Ministry is implementing a series of electricity price mitigation initiatives, such as the Ontario Rebate for Electricity Consumers (OREC provides a rebate of 8% of electricity bills) that launched January 1, 2017. OREC is currently funded from taxpayers. The Ministry is also developing further electricity rate mitigation initiatives that utilize cap and trade proceeds, including rate relief for industrial and commercial consumers. In addition, MOECC's Climate Change Agency is expected to develop further programs that could provide rate relief.

Global Adjustment (GA) is comprised of several elements. A key GA charge is to electricity consumers to make up the gap between the market price of electricity and the higher, non-market prices that most electricity producers, both public and private producers, receive through contract prices. For residential customers, GA is embedded within time of use rates as a cost per kilowatt hour. For major manufacturers and large businesses, the fee appears separately on electricity bills. Our understanding if that currently the GA is fiscally neutral to the Province (excluding the amount of the payments that are received by OPG and therefore, consolidated.) The payments to the producers made by IESO are passed through to the LDCs for billing to the ratepayers.

The current proposal is that debt would be issued to finance a portion of IESO's costs resulting from the timing gaps between producer/program expenses and proceeds collected from energy consumers through the GA. It is not clear which entity (the Province or IESO or some other entity) would issue the debt, and therefore whether IESO would receive proceeds, and if so, how that would be recorded. For now an assumption has been made that OFA would borrow in the market and lend the money to IESO to bridge the gap between the amounts paid to the producers and the amounts collected from ratepayers as it related to the GA.

Energy's proposal includes scenarios that set the 2017 amount of GA paid by ratepayers at a value lower than the true cost of GA and increasing that amount year-over-year at inflation (assumed to be 2%) until the debt has been paid off.

The proposal would have impacts on the Province's consolidated debt position and Interest On Debt, in addition to any fiscal impacts that would arise through consolidation of IESO.

The assumptions and numbers in the proposal would need further review. The Ministry of Energy notes a number of impacts on ratepayers. It is unclear whether these could result in further pressure on government to offset these. These include:

- Incurring debt to finance the GA, while lowering costs in the short term, results in a more rapid rise in electricity prices beyond the rate of increase already expected.

- The GA financing proposal involves accruing large amounts of debt to reduce electricity rates. This debt would be highly sensitive to interest rates which could extend repayment timelines or put significant pressure on rates (see Scenario 3 for an example of such interest rate risk).

- GA and HOEP provide a natural hedge against each other. Smoothing only one component would lead to greater price volatility. For example, if HOEP is higher than expected (due to higher gas or carbon prices, for example), all-in rates will rise significantly as the natural decrease in GA would not occur given the prescribed GA rate.

- Conversely, if GA is higher than forecast (i.e., because of lower HOEP or additional out-of-market costs), the debt would increase to a higher amount, requiring additional debt service payments and/or a longer recovery period.

- Should Ontario demand be lower than forecasted, the cost of paying off the debt will be shared by a smaller pool of consumption, further increasing future costs for individual ratepayers.

<u>Accounting Treatment and Risks</u>

The following analysis is based solely on the deck provided (included in Appendix A) as we have not had any conversations with the Ministry of Energy regarding whether they have completed an accounting analysis on this issue.

The focus on the accounting treatment is based on the impact to the consolidated financial statements of the Province. IESO is a consolidated entity of the Province and follows Public Sector Accounting Standards. As such, IESO does not follow rate-regulated accounting (no such concept exists in PSAS). Therefore, based on the proposal, it is likely that the difference between the amounts paid to the producers and the amount collected from the ratepayers (which would now differ), will be an expense in the period (e.g. an increase to the deficit of the Province.). In addition, the amount of interest incurred on the new debt would also be an expense of the Province (e.g. an increase to the deficit of the Province.).

While it is the case that the amounts incurred related to the Global Adjustment that are not billed in the period would be billed in a future period (unclear that this is with or without interest), prior to billing, those amounts do not meet the definition of an asset. The amounts may meet the definition of a rate regulated asset, but as noted above, PSAS does not include this concept.

In summary, in the early years, during the period that the amounts collected from the ratepayers is lower than the amounts paid to the producers, a fiscal pressure would result from this gap in addition to the interest expense.

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Date: January 13, 2017