Ontario

MINISTRY OF
ENERGY

Global Adjustment Financing

Working Draft

January 2017

CONFIDENTIAL DRAFT

Accounting Treatment: Key Tests

Does Province Control Entity?

- NO: *entity not consolidated*
- Yes: *entity consolidated*

Does Entity Receive Rate Regulated Accounting Treatment?

- No: *direct fiscal impact to income statement*
- Yes: *liability may be offset by asset*

Is Recovery Mechanism an Asset?

- No: *direct fiscal impact to income statement*
- Yes: *liability offset by asset, no income statement impact*

Accounting Treatment: Does Province Control Entity?

Determining Whether Control Exists

- Requires the application of professional judgment based on the definition of control and the substance of the relationship.
- It is the preponderance of evidence that would be considered in assessing whether a government controls an organization.

Indicators of Control

- There are certain indicators that provide more persuasive evidence of control:
  - Government has the power to unilaterally appoint or remove a majority of the members of the governing body of the organization;
  - Government has ongoing access to the assets of the organization, has the ability to direct the ongoing use of those assets, or has ongoing responsibility for losses;
  - Government holds the majority of the voting shares or a "golden share" 1(1) that confers the power to govern the financial and operating policies of the organization; and
  - Government has the unilateral power to dissolve the organization and thereby access its assets and become responsible for its obligations.
- Other indicators that may provide evidence of control exist when the government has the power to:
  - Provide significant input into the appointment of members of the governing body of the organization;
  - Appoint or remove the CEO or other key personnel;
  - Establish or amend the mission or mandate of the organization.

Accounting Treatment: Is the Entity Rate Regulated?

Determining Whether Rate Regulated Accounting Treatment is Applicable

- **TBD**

Accounting Treatment: Is the Recovery Mechanism an Asset?

In order to establish an asset, for accounting purposes

- Need to demonstrate that future cash flow / value can be derived
- Financing costs can be recoverable
- The counterparty has the willingness and ability to pay
- **ETC TBD**

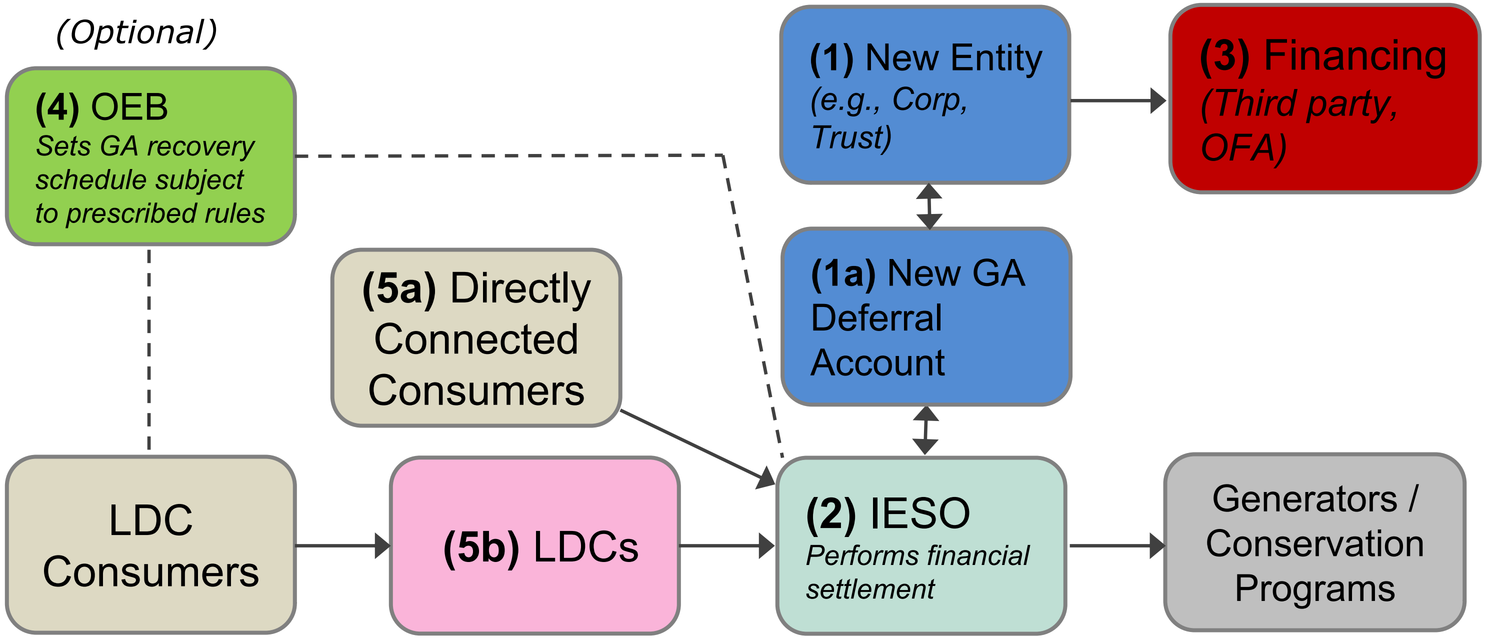
Accounting Treatment: IESO and the Province

- In addition to considering accounting treatment for the entity, also need to consider impacts to IESO and consolidation to the Province's financials
- **IESO Considerations**
  - Will funds flow through IESO and if so, will IESO record on its financials?
  - Does IESO and the recovery mechanism constitute and asset, per the tests described on prior slides?
  - If these tests are not met, are there alternative mechanisms to flow funds that do not involve the IESO?

- **Provincial Consolidation Considerations**
  - Ongoing analysis on whether such changes to the financing of the GA would affect the Province's current accounting treatment for the GA and represent a potential fiscal risk (i.e., consolidation).
  - The significant amount of additional Provincial borrowing needed to finance the GA, and associated risks (e.g., interest rates, repayment timelines), could put pressure on the Province's credit rating and overall borrowing capacity.
  - The Auditor General (AG) may comment on the appropriateness of financing the Global Adjustment and/or on the need to consolidate any financing on the Province's books.

GA Financing – Implementation Approach

- The diagram outlines a implementation approach that includes a new entity.



Corporate Structure: Overview

- The following three structures are under consideration
- Regardless of the preferred model, control and flexibility will depend on the legislative and governance framework associated with the specific entity

Trust

Non-Share Capital Corporation

Business Corporation

High level descriptions to be filled in

Corporate Structure: Trust

A trust is managed by trustees for beneficiaries, who in this case would be the debt holders

A trust is not a legal entity in its own right and can only act through its trustees.

A trust could be established by statute, a trust indenture or a combination of both instruments

To meet the control test, the Province would not be able to preserve any ability to alter the trust after the Province settles the property of the trust (the debt) with the trustees

While the Province would appoint the first trustees, the trust structure would have to include mechanisms for subsequent appointments. Ongoing governance would be entirely within the purview of the trustees

Corporate Structure: Non-Share Capital Corporation

Managed by a board of directors to achieve the objects of the corporation.
Could be created by statute and corporate documents and objects and powers would be set out therein.
Board of directors is accountable to members, who may be the board.
To meet the control test, the Province would choose the first board members but then would not have ongoing involvement in the selection of the board or key personnel. The Province could have no right to approve the entity's business plan, budget or financing. Mechanisms would have to be created to prevent the Province from winding up the corporation through legislation or otherwise.

Corporate Structure: Business Corporation

Similar to non-share corporations.
Board of Directors is accountable to shareholders.
Could be created by statute and corporate documents and objects and powers would be set out therein.
To meet the control test, the Province would choose the first board members but then would not have ongoing involvement in the selection of the board or key personnel. The Province could not have a majority of shares. The Province could have no right to approve the entity's business plan, budget or financing. Mechanisms would have to be created to prevent the Province from winding up the corporation through legislation or otherwise.

Corporate Structure: Summary

- [eventually want something high level that allows for comparison across options]

	1. Trust	2. NSCC	4. Business Corporation
Mandate & Flexibility to Amend	• xx	• xx	
Appointment of Directors	• xx	• xx	
Contracts & Obligations	• xx	• xx	
Other Consideratio ns	• xx	• xx	

Issues for Future Consideration

- Other issues to consider in the coming days / weeks (see appendix for details):
  - Mandate of the entity
  - Recovery Mechanism
  - Financing
  - Interaction with other entities in the sector (IESO/OEB/LDCs)
  - Legislative framework

Test Case: Non-Share Capital Corporation

- [suggest we build out a live example and apply accounting tests to it]
- *NTD: Consider using the IESO as a model and then show how this would be different*

Timing/Expectations

Hypothesis Development/ Due Diligence
(Late Jan 2017)

- Develop strategic options
- Conduct preliminary analysis and assessment(fiscal/ accounting/governance)

Internal Market Sounding
(Early Feb 2017)

- Canvas players on options for initial thoughts/insight
- Further due diligence

Due Diligence / Communications / Dev. Legislation
(Feb 2017)

- Conduct analysis to understand financial impact
- Understand governance structures and public interest protections
- Fiscal/cash implications
- Ratepayer impacts
- Develop communications strategy
- Develop legislative framework / begin drafting

Announcement
(February 16, 2017)

- Announcement of high level rate mitigation plan

Legal/Governance Analysis
(Feb/March)

- Understand legal and regulatory implications
- Evaluate changes required to facilitate
- Draft legislative/regulatory changes

Legislative Changes
(Spring 2017)

- Introduce enabling legislation/ regulations

Governance Set-Up
(May/June)

- Creation of new entity
- Filing documents
- Recruit Directors

Administrative/Operational Changes
(June)

- Fund flow mechanisms in place
- Management functions in place

Rate Reductions
(Summer 2017)

- Rate reduction kicks in

A. Planning | B. Preparation | C. Implementation

Timing/Expectations: Next Two Weeks

- More detailed workplan showing what we can do between now and February 16th

Appendix

Legislative Framework

- Legislation would be required to authorize the financing proposal.
  - Amendments to the *Electricity Act, 1998* (EA) could authorize the financing of certain costs within or part of the GA. However, whether any other legislation requires amendment is not known at this time.
  - The GA regime currently provides that “true costs” represent the true costs of making payments to generators or counter parties to contracts, not the incurring of discretionary financing or interest costs or the administrative costs of a new entity.

Mandate

- Consider benefits and drawbacks of various mandates

- **Narrow Mandate**: To finance and recover a specific amount of the GA over a specified period of time

- **Broad Mandate**: To better implement and recover the Global Adjustment
  - Consider inter-generational equity
  - Ability to shift financing and recovery in order to protect and benefit ratepayers
  - Potential to directly subsidize and collect from IESO market participants (LDCs and directly connected customers)
  - Less certainty with meeting rate reduction targets as well as mechanism and rate of recovery, but more likely to meet accounting thresholds

Recovery Mechanism

- Exploring different recovery / administrative options
  - Separate charge on the bill (DRC)
  - Included as part of RRP
  - Tax Rebate (OCEB)
  - A regulatory charge must be ancillary to a regulatory scheme and meet indicia outlined by the Supreme Court of Canada [legal advice pending]

Financing Mechanism

- Regardless of corporate structure, the entity would require the financial and operating authority to carry out its mandate
- Type of financing
  - Debt/Equity
- Financier
  - (OFA , IO, Third Party, Hybrid Approach)
  - Historically electricity sector financing has been conducted by the Ontario Financing Authority (i.e., managing OEFC's stranded debt and borrowing on behalf of IESO)
  - Private debt will cost more than public debt
  - Lenders would require certainty of payment (e.g. through legislation) absent assets to secure the debt

Interaction with Sector

- What is the interaction with other entities in the sector:
  - IESO/OEB/LDCs
    - Oversight
    - Flow Funds (either through IESO or direct interaction with LDCs and large consumers)

- The OEB could provide oversight over the entity's administrative costs through regulatory processes
- The entity would transact with the IESO, which would receive funds from the entity to pay the GA and pay funds to the entity to repay the debt and interest

Accounting Case Studies: IESO and Conservation

- EY analyzed whether CDM costs under an amortized scenario could still be considered an asset. In this regard, EY notes that *“ In evaluating the costs incurred by the IESO to reimburse the LDCs, an argument could be made to support the recognition of the costs as an asset as the costs meets the three essential characteristics prescribed by PS 100”.* The three characteristics include:
  - <u>Future economic benefit</u>- IESO expect to generate future economic benefit from the reimbursement of amortized CDM costs, i.e. IESO has the ability under the current regulatory framework to recover reasonable costs through GAM.
  - IESO <u>controls access</u> to the recovered funds.
  - Transaction or event giving rise to IESO’s control has already occurred- i.e, the CDM costs being amortized have been incurred

Structures Case Studies: WSIB (not recommended)

- TBS
- *WSIB is a statutory corporate body that holds money in trust for workers, but is not a trust. The Workplace Safety Insurance Act requires the Board to maintain an insurance fund. The Board receives money from employers and pays money out to injured workers, in accordance with the scheme set out in the Act. Use this model if it's helpful, but it seems to me that there is a tremendous amount of misunderstanding about it.*

Structures Case Studies: ISO-NE (NSCC)

- TBS

Structures Case Studies: GTAA (NSCC)

- TBS

Structures Case Studies: Aggregate Resources (Trust)

- Aggregate Resources Trust is a potential example because it is administered outside government – tbc

Structures Case Studies: TBD (Business Corporation)

- TBS