Backgrounder on Electricity Sector Stranded Debt in the Context of Electricity Price Mitigation Discussion

The following note provides background information on the electricity sector stranded debt of the Ontario Electricity Financial Corporation (OEFC).

ACCOUNTING FOR THE OEFC'S STRANDED DEBT

Context

- OEFC is an agency of the Ministry of Finance and the legal continuation of the former Ontario Hydro.
- OEFC's mandate includes managing the debt and other liabilities of the former Ontario Hydro.
- OEFC has no staff, and it contracts for services from the Ontario Financing Authority and the Ministry of Finance.
- OEFC is not a rate-regulated entity, .
- OEFC is consolidated line-by-line into the Province's accounts, including revenues (e.g., Debt Retirement Charge, payments-in-lieu of taxes) and interest expense (into IOD).

Stranded Debt

- The OEFC stranded debt arose in 1999 as a result of the restructuring of the electricity sector under the Emergy Competition Act, 1998, including the break up of the former Ontario Hydro, introducing competition and creating a tax-payments-in-lieu of taxes level playing field for private and publc sector owned electricity companies.
- OEFC's initial unfunded liability of $19.4 billion (the initial stranded debt of $20.9 Bn less $1.5 Bn of other OEFC assets, primarily accounting assets) was initially reported through a separate one line disclosure in Public Accounts based on the structure to retire OEFC's obligations wholly through dedicated electricity sector revenues and not taxpayers, and an annual assessment, as required by the Provincial Auditor, that OEFC was self-sustaining over time.
    - OEFC's bottom-line from its statement of operations was also initially consolidated into Public Accounts on a one-line basis, "below-the-line" in Public Accounts (such that the Province had two bottom lines, before and after OEFC's operating results).
- In accordance with Public Sector Accounting Board (PSAB) recommendations, and consistent with the Provincial Auditor's recommendation, since 2003, in Public Accounts, OEFC has been consolidated on a line by line basis where assets, liabilities, revenues and expenses are combined with the Province, as adjusted to eliminate inter-organization balances and transactions.

- In order to service and pay down its debt and other liabilities, the government enacted in the Electricity Act, 1998, a number of dedicated revenue streams that include the Debt Retirement Charge (DRC), Payments in Lieu of Taxes, and the Gross Revenue Charge.
    - Since OEFC has been consolidated on a line by line basis, these revenues appear as part of the Province's revenues in the Public Accounts.
    - As well, the OEFC's interest payments are included in the Province's IOD expenses.
- Over time, the OEFC's stranded debt has fluctuated, with corresponding increases and decreases reflected in the Province's net debt. Since 2004, the stranded debt has been reduced each year.
    - Note that because of the inter-organisation transactions, eliminating on consolidation some of OEFC's revenues and expenses, the change in stranded debt each year is not equal to the net bottom line impact on the Province in Public Accounts.

- Various potential changes in the annual amount of OEFC (non-Provincial) revenues or expenses that affect the pay down of stranded debt would affect the Province's bottom line.

  - For example, the ending of the Debt Retirement Charge (DRC) on residential consumers has reduced OEFC revenues by about $340 million per year, which has a dollar-for-dollar impact on the Province on consolidation.
  - Once the DRC on the remaing DRC payers (e.g., industrial, commercial and institutional users of electricity) ends (currently legislated as at April 1, 2018, there would be a reduction in annual revenue of about $625 million.

OTHER ELECTRICITY AGENCIES

- Other electricity sector entities, such as the Ontario Energy Board (OEB) and the IESO, are also consolidated line-by-line in the Province's Public Accounts.
  - OEB and IESO are consolidated under the Ministry of Energy.
  - Currently, these electricity sector entities are regulated by OEB and operate on a cost-recovery basis from the ratebase with no significant fiscal impact.
- The Province's electricity sector government business enterprises (GBEs) are consolidated into the Province's accounts on a modified equity basis and and directly impact the Province's surplus/deficit position as well as its net debt.

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