January 8, 2018

CONSOLIDATION CONSIDERATIONS OF THE FAIR HYDRO TRUST UNDER IFRS

Purpose:

The purpose of this memorandum is to summarize the preliminary views of Ontario Power Generation's (OPG) on its ability to consolidate the Fair Hydro Trust (the "Trust"), which is a financing entity contemplated by the *Ontario Fair Hydro Act, 2017* (the Act) under International Financial Reporting Standards (IFRS).

Background and Transactional Highlights:

On March 2, 2017, the Province of Ontario (the Province) announced the Ontario Fair Hydro Plan (the Fair Hydro Plan) aimed at reducing electricity bills by 25 percent on average for all residential consumers in the province. As part of the Fair Hydro Plan, a portion of the Global Adjustment costs will be refinanced over a longer period for Regulated Price Plan (e.g., residential, farm, small businesses) and other eligible consumers (FHP Program). Under the Act, OPG is appointed as the Financial Services Manager (FSM) and is given the authority to, among other things, establish and manage one or more financing entities to raise debt financing (referred to as "funding obligations") for the purposes of the Act.

The following outlines key transactional details relating to the FHP Program:

- Pursuant to the Act, the Independent Electricity System Operator (IESO) will determine the shortfall resulting from the rate reduction on a monthly basis and record the amount in a variance account. The Act refers to this shortfall balance as a Regulatory Asset.
- The IESO may offer for sale a specified portion of the Regulatory Asset to the Trust pursuant to a Master Transfer and Servicing Agreement (MTSA) in return for cash proceeds.
- Upon the sale of a specified portion of the Regulatory Asset to the Trust, the Trust acquires a GA deferral asset, designated as an "investment asset" under the Act, which is a right to collect, among other things, future cash flow streams representing:
    - principal repayments on the related debt tranche issued;
    - interest on the related debt tranche issued;
    - reimbursable costs and expenditures paid or payable during the period, including those incurred by OPG as FSM on behalf of the Trust as stipulated in sections 10.2(3) and 10.13(3) of *Ontario Regulation 206/17 General* (General Regulation); and
    - OPG's fees as FSM paid or payable during the period which is comprised of both base and variable components, the calculations for which are stipulated in the General Regulation.
- Investment asset owners have a right to collect carrying costs (interest on debt and other expenses but not principal) from the IESO up to July 31, 2021 and all amounts due (including principal) from specified consumers through clean energy adjustments (CEAs) from May 1, 2021 onward. CEAs represent the carrying costs of the Trust (which is the sum of: interests, derivative payments, reserve account deposits, costs and expenditures for the period, and tax liabilities less the sum of: reserve account withdrawals, payments

from derivative agreements, and tax refunds) plus principal repayments and true up amounts. CEA payments will continue until all debt issued by the Trust is repaid.

- Section 25(3) of the Act stipulates that the IESO cannot collect the balance recorded in the variance account from specified consumers before May 1, 2021 (moratorium period). Note that the collection by the IESO of the amounts in the variance account from specified consumers is not through CEAs, but through a separate mechanism to adjust rates charged to specified consumers. CEAs are for the benefit of GA deferral asset owners, not the IESO (see sections 13(1) and 16(1) of the Act, which stipulate that the Electricity Vendors and the IESO, respectively, are collecting the CEAs as agent for investment asset owners).
- During the period from December 1, 2017 to July 31, 2021, the IESO will pay for the carrying costs of the Trust pursuant to section 9.1 (1) of the General Regulation. These costs then are added to the variance account for the IESO deferral (per section 16, paragraph 3 of the General Regulation), which specified consumers have the ultimate obligation to bear.
- In order for the Trust to fulfil its business purpose of financing the GA deferral, it has to raise debt. The debt is expected to be obtained through the following sources, with Tranche A comprising not less than 51% of the total funding:

<u>Table 1 – Type and Source of Fair Hydro Trust Debt Funding</u>

Tranche and Debt Type	Source of Funding	% of Total Funding Requirement
Tranche A Senior Debt	Capital Markets (privately-placed debt)	51%
Tranche B Subordinated Debt	OPG via Province (equity injections)	39%
Tranche C Junior Subordinated Debt	OPG via Province (equity injections)	5%
	OPG via Capital Markets (Medium-term note program – public debt)	5%

- The Province's equity contributions will be used solely for OPG's subordinated debt investment in Tranche B and Tranche C.
- The General Regulation was amended in November 2017 to stipulate, among other things, OPG's fees as FSM as follows:
  - o <u>Fees for 2017:</u> For 2017, OPG will receive $3.1 million and an amount to cover up-front costs incurred between June 1 and December 31, 2017 by OPG on behalf of the Trust (e.g. legal fees, rating agency fees, trustee fees). The $3.1 million includes a $600,000 fee and $2.5 million to cover costs incurred prior to June 1, 2017. The expenses between June 1 and December 31, 2017 will also include direct costs of OPG employees who are dedicated exclusively to Fair Hydro matters. OPG will also provide a specified procedures report from external auditors to the OEB regarding the expenses.
  - o <u>Fees for 2018-19</u>: For January 2018 to March 2019, OPG will receive (i) a monthly base fee equal to 7.5 basis points, divided by 12, multiplied by the average monthly outstanding debt of the Trust, (ii) a variable fee that is calculated based on how the interest rate for external funding tranches for that period compare to forecast interest rates for the period (and which fee is limited to ± 2% of 5% of the total senior debt issuances in the period), and (iii) third-party expenses and direct employee costs of dedicated Fair Hydro employees.

- o Fees for 2019-20 and Fees for subsequent years. For April 2019 to March 2020, and every 12-month period thereafter, OPG will make submissions to the OEB on the base fee, variable fee and expenses. The base fee will be based on comparable fees charged by full-service managers of securitization vehicles (and other similar funds). The variable fee will be calculated in the same manner noted above, but with a refresh of forecast interest rates for the relevant period. For 2019 onward, the expenses will include direct employee costs of dedicated Fair Hydro employees only if the fees of comparable managers also include such direct costs.

Key Program Agreements

The program documents/agreements referenced herein include the following:

- Master Transfer and Servicing Agreement – December 21, 2017
- Management Agreement – December 20, 2017
- Master Trust Indenture – December 21, 2017
- Financing Plan – December 18, 2017
- Subordinated Debt Pricing Protocol
- Change of Law Protection Agreement – December 21, 2017
- Change of Law Process Agreement – December 21, 2017

Accounting Assumptions and Resolutions:

- o The Regulation must require interest, carrying and administrative costs to be paid to the Trust in cash on a monthly basis, so that the Trust is able to recognize appropriate cash flows to offset any ongoing costs.
  - o **Accomplished** – During the period from December 1, 2017 to July 31, 2021, the IESO has a regulatory obligation to pay for the carrying costs of the Trust pursuant to section 9.1 (1) of Ontario Regulation 206/17 General (General Regulation). Specified consumers are obligated to pay CEAs after May 1, 2021 pursuant to the Act. Note that the IESO's obligation to pay the carrying costs of the Trust is made on behalf of the specified consumers, as the carrying costs of the Trust paid by the IESO are added directly to the variance account, which forms the regulatory asset.
- o The regulations and various program agreements will provide that OPG will have significant variability and exposure from the activities of the Trust relative to the rate of return that OPG would recognize from its role as the FSM of the Trust. The variable management fee will be meaningful and allow OPG to make decisions that will significantly impact its returns.
  - o **Accomplished** – OPG's fees as FSM include both base and variable fee components. The variable fee compensates OPG for its at-risk performance for ongoing issuances of senior external debt tranches and satisfies this criterion. The General Regulation stipulates that the variable fee will be calculated based on how the interest rate for external funding tranches for that period compare to forecast interest rates for the period and which fee is limited to ± 2% of 5% of the external funding tranches in the period.
- o The Minister of Energy (MOE) will have the ability to replace the FSM if there is a failure to perform. There will be a bifurcation of roles where the Province could not remove OPG as manager/administrator with respect to the existing debt placed by the Trust, but could remove OPG's responsibility/right to prepare the Financing Plan going forward. The ability for the MOE to remove OPG as the FSM should not impact the recoverability of existing investment assets.
  - o **Accomplished** – Section 18 of the Act stipulates that the MOE can appoint a different FSM if OPG is "unable or unwilling to do so". Management considers that the failure to perform standard would fall under the "unable to" criterion specified by the section.

If there were a new FSM, they would have the statutory duties under the Act to administer financing entities, calculate the CEAs, etc. They would perform those statutory duties on behalf of the Fair Hydro Trust. The new FSM could set up new trusts, but would also have the statutory duties with respect to existing trusts at the time. OPG will continue to have some contractual obligations under the Management Agreement to the Fair Hydro Trust, but will not have the statutory duties of the FSM.

- Further, section 5(3)(a)(i) of the Act provides the mechanism to authorize the Minister of Finance to agree to "*guarantee any debts, obligations, securities or undertakings associated with an investment interest...".* This provision allows for the limited guarantee on the recoverability of the GA deferral assets that have already been issued to the extent covered by the Change of Law Protection Agreement.

- The calculation of the Fair Allocation Amount (FAA) will be performed by the MOE as noted in *Section 20 - Fair Allocation Amount* of the Act and further detailed in *Section 11-13 – Fair Allocation Amount* of the General Regulations (Ontario Regulation 206/17). This does not impact the relevant activities of the Trust.
  - **Accomplished** – Refer to the above referenced sections.
- OPG has the ability to appoint and remove the Trustees and there are no veto rights by the Province. No party has the ability to remove OPG from its role and authority in the Trust.
  - **Accomplished** – OPG appointed BNY Trust Company of Canada as the Indenture Trustee and Computershare Trust Company of Canada as the Issuer Trustee. Under 6.2 of the Declaration of Trust, the unitholders of the Trust can remove the Issuer Trustee by majority vote. FHP2017 Inc. is a wholly-owned subsidiary of OPG and owns 99.9999% of the units in the Trust, therefore, OPG will have the ability to remove the Issuer Trustee. The Indenture Trustee may only be removed by the bondholders whom it represents. This is a typical commercial arrangement and management concludes that there are no issues presented.
  - Section 8.10 of the MTI outlines that OPG as Manager (under the Management Agreement) and the IESO as Servicer (under the MTSA) may be terminated by the Indenture Trustee upon the occurrence and during the continuance of an Event of Default (defined in the MTI under section 8.01). If OPG is no longer the FSM, this will not trigger an Event of Default, so the Indenture Trustee cannot terminate for that reason. Management believes that this ability of the Indenture Trustee is a form of a protective right and represents reasonable and commercial terms given they are acting on behalf of the specified creditors. Management also notes that this ability is only under limited circumstances where OPG as Manager or Servicer is not performing its duties and obligations at the appropriate level. Therefore, the presence of this provision does not provide the Indenture Trustee a controlling financial interest over the Trust.
- Neither the Ontario Energy Board (OEB) nor any other party can discretionally reduce the base and variable management fee except due to a calculation error.
  - **Accomplished** – The final terms of the OEB's role in reviewing and approving OPG's fees as FSM in the General Regulation set outs market-based parameters that the OEB must adhere to when reviewing OPG's submission for its fees. Management concluded that the OEB's review role is reasonable and does not permit for any subjective discretional reduction in OPG's fees as FSM. In addition, the OEB's typical application of a broad prudency test on rate regulated entities' rates in the Ontario electricity market do not apply to their review of OPG's fees as FSM.
- The margin on the interest rates associated with Tranche B and Tranche C, which will be recovered from specified consumers, will be reflective of the risk profile of the debt and the associated market terms.
  - **Accomplished** – The Financing Plan (which is a requisite document that OPG must prepare and deliver to the MOE for the FHP Program) outlines risk-appropriate spreads for subordination. The final rates (and therefore spreads) will be determined when the

first tranche of debt is acquired to purchase investment assets. The credit range for each debt tranche will be determined by the overall credit strength of the financing structure and its resilience under various credit stress scenarios (i.e. the subordinated debt will be priced accordingly in relation to the senior debt using standard market pricing practices). The concept of subordination of OPG's investment in the Trust will be documented in the Protocol Agreement between OPG and the Province.

- The indemnification provided to the Trust by the Minister of Finance on behalf of the Province as described in *Part I – General – Section 5(3) Guarantee, indemnification* of the Legislation will be subject to terms and conditions in a separate Provincial support agreement. The guarantee will be in place only in the event of a protection event, such as if the Legislative Assembly of Ontario repeals the Fair Hydro Act or amends the Act in a way that adversely impacts the ability of the Trust to fully recover an investment asset in order to pay the obligations of the Trust.
    - **Accomplished** – The Change of Law Protection Agreement between the Trust, the Indenture Trustee, Issuer Trustee and the Province was executed on December 21, 2017. The agreement provides bondholders a conditional guarantee in the event of a protection event as described above in the condition section. If triggered, the Indenture Trustee may demand the Province to make payments on the Trust's outstanding obligations (includes debt and other obligations that would form a part of the GA deferral asset) provided that such obligations have met the adherence requirements outlined in section 4.01 of the agreement. Management believes that the circumstances covered under the agreement represent limited and narrow applications of the indemnification provided by the Province to the Trust.
- The approval by the OEB of the FSM (i.e. OPG's) fees as described in *Part IV – Implementation – Section 14.4 Same, Board Approval* will not allow them to change or limit the management fee structure, but only ensure that it is prudent by ensuring it is calculated in accordance with the Regulations.
    - **Accomplished** – see discussion under point 6 above. The final terms of the OEB's role stipulated in the General Regulation with respect to their review and approval of OPG's fees as FSM is limited to market-based parameters, which is a more favourable outcome than if they can exercise prudency tests. Specifically, the OEB, in its review of OPG's proposed fees for the upcoming term, is limited to an objective basis using market comparable data as the basis for their opinion, whereas a prudency test can incorporate subjectivity in the process. In addition, if the OEB does not approve a proposed fee, the General Regulation stipulates that they may make recommendations on what rate they found materially inconsistent and OPG can revise the proposal and re-submit.
- In the event that a different FSM is appointed by the MOE, the IESO is required to continue to make cash payments for interest to the Trust for the existing debt. Principal repayments on existing debt will continue to be repaid by specified consumers to the Trust in accordance with the terms of the issued debt.
    - **Accomplished** – the November 2017 amendment to the General Regulation added section 9.1(1) stipulating the that IESO "shall pay and remit to a financing entity any amounts charged to the IESO by the financing entity in respect of carrying costs of the financing entity during the period beginning on June 1, 2017 and ending on July 31, 2021.". This provision gives the IESO the legislative obligation to pay carrying costs (which includes interest costs) of any financing entity (not necessarily OPG as FSM) during the moratorium period and a two months after to account for collection lag. After the moratorium, section 16(4) of the Act stipulates that the IESO is to remit amounts it receives in respect of CEAs (which includes interest costs) to owners of the GA deferral asset. The CEAs will include a portion relating to principal repayments, and will be repaid by specified consumers after May 1, 2021.

- All other items as indicated in Appendix A.

Accounting Analysis:

In order to meet the accounting definition of 'control', accounting guidance must be considered. There are no bright lines to determine whether OPG has exposure, or rights, to variable returns from its involvement with the Trust, or whether it has the ability to affect the returns of the Trust through its power over the Trust. Rather, all facts and circumstances are considered when assessing whether an entity has control over another entity.

In order to consolidate the Trust, OPG must be able to demonstrate that it controls the Trust.

Control

An investor controls an investee if and only if the investor has all the following:

a) *power over the investee;*

b) *exposure, or rights, to variable returns from its involvement with the investee; and*

c) *the ability to use its power over the investee to affect the amount of the investor's returns.* **[IFRS 10, paragraph 7]**

Purpose and design of the investee *When assessing control of an investee, an investor shall consider the purpose and design of the investee in order to identify the relevant activities, how decisions about the relevant activities are made, who has the current ability to direct those activities and who receives returns from those activities.* **[IFRS 10, paragraph B5]**	
Criteria	**Analysis**
Purpose and design of the Trust	The purpose of the Trust is to allow OPG to participate in the Fair Hydro Plan and earn a return for its role as FSM through effectively managing the FHP Program. OPG is expected to earn a) management fee revenue and b) interest income on the subordinated debt issued to the Trust (via MOE equity injections). Refer to **Table 1** above to note the financing structure of the Trust.
Relevant activities of the Trust and how decisions are made about those activities	**<u>Relevant activities:</u>** The relevant activities of the Trust are: • Prepare a written Financing Plan and deliver to the MOE and it is to be used by OPG as FSM to evaluate whether funding obligations should be incurred by the Trust. • Raising debt, paying bond debt holders, and determining the capacity of the Trust to raise additional financing. • Determining the CEAs for a particular reference period. • Evaluating and making decisions on financing alternatives, duration, and the strategy to minimize financing costs. • Making capital and funding decisions in a manner consistent with the Financing Plan. • Ongoing day-to-day management and administration of the program, including fulfilling various reporting requirements to stakeholders. **<u>Decisions made and voting rights of the Trust</u>**

Purpose and design of the investee *When assessing control of an investee, an investor shall consider the purpose and design of the investee in order to identify the relevant activities, how decisions about the relevant activities are made, who has the current ability to direct those activities and who receives returns from those activities.* **[IFRS 10, paragraph B5]**	
	OPG has the ability to appoint and remove the Trustees and there are no veto rights by the Province. No party has the ability to remove OPG from its role and authority in the Trust. o **Accomplished** – OPG appointed BNY Trust Company of Canada as the Indenture Trustee and Computershare Trust Company of Canada as the Issuer Trustee. Under 6.2 of the Declaration of Trust, the unitholders of the Trust can remove the Issuer Trustee by majority vote. FHP2017 Inc. is a wholly-owned subsidiary of OPG and owns 99.9999% of the units in the Trust, therefore, OPG will have the ability to remove the Issuer Trustee. The Indenture Trustee may only be removed by the bondholders whom it represents. This is a typical commercial arrangement and management concludes that there are no issues presented. o Section 8.10 of the MTI outlines that OPG as Manager (under the Management Agreement) and the IESO as Servicer (under the MTSA) may be terminated by the Indenture Trustee upon the occurrence and during the continuance of an Event of Default (defined in the MTI under section 8.01). As noted above, management believes that this ability of the Indenture Trustee is a form of a protective right and represents reasonable and commercial terms given they are acting on behalf of the specified creditors. Management also notes that this ability is only under limited circumstances where OPG as Manager or Servicer is not performing its duties and obligations at the appropriate level. Therefore, the presence of this provision does not provide the Indenture Trustee a controlling financial interest over the Trust. Except as otherwise stated, all decisions of the members (if applicable) shall be made by the Trustee who will be appointed by OPG. **Accomplished** – See discussion above. **<u>Termination Rights</u>** • OPG cannot be removed from its role in the Trust. The MOE will have the ability to replace OPG as the FSM for failure to perform. There will be a bifurcation of roles where the Province could not remove OPG as manager/administrator with respect to the existing debt placed by the Trust, but could remove OPG's responsibility/right to prepare the Financing Plan going forward. The ability for the MOE to remove OPG as the FSM should not impact the recoverability of existing investment assets. **Accomplished –** Section 18 of the Act stipulates that the MOE can appoint a different FSM if OPG is unable or unwilling to do so. Management considers that the failure to perform standard would fall under the "unable to" criterion specified by the section. Therefore, OPG has the ability to decide whether it will continue to be the FSM and not the Province.
Assessment	The purpose of the Trust is to allow OPG to participate in the Fair Hydro Plan and earn a return for its role as FSM through effectively managing the FHP Program. OPG is expected to earn a) management fee revenue and b) interest income on the subordinated debt issued to the Trust (via MOE equity

Purpose and design of the investee *When assessing control of an investee, an investor shall consider the purpose and design of the investee in order to identify the relevant activities, how decisions about the relevant activities are made, who has the current ability to direct those activities and who receives returns from those activities.* **[IFRS 10, paragraph B5]**	
	injections). For the reasons noted above, OPG has control over the decisions to be made about the relevant activities.

Power over the investee	
Criteria	**Analysis**
Identify whether OPG's rights give it the current ability to direct the relevant activities of the Trust (Substantive rights)	OPG has power to direct the following key activities of the Trust: • OPG is to design the Financing Plan to reasonably align with the Fair Allocation Amount Pursuant to section 21 of Act. The Fair Allocation Amount, along with the requirements stipulated in section 14 of the General Regulation, guided the design of the Trust's Financing Plan. Although the Province determines the principles around the Fair Allocation Amount, management believes that it does not impact the activities of the Trust once the Trust has purchased the GA deferral asset from the IESO. OPG may also amend the Financing Plan at any time pursuant to section 21(6) of the Act without affecting CEAs that have already been determined or any existing debt and without the consent of the Province. • In executing the Financing Plan and managing the FHP Program, OPG will arrange to raise debt and service outstanding debt, and determine the capacity of the Trust to raise additional financing. This includes the task of evaluating and making decisions on financing alternatives, duration, and the strategy to minimize financing costs. • OPG is to calculate the CEAs per section 15 of the Act and the OEB cannot change the amount provided by OPG when they are determining the new rates to charge specified consumers per section 15(4) of the Act See above for further discussion regarding the relevant activities of the Trust. The Change of Law agreements provides the Province with the following protective rights: • they will be privy to all of the constating and program documentation prior to the start of the program (i.e. before first purchase of the IESO's regulatory asset) in order to understand the obligations that the Province may need to assume if a protection/trigger event occurs • for every debt issuances thereafter, OPG will provide certification confirming the debt is issued under significantly similar terms as the initial documentation • OPG is required to deliver any material changes to previously provided transaction documents (excluding any changes to financial terms, rates or levels) and any new transaction documents, at least 10 business days in advance of making the material change or entering into the new agreement per section 2.01(b) of the process agreement. The Province has the right to object to these material changes or to the new transaction

Power over the investee	
	documents, only if the amendment or new transaction document has a "material effect" per section 3.04(b) of the process agreement. OPG is also required to seek the consent of the Province if it wants to make changes to the program agreements or make certain changes to the approved obligations, if such action could reasonably be expected to have a material effect per section 2.02(a)(v). A "material effect" is defined as a material adverse effect on the obligations and rights of the Province under the protection agreement or the process agreement that materially differ from the terms or conditions include in previously review documentation and that relate to one of the following: i. the timing of or circumstances under which related payments would or may become due or accrue is inconsistent with the Fair Allocation Amount; ii. the appointment, obligations or duties of OPG as the Manager; iii. the existence, powers or authority of the Financing Entity or the Financing Entity Trustee; iv. the obligations of the Indenture Trustee to or in respect of the Province as a Specified Creditor; v. the payment provisions and associated priorities set forth in the Trust Indenture; vi. compliance by the FSM with the then applicable Financing Plan; vii. compliance by the FSM or the Financing Entity with the Act or the General Regulation; or viii. the Province's rights of subrogation or assignment or its interests as a subrogee or an assignee. • Despite the ability of the Province to provide an objection or for the requirement for OPG to seek their consent, management believes that the nature of the conditions or instances where an objection could be raised do not impair OPG's ability to direct the key activities of the Trust. Specifically, for (ii) to (vii) above, management is of the view these items are structural or compliance in nature, and would not have a material impact to the way OPG as FSM would direct and control the key activities of the Trust (i.e. financing the GA deferral). • OPG is also required to deliver a process certificate under section 3.01 of the process agreement, on or before but not more than 5 business days, before the incurrence or any amendment of a funding obligation (as defined in the Act) which would exceed $5 million (e.g. individual invoices, blanket POs, debt issuances). Management expects that the materiality limit would only filter in OPG's management fees as the rest of the other obligations (other than debt) is expected to be less than $5 million. There are other post-incurrence/amendment reporting requirements outlined in section 2.01 (d) and (e) of the process agreement. Management concludes that these reporting requirements represent protective rights and do not impair or impact that way OPG would direct the activities of the Trust. • If there is a breach, the Province is entitled to deliver a suspension notice, where any new issuances of debt or any other new obligations of the Trust will not have the benefit of the Change of Law guarantee. Any existing debt would not be impacted. Management believes that this does not give the Province the power to direct the key activities of the Trust because a suspension notice will not lead to a default and would not impact the way OPG as FSM would manage the existing debt. OPG would continue to service existing debt through IESO payments of carrying costs during the

Power over the investee	
	moratorium and clean energy adjustments afterward, without issuing any new debt. In addition, OPG can still issue debt, without the Change of Law guarantee, although it will be at a higher rate to reflect the additional change of law risk.
Assessment	OPG has the ability to direct the activities of the Trust. OPG will be in charge of securing the financing and all related decision-making, and it can amend the Financing Plan at any time, without approval from the MOE. Further, if the MOE chooses not to continue with OPG's current Financing Plan, the Province would just appoint a new party to participate in future securitizations and OPG would continue to manage the debt that already exists in the Trust. If future financing transactions are with a different financing entity, a separate consolidation analysis would be prepared at that time as to which party, if any, would consolidate the Trust.

Exposure or rights to variable returns

Criteria	**Analysis**
Dividends, other distributions of economic benefits from an investee and changes in the value of the investor's investment in that investee [IFRS 10, paragraph B57(a)]	OPG will earn management fees in its role as the FSM of the Trust. Refer to further discussion below on the nature of said management fees.
Remuneration for servicing an investee's assets or liabilities, fees and exposure to loss from providing credit or liquidity support, residual interests in the investee's assets and liabilities on liquidation of that investee, tax benefits, and access to future liquidity that an investor has from its involvement with an investee [IFRS 10, paragraph B57(b)]	OPG has exposure and rights to variable returns from the Trust in the form of the following: • The regulations and various program agreements will provide that OPG will have significant variability and exposure from the activities of the Trust relative to the rate of return that OPG would recognize from its role as the FSM of the Trust. The variable management fee will be meaningful and allow OPG to make decisions that will significantly impact its returns. **Accomplished** – OPG's fees as FSM include both base and variable fee components. The variable fee compensates OPG for its at-risk performance for ongoing issuances of senior external debt tranches and satisfies this criterion. The General Regulation stipulates that the variable fee will be calculated based on how the interest rate for external funding tranches for that period compare to forecast interest rates for the period and which fee is limited to ± 2% of 5% of the external funding tranches in the period. In determining what the meaningful variable fee is for OPG, management compared what would be material relative to the following factors:

Exposure or rights to variable returns	
	• **Return on equity Excluding Accumulated Other Comprehensive Income (ROE) of about 4%** – OPG uses the ROE metric in its internal and external reporting to measure the performance of the company against its objective to provide value to its shareholder. Management believes that deriving a benchmark using OPG's ROE will provide a meaningful variable fee given the purpose of the metric. Management considered that any change to OPG's ROE of about 25% would represent a material impact to OPG's financial results (i.e. 1% of the average 4% ROE). In applying this information to the planned debt issuances for the FHP Program, OPG's at-risk investment of 5% of the total debt would equal $100 million, assuming an average debt issuance of $2 billion per year for the next 10 years based on the Fair Allocation Amount. Therefore, OPG believes that using a 1% benchmark and applying it to OPG's 5% investment, would equate to a meaningful return on its at-risk amount. Using the example provided, 1% on OPG's at-risk investment of $100 million would equal to $1 million. • **Spread on the junior subordinated debt** – management's current pricing estimate for the Tranche C debt is about 5.5% and the cost to OPG is 4%, which amounts to a spread of 1.5%. One percent out of the 1.5% spread OPG will be realizing from its investment in the Trust represents two-thirds of the total spread, which is deemed to be material. These consideration factors indicate that 1% of OPG's 5% investment in the Trust represents a meaningful variable return for OPG. Management will re-assess the variable fee return periodically and when required to ensure it remains meaningful for OPG (i.e. if there are material changes to the corporate ROE or to the actual junior subordinated spread). OPG, through ownership of the most subordinated debt, is exposed to risk of non-collection. Given that the program is expected to run until 2047, this 30-year time period results in uncertainty about the future collection of OPG's amount at risk. OPG and the Province would be the last parties to get paid in the event that the program stops running if there is an event of default that cannot be cured, a protection event from a change in law that significantly adversely impact bondholders, or if electricity demand is not high enough to allow for collection from specified consumers in a timely manner, etc. The expected program end date of 2047 results in uncertainty toward whether this program will continue and whether OPG will have collected its amount at-risk at that time. By utilizing a tiered-debt structure (i.e. senior, subordinated and junior subordinated in Table 1), the Trust has delineated the financing of lower risk investments and those that would bear higher residual risk. OPG's exposure in holding the most subordinated debt in Tranche C will receive a commercial rate

Exposure or rights to variable returns	
	of return consistent with its risk profile. The final rates (and therefore spreads) will be determined when the first tranche of debt is acquired to purchase GA deferral assets. The credit range for each debt tranche will be determined by the overall credit strength of the financing structure and its resilience under various credit stress scenarios (i.e. the subordinated debt will be priced accordingly in relation to the senior debt using standard market pricing practices). The concept of subordination of OPG's investment in the Trust will be documented in the Protocol Agreement between OPG and the Province. In the event that there is an exceptional circumstance, such as a change in law that materially adversely affects the ability of the Trust to service interest or principal payments on its debt, or the Act is declared invalid/unconstitutional. This is considered to be a protective right designed to protect the interest of the bondholders without giving that party controlling interest in the Trust. **Accomplished** – The Change of Law Protection Agreement between the Province and the beneficiaries (Indenture Trustee on behalf of creditors) provides bondholders a conditional guarantee in the event of a protection event and acts as a credit enhancement for the Trust's senior debt. The guarantee will be triggered if the Province changes the Fair Hydro legislation/regulations or passes other legislation/regulation that materially adversely affects the ability of the Trust to service interest or principal payments on its debt, or the Act is declared invalid/unconstitutional. If triggered, the Indenture Trustee may demand the Province to make payments on the Trust's outstanding obligations (includes debt and other obligations that would form a part of the GA deferral asset) provided that such obligations have met the adherence requirements outlined in section 4.01 of the agreement. Management believes that the circumstances covered under the agreement represent limited and narrow applications of the indemnification provided by the Province to the Trust.
Returns that are not available to other interest holders. For example, an investor might use its assets in combination with the assets of the investee, such as combining operating functions to achieve economies of scale, cost savings, sourcing scarce products, gaining access to proprietary knowledge or limiting some operations or assets, to enhance the value of the investor's other assets	OPG will have synergistic benefits from combining operating functions with the Trust given its extensive knowledge on the market and current regulatory knowledge.

Exposure or rights to variable returns	
[IFRS 10, paragraph B57 (c)]	
Assessment: To determine which party is the most 'at risk' in the event that the loans default, expected loss rates were obtained from Moody's and DBRS. Using the *Moody's Investors Service – Loss Given Default for Speculative Grade Companies* dated December 4, 2015, the 4-year Idealized Expected Loss ranges from 0.00% for a triple A rated bond to 0.30% for an A3 rated bond. DBRS Expected Loss Ratings give an indication of the expected loss of a loan portfolio. As per a November 2016 publication, the 10-year expected loss rates range from 0.1% for a AAA rated bond to 1.7% for an A (low) rated bond. OPG's at-risk investment of 5% of the total debt will be invested as junior subordinated debt in Tranche C, along with the Province's contribution of 5% of the total debt. Given that each of OPG's and the Province's junior subordinated debt percentages are higher than the default rates above, 100% of the risk is with both OPG and the Province since they are the last parties to get paid should there be any default with the debt. OPG is also exposed to variable returns from the Trust from its performance on decisions made on financing alternatives, duration, and the strategy to minimize financing costs through the variable fee component of the management fee. Therefore, OPG has the exposure to variable returns from the Trust.	

Ability to use power to affect returns	
Criteria	**Analysis**
Ability of investor to use its power to affect the investor's returns from its involvement with the investee	OPG needs to have both power over the Trust (i.e. as a principal, not an agent), exposure or rights to the variable returns from the Trust, and the ability to use its power to affect OPG's returns from its involvement with the Trust OPG has the ability to use its power over the relevant activities of the Trust to affect its returns in its role as the FSM under the Act and as Manager under the Management Agreement for which it earns management fees, which includes a variable component. Further, the Trust's ability to use its power to affect returns is in a manner that is consistent with being a principal. See **Appendix B** for the Principal-Agent analysis management conducted.
Assessment	OPG has the ability to use its power to affect returns of the Trust.

Conclusion:

On the basis of the discussion above, the Act, the General Regulation and various program agreements are reflective of the conditions required to ensure the ability of OPG to consolidate the operations of the Trust. Accordingly, OPG will consolidate the Trust. For further discussion of the requisite conditions that have been satisfied, refer to Appendix A.

APPENDIX A:

Terms necessary for OPG to consolidate the Fair Hydro Trust

Legend:

✓	Addressed by either: • *Bill 132 – An Act to enact the Ontario Fair Hydro Plan Act, 2017 and to make amendments to the Electricity Act, 1998 and the Ontario Energy Board Act, 1998* • Ontario Regulation 206/17 (General)
π	Addressed by the Trust's key program agreements and/or documents including, but not limited to the: • Management Agreement • Master Trust Indenture • Financing Plan • Subordinated Debt Pricing Protocol • Change of Law Protection and Process Agreements
Ω	General requirement that does not have to be addressed by legislation, regulations, or the Trust's key program agreements or documents.

Issue	No.	Requirements
Directive	1 ✓	The Trust must be undertaken by OPG as a business initiative on its merits. A Shareholder Directive is to be limited to directing OPG to investigate the option of establishing a Trust vehicle to administer, finance and operate the Global Adjustment plan and the operation of that Trust and the control, risk and rewards of that Trust will determine its consolidation into OPG as a business enterprise. **The Province will not direct OPG to participate in the Fair Hydro Plan. A letter was issued from the Minister of Energy to OPG on April 13th requesting OPG's involvement in the implementation of the Fair Hydro Plan. OPG's Board Chair responded to the Minister on April 18th committing OPG to work with the IESO and OEB to develop a plan. OPG will have the option to prepare, implement and amend a Financing Plan (in accordance with principles set out in the legislation and assumptions set out in the General Regulation). OPG will have the right to withdraw its Financing Plan at any time.**
Trust	2 π	The Trust should not operate in a predetermined way such that OPG does not have decision-making authority over the Trust's ongoing activities after its formation (i.e. should not operate on 'autopilot'). **Article 4 of the Management Agreement between the Trust and OPG outlines all of the duties and obligations of OPG as the manager. Decisions over all key and day-to-day activities of the Trust (as described above) will be made by OPG.**
	3 π	OPG must have the ability to appoint and remove the Trustee (or Board of Trustees), with no veto right by the Province. No party shall have the ability to remove OPG from its role and authority in the Trust.

Issue	No.	Requirements
		OPG appointed BNY Trust Company of Canada as the Indenture Trustee and Computershare Trust Company of Canada as the Issuer Trustee. Under 6.2 of the Declaration of Trust, the unitholders of the Trust can remove the Issuer Trustee by majority vote. FHP2017 Inc. is a wholly-owned subsidiary of OPG and owns 99.9999% of the units in the Trust, therefore, OPG will have the ability to remove the Issuer Trustee. The Indenture Trustee may only be removed by the bondholders whom it represents. This is a typical commercial arrangement and management concludes that there are no issues presented. **Section 8.10 of the MTI outlines that OPG as Manager (under the Management Agreement) and the IESO as Servicer (under the MTSA) may be terminated by the Indenture Trustee upon the occurrence and during the continuance of an Event of Default (defined in the MTI under section 8.01). As noted above, management believes that this ability of the Indenture Trustee is a form of a protective right and represents reasonable and commercial terms given they are acting on behalf of the specified creditors. Management also notes that this ability is only under limited circumstances where OPG as Manager or Servicer is not performing its duties and obligations at the appropriate level. Therefore, the presence of this provision does not provide the Indenture Trustee a controlling financial interest over the Trust.**
	4 TT ✓	The Province cannot have the right to veto OPG's decisions about the relevant activities of the Trust. OPG must have the power over the relevant activities of the Trust and be compensated. The relevant activities of the Trust include (but are not limited to) the evaluation and decisions on financing alternatives, duration, and the strategy to minimize financing costs. OPG must have the power to establish operating and capital budgets of the Trust. **Refer to Item 2 above for OPG's ability to control all of the Trust's key and day-to-day activities. None of the program agreements gives the Province any veto rights.** **The General Regulation under the section "Financial Services Manager – Fees" outlines OPG's fees as FSM.** **OPG has prepared and delivered to the MOE a draft Financing Plan, which outlines the key principles, assumptions and methodologies that will guide OPG in its funding decisions.**
	5 TT	OPG must have the power to determine or change operating and financing policies of the Trust, which will affect the variability of risks and returns. **OPG as FSM is required to administer and execute on the Financing Plan that it delivers to the MOE. Periodically, as required, OPG has the ability to update the Financing Plan in response to significant changes in assumptions. OPG's fees as FSM per the General Regulation provide that it will be subject to variability and exposure from the activities of the Trust relative to the rate of return that OPG would recognize from its role as FSM of the Trust. The variable**

Issue	No.	Requirements
		management fee will be meaningful and allow OPG to make decisions that will significantly impact its returns.
	6	The Province or its agencies must not directly or indirectly fund (through debt or equity) more than 50% of the following: a. The Trust b. The most subordinated debt of the Trust **The Province's equity injections into OPG will be invested as subordinated debt in the Trust. The Financing Plan outlines the step-lock of funding source outlined in the table below. Every time an investment asset is purchase, debt will be sourced in the same percentages, which means that the Province's indirect funding will not exceed 50% (i.e. it will be limited to an indirect funding of 49%). Refer to table 1 above for the financing structure. Appendix B provides further analysis on the relationship between OPG and the Province under the principal vs. agent guidance. The most subordinated debt of the Trust in Tranche C will be comprised of 50% Province's equity contribution and 50% OPG's investment.**
	7	OPG must own at least 50% of the most subordinated debt and must be no less than 5% of the debt of the Trust. Such ownership must be financed entirely by OPG through operating cash flows or external debt, without assistance from Provincial sources. **Table 1 shows the financing structure of the Trust and the same is outlined in the Financing Plan. Refer to the discussions in point #6 above and the accompanying analysis in Appendix B.**
	8 ✓	OPG must have the ability to earn variable returns by exercising its authority, which shall be accomplished as follows: a. The cash flow from the investment asset shall include interest determined based on a relevant benchmark that is appropriate relative to the investment asset, plus an appropriate margin consistent with the relevant market and other risks **OPG will be benefitting from the interest it earns on its subordinated debt investment as follows:** • **earning the full rate it charges to the Trust on the Province's portion (39% in Tranche B and 5% in Tranche C) because there is no cost to OPG of the Province's equity injection** • **earning the spread between OPG's cost of debt and the rate its charging the Trust on its 5% investment in Tranche C** **OPG will also be earning meaningful management fees pursuant to the General Regulation as described under the section *Background and Transactional Highlights*.**
	✓	b. OPG shall have the authority to determine the financing strategy, which will vary the financing costs with the objective of enabling the Trust to achieve a more favourable return compared to the benchmark for interest on the restructured asset.

Issue	No.	Requirements
		Pursuant to the Act, OPG has prepared a draft copy of the Financing Plan and delivered to the MOE. Upon finalization, a final copy of the Financing Plan will be delivered to the Minister. The Financing Plan outlines the key principles, assumptions and methodologies that will guide OPG in its funding strategy and decisions. The Financing Plan is required to follow general parameters and principles as set forth in the Act and the General Regulation, however, all funding strategies and decisions will be made by OPG. OPG, as FSM, will receive variable compensation related to the decisions it makes through the variable fee.
	π	c. The Trust shall establish classes of liabilities (senior, subordinated and the most subordinated). The classes would allow the Trust to delineate financing of lower risk investment and investment that would bear higher residual risk. The delineation would limit OPG's self-funded investment to a reasonable level in order to allow OPG to remain a self-sustaining entity. **Refer to Table 1 for the tiered-debt financing structure of the Trust (which are also outlined in the Financing Plan). OPG's exposure in holding the most subordinated debt in Tranche C will receive a commercial rate of return consistent with its risk profile. The final rates (and therefore spreads) will be determined when the first tranche of debt is acquired to purchase GA deferral assets. The credit range for each debt tranche will be determined by the overall credit strength of the financing structure and its resilience under various credit stress scenarios (i.e. the subordinated debt will be priced accordingly in relation to the senior debt using standard market pricing practices). The concept of subordination of OPG's investment in the Trust will be documented in the Subordinated Debt Pricing Protocol between OPG as FSM and the Ontario Financing Authority.**
	π	d. OPG shall, through its ownership of the most subordinated liability, be able to capture and retain the pricing difference between cost of financing and benchmark for interest on the restructured asset, or any residual risk of restructured asset. The targeted return of the subordinated liability should be reflective of the underlying risks and compensate holders for active management that would be required. **OPG will be able to capture the pricing difference between cost of financing and benchmark for interest through the variable management fee which is described in point 8a) above. Also, the discussion on point 8c) above states that OPG's investment in Tranche C will receive a commercial rate of return consistent with its risk profile.**
	Ω	OPG should participate in the detailed design of the above and the Trust documentation to ensure that it has substantive power and variability, which will allow OPG's Board of Directors to evaluate the opportunity as a business initiative instead of through a shareholder directive.

Issue	No.	Requirements
		OPG, as the reporting entity, has participated significantly in the design of the Trust through extensive involvement in the drafting of the Act, regulations, the MTSA, MTI and other program documents.
		Defined Forced Majeure for emergency events (e.g. unlikely credit market event or disruption where it is not possible to borrow from the market at a reasonable rate), OFA may provide bridge financing beyond the designated percentage for a defined period. **The Change of Law Protection Agreement provides bondholders a limited guarantee if the Province changes the Fair Hydro legislation or regulations or passes other legislation/regulation that materially adversely affects the ability of the Trust to service interest or principal payments on its debt, or the Act is declared invalid/unconstitutional.**
Legislation	9 ✓	The Legislation must require interest, carrying and administrative costs to be paid to the Trust on a monthly basis, so that the Trust is able to recognize appropriate revenue to offset any ongoing costs. **During the period from December 1, 2017 to July 31, 2021, the IESO will pay for the monthly carrying costs of the Trust pursuant to section 9.1 (1) of the General Regulation. Specified consumers are obligated to pay CEAs after May 1, 2021 pursuant to the Act.**
	10 ✓	The Legislation must dictate the manner in which the GA deferral asset would be determined, collected, and the period of collection, so that the determination of the restructured asset will not be subject to the Province's decisions on an ongoing basis, but determined based on a formula. Alternatively, the Legislation may allow for an adjustment to the pre-determined deferral formula based on specific parameters that would limit the adjustment to the restructured asset. Adjustments beyond the specific parameters would require approval by the Board of Trustee. **The Act and regulations have been designed to limit the Province's involvement on an on-going basis. To effect the conditions above, the following have been established:** • **25% electricity bill reduction for specified consumers effective as of July 1, 2017 under section 9 of the Act** • **Determination of the GA deferral asset/IESO's Regulatory asset per section 15 of the General Regulation and section 23 of the Act** • **Electricity vendors have the obligation to invoice specified consumers (section 17(1) of the Act) and collect the CEAs (section 17(3) of the Act). The IESO then receives the CEA collections from electricity vendors (section 16(1) of the Act) and remits it to the Trust who holds the GA deferral asset (section 16(4) of the Act).**

Issue	No.	Requirements
		• **During the period from December 1, 2017 to July 31, 2021, the IESO will pay for the carrying costs of the Trust pursuant to section 9.1 (1) of the General Regulation. These costs then are added to the GA, which specified consumers have the ultimate obligation to bear.** • **OPG is to calculate the CEAs per section 15 of the Act and the OEB cannot change the amount provided by OPG when they are determining the new rates to charge specified consumers per section 15(4) of the Act** • **The moratorium period where CEAs cannot be collected under section 21(4) of the Act, and the IESO may not collect balances in its variance account per section 25(3) from specified consumers established the timelines for CEA collection. After this point in time (i.e. May 1, 2021), CEAs can be collected from specified consumers and the IESO can also collect any balance in its variance account** • **The OEB reviews OPG's proposed management fees using market comp arable data and can only challenge OPG's proposal if the fees are materially inconsistent under sections 10.6, 10.9, 10.10, and 10.13 of the General Regulation.** • **OPG is to design the Financing Plan to reasonably align with the Fair Allocation Amount Pursuant to section 21 of Act. The Fair Allocation Amount, along with the requirements stipulated in section 14 of the General Regulation, guided the design of the Trust's Financing Plan. Although the Province determines the principles around the Fair Allocation Amount, management believes that it does not impact the activities of the Trust once the Trust has purchased the GA deferral asset from the IESO.** • **OPG may amend the Financing Plan at any time pursuant to section 21(6) of the Act without affecting CEAs that have already been determined or any existing debt.** • **The Financing Plan outlines the duration of the financing period for the FHP Program, expected to be from 2017 to 2047. The financing plan also outlines the key principles, assumptions and methodologies that will guide OPG in its funding decisions.** • **The Province cannot materially adversely impact the recoverability of the existing GA deferral assets through legislative action as it has provided change of law protection through the Change of Law Protection Agreement.**
	11	The Legislation must be written in accordance with all applicable laws and be irrevocable to reduce the cost of borrowing and with a specific formula which determines the deferral amount. **The determination of the GA deferral asset/IESO's Regulatory asset is outlined in section 15 of the General Regulation and section 23 of the Act.**

Issue	No.	Requirements
	12 **TT**	The spirit of the above terms should be reflected in the Trust Indenture Agreement as well as Legislation, wherever possible. **The program agreement and documents, as well as the Act and General Regulation, where applicable, reflect the terms discussed above.**

APPENDIX B:

Link between power and returns: principal-agency situations

The third criterion for having control is that the investor must have the ability to use its power over the investee to affect the amount of the investor's returns. When decision-making rights have been delegated or are being held for the benefit of others, it is necessary to assess whether the decision-maker is a principal or an agent to determine whether it has control. This is because if the decision-maker has been delegated rights that give it power, the decision-maker must assess whether those rights give it power for its own benefit, or merely power for the benefit of others. As an agent cannot have control over the investee, it does not consolidate the investee. A principal may have control over the investee, and if so, would consolidate the investee.

A decision maker shall consider the overall relationship between itself, the investee being managed and other parties involved with the investee, in particular all the factors below, in determining whether it is an agent:

a) the scope of its decision-making authority over the investee

As discussed above, OPG has decision-making authority over the Trust and its relevant activities. The Province has no right to determine what sort of funding decisions OPG should make to fund the GA deferral assets that they will purchase and OPG can choose not to purchase future GA deferral asset purchases.

Terms necessary for OPG to consolidate the Fair Hydro Trust (Appendix A) to support this point: **1, 2, 3, 4, 5**

b) the rights held by other parties (paragraphs B64–B67).

There are no substantive removal rights held by the Province for debt that already exists in the Trust.

Terms necessary for OPG to consolidate the Fair Hydro Trust (Appendix A) to support this point: **3, 4, 5**

c) the remuneration to which it is entitled in accordance with the remuneration agreement(s) (paragraphs B68–B70).

See section on 'Exposure or rights to variable returns' above.

Terms necessary for OPG to consolidate the Fair Hydro Trust (Appendix A) to support this point: **6, 7, 8, 9**

d) the decision maker's exposure to variability of returns from other interests that it holds in the investee (paragraphs B71 and B72).

See section on 'Exposure or rights to variable returns' above.

OPG will receive a 44% equity injection from the Province of Ontario. Given that the financing structure designed the majority (currently 51%) of the Trust's debt will be from external markets and not the Province, it can be argued that OPG did not receive

the majority of its interest in the investee as a contribution or loan from the Province. This shows that OPG is a principal, not a *de-facto* agent.

***Terms necessary for OPG to consolidate the Fair Hydro Trust (Appendix A) to support this point:* 6, 7, 8, 9**

Conclusion: OPG is not an agent for the Province, as the arrangement does not provide for the Province to directly absorb any variability associated with the structure. If the Province decides to intervene at a later date due to evolving market conditions, a reassessment would be made at such time.

Management's considerations on whether OPG is an agent for specified consumers

OPG is not an agent for the specified consumers because OPG has substantive exposure to risk of loss of its own funds invested in the Trust. The specified consumers do not have any of their own funds in any of the subordinated tranches and further, no decision making authority is delegated to the specified consumers relating to the relevant activities of the Trust.

Management's considerations on whether OPG is an agent for the IESO

Section 3.4 (k) of the MTSA notes that the IESO in its capacity as Servicer *"… shall hold the Issuer Share of Servicer CEA Receipts and the Issuer Share of any other proceeds in respect of the Clean Energy Adjustment received by it in trust for the benefit of the Issuer and remit such amounts in accordance with Section 3.6 without any surcharge, fee, offset, charge or other deduction."*, where the Issuer is the Trust.

Therefore, OPG is not an agent of the IESO because the IESO faces no continuing risk of loss after sale of the GA deferral asset to OPG; all of the risk therein applies to the Trust. In its role in collecting the CEA payments from the specified consumers, the IESO acts as an agent on behalf of the Trust, and thereby OPG, as detailed above.