IESO FAIR HYDRO PLAN CREDIT FACILITY
INTENDED USE – DISCUSSION WITH ENERGY STAFF

In a discussion with Energy staff [following comments heard in a call to discuss the Change of Law Protection Agreement call on December 1, 2017], Corporate and Electricity Finance Division (CEFD) staff became aware of one aspect of the use of the Ontario Financing Authority (OFA) $2 billion credit facility for the Independent Electricity System Operator (IESO) developed for the implementation of the Fair Hydro Plan (FHP).

For the "moratorium" period of the FHP where the customer bill increases are to be kept to the rate of inflation, the described plan would use the $2 billion credit facility provided by the OFA to cover interest costs and fees charged by the Fair Hydro Plan Trust (OPG Trust) to the IESO [TBC].

Preliminary estimates from Energy materials could indicate an accumulation of approximately $1.2 billion in interest at the end of the moratorium period.

Furthermore, it is unclear how the IESO would [generate funds to] pay the associated interest costs to the OFA for drawdowns of the $2 billion credit facility; i.e., ratepayer recovered on an ongoing basis or be capitalized and paid off after the moratorium period.

CONTEXT

The Independent Electricity System Operator (IESO) requested and entered into a revolving credit facility for an amount of up to $2 billion from the OFA to support its role in the implementation and participation under the *Ontario Fair Hydro Plan Act, 2017* ("OFHP Act").

To accommodate this request, the OFA obtained a Lending Directive from the Minister of Finance on June 29, 2017.

- The $2 billion IESO FHP-related facility was requested with an initial term of 5-years plus a contingency of three months (effectively expiring on September 30, 2022).

- The request in part enabled the IESO to have the facility beyond the initial moratorium period of customer bill increases being constrained by the rate of inflation.

In the briefing note outlining CEFD and other OFA staff recommendation to the Minister of Finance, there were three rationales provided for the requested $2 billion credit facility:

- One of the primary reasons for putting in place a fairly large credit facility was to manage the initial transition as OPG Trust was not anticipated to be established nor able to borrow to finance the purchase of the regulatory asset from the IESO until later in 2017. Currently OPG Trust is expected to start using its own warehousing facility on December 18, 2017 for the first time. To this end, the facility served this intended roles effectively as it is maintaining the deferred GA portion in this facility currently.

- At the time of initial consideration, it was also discussed that under the legislation, OPG Trust is not required to purchase any portion of the regulatory asset, which led to discussions around how it could result in longer than planned IESO draws on the credit facility and a large balance accumulating in the facility.

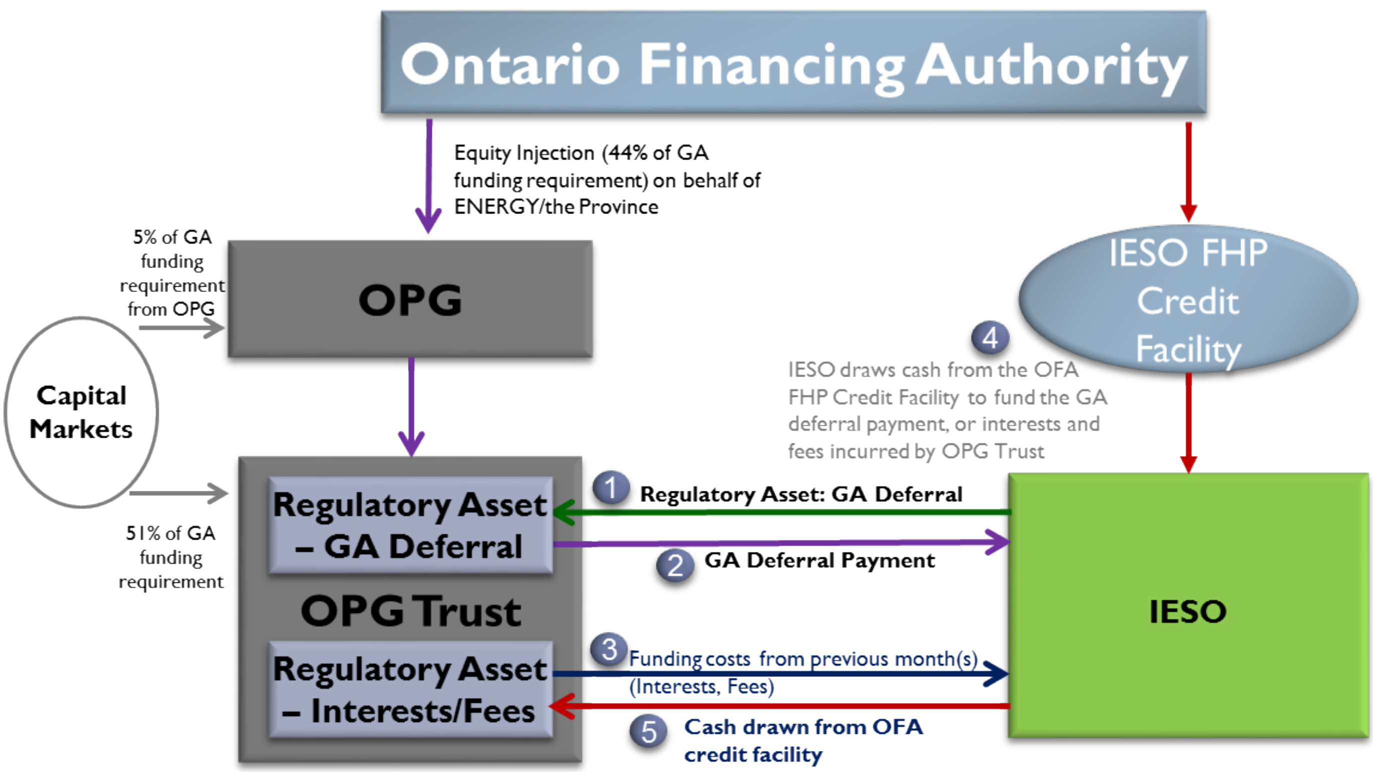
- In the recommendation, staff referenced the need to allow the IESO to finance short to medium term funding shortfalls in its role in the FHP. It was always anticipated that there would be short and medium term timing differences in funding as mentioned in the Briefing Note as part of the Minister's Directive Package (see the actual wording below):

This will help the IESO to fulfil the commitments under the OFHP Act as the IESO will have to finance short to medium term funding shortfalls in the implementation of the Fair Hydro Plan.

INTENDED USE OF THE FHP-RELATED FACILITY

As in many policy initiatives, the program parameters continue to evolve for a number of FHP-related items, including the use of the $2 billion OFA facility for the IESO. Energy staff indicated that in order to facilitate the implementation of the FHP, the IESO will likely utilize the $2 billion OFA credit facility to defer the interest cost and fees component of the global adjustment (GA) deferral for the first 4 years of the FHP when the customer bills are to increase only by the rate of inflation.

See the diagram below for details of how the deferral of the interest cost and fees would occur in parallel to the deferral of the GA amounts:



1. *IESO calculates the total amount of GA deferral for the month*
2. *OPG pays the GA deferral amount to the IESO*
3. *OPG calculates the total interest cost and fees (e.g., interest, management fees, etc., for the previous month), and sends the invoice to the IESO*
4. *IESO draws cash from the OFA FHP Credit Facility to pay for the funding costs incurred by OPG Trust. IESO could use the credit facility to pay for the GA deferral amount as well in case of a shortfall*
5. *IESO prepares the Regulatory Assets, which consist of the GA deferral amount for the month and payment for the funding costs for the previous month, and sells the Regulatory Assets to OPG Trust.*

ANALYSIS

The use of the credit facility to specifically fund interest cost and fees for the first four years is a relatively recent development for the intended use of the facility.

Short to medium term funding shortfalls were always expected to be financed by this facility, as there would be potential timing differences each monthly settlement period and the OPG trust is not required to purchase the regulatory asset. In addition, there were explicit discussions about the potential for market interruptions that could lead the IESO to be required to finance deferrals related to the GA refinancing.

A systemic use of the facility for funding interest costs and fees for the first four years, while a relatively recent development/understanding for CEFD staff, it could be seen as consistent with the purpose of the facility to support the IESO in managing short and medium term timing differences and the OPG financing entity's potential constraints in providing financing.

As the borrowing to fund interest cost and fees would only begin to be paid off after the initial moratorium period, the accumulation of interest cost and fees in the $2 billion credit facility would lead to decreased room for future GA deferral/borrowing needs. As such there may be a request for an expansion to the credit facility in the future. This is not expected to be likely in the ordinary course of operations of the FHP, as the otherwise largest purpose of the facility was to provide financing in the initial period before the OPG financing entity was fully established and able to acquire the regulatory asset.

<u>FISCAL IMPACT</u>

OPCD would need to opine on the potential fiscal impacts [TBC] of this funding structure due to the ongoing and cumulative nature of the funding of interest cost and fees via the $2 billion credit facility.

If the IESO draws cash from the FHP credit facility to fund interest cost and fees for the first four years, it's unclear how and when IESO will pay back the credit facility; i.e., OPG creates an account payable, or equivalent, to the IESO for the cash received, and pays it back when the collection of Clean Energy Adjustments starts.

[IESO staff indicated that they have consulted with OPCD staff on the accounting structure of such intended use of the IESO FHP credit facility, and there won't be a fiscal impact to the Province as it was set out via regulation. CEFD staff is getting clarification from OPCD on this.]

Without a mechanism to link the interest cost and fees back to the ratepayers, there could be fiscal implications related to such costs.

BACKGROUND

<u>MINISTER'S DIRECTIVE</u>

On June 29, 2017, Minister of Finance's Lending Directive authorized the OFA to provide a revolving credit facility in an amount of up to $2 billion with a maturity date of September 30, 2022. The Lending Directive also included the following conditions:

- The interest rate charged to IESO on all advances will be based on the Province's cost of funds plus a twenty-five basis point (0.25%) spread, consistent with the spread for current and past OFA credit facilities for the IESO.

- The credit facility agreement shall be subject to such other terms as the OFA deems appropriate from time to time.

  – This standard clause in the Minister's Directive was utilized recently to allow for changes to the definition of the Permitted Liens and other related sections of the OEFC lending agreements.

FISCAL IMPACT

- There would be a relatively small but positive fiscal impact for the Province as a result of this credit facility.
  – The Province receives a small fiscal benefit by adding 25 basis points (i.e., 0.25%) to the Province's cost of funds provided to the IESO under the facility, which should more than offset any administrative cost impact on the OFA and Province.
  – The actual amount is expected to be small, as the IESO is expected to make draws for short periods to bridge brief timing differences in cash flows.

- Both the IESO and OFA are consolidated with the Province on a line by line basis. For the OFA and the Province, costs associated with the credit facility are recovered from the IESO. For the IESO, principal and interest associated with the credit facility are ultimately recovered from electricity ratepayers.
  – Notwithstanding this, recovery from electricity ratepayers is determined by the Ontario Energy Board. If the IESO cannot sell the regulatory asset created under the *Ontario Fair Hydro Plan Act, 2017* to a financing entity as per the Act, the IESO will have this revolving debt that can only begin to be repaid once ratepayers begin to pay down the deferred GA amount.

FHP ACT

- On May 31, 2017, the government passed the OFHP Act to enable the implementation of the Ontario Fair Hydro Plan, which will lower electricity bills by 25 per cent on average for eligible residential customers. Eligible farms and small businesses will also receive benefits (essentially for those eligible for the Regulated Price Plan).

- Under the OFHP Act, the IESO will incur a monthly funding shortfall in the early years of the plan, as a portion of the GA charge to ratepayers will be deferred to the future.

- During this period, GA amounts collected from ratepayers will, therefore, be insufficient to fund the IESO's contractual obligations to electricity producers and service providers.

- The OFHP Act gives the IESO the right to recover those deferred amounts from specified consumers in the future (the "regulatory asset") and the ability to sell the regulatory asset (i.e., the right to recover the deferred amounts in the future) to a financing entity.
  – It is anticipated that the regulatory asset will be purchased by the financing entity to be established by OPG (OPG Trust).
  – The cash received from selling the regulatory asset will be used by the IESO to fund the incurred GA shortfall.

- For the first four years, it [now] appears that part of the deferred amounts related to interest cost and fees would be funded through IESO's facility from the OFA.

- The IESO had always been expected to need short-term financing to manage initial and ongoing monthly IESO cash flow requirement timing differences.
  - Even once the OPG Trust is fully set up to borrow, there is expected to be continued timing differences between the IESO's monthly settlement process when it has to pay generators and when the Trust purchases the asset from IESO.
  - Also, under the legislation, OPG Trust is not required to purchase any portion of the regulatory asset, which could result in longer than planned IESO draws on the credit facility, and an accumulation of a larger balance in the facility.

OFA FACILITIES FOR IESO

- An existing credit facility between the IESO and the OFA is currently available for $475 million (previously $975 million), which includes support for the current Regulated Price Plan (RPP) program. The IESO has proposed that a separate credit facility be provided to support only the FHP credit needs. A separate facility for the FHP is preferable to ensure operational efficiency and tracking of related costs.
- As a result, the IESO has proposed to reduce the current $975 million credit facility by $500 million and create a new FHP facility in the amount of $2 billion.
  - The $500 million reduction in the current OFA facility is to eliminate duplicate credit needs and reflects that the FHP prices for eligible consumers is being implemented through the setting of prices under the RPP.
  - Specific terms of the agreement are being negotiated between the IESO and OFA.

	Existing OFA-IESO Facility	**New Proposed OFA-IESO FHP Facility**
Pre-Existing Credit Facilities	$975 million	-
Reduction due to FHP	($500 million)	-
Increase due to FHP	$ -	$2,000 million
Total Credit Facilities	**$475 million**	**$2,000 million**

- The OFA facilities provided to the IESO currently have the intercept provision as required under the OFA's Lending Policy, dated April 16, 2010. The pre-existing $975 million facility (now the $475 million facility) was amended to incorporate the required intercept provision. The intercept provision is intended to provide security to the OFA in its role as a lender to public bodies.

IESO

- The IESO is a not-for-profit corporate entity established in 1998 by the *Electricity Act, 1998*. It is governed by an independent Board of Directors and its Chair and Directors are appointed by the Province.
- The IESO has full statute-based authority for establishing, monitoring and enforcing reliability standards in the province. All the companies that make up the power system in Ontario must meet the IESO's standards.
- Its fees and licences to operate are set by the Ontario Energy Board and it operates independently of all other participants in the electricity market.

Electricity Finance Branch / Corporate and Electricity Finance Division
Ontario Financing Authority
December 4, 2017