RE: FHP - OPG Performance Fee

From: Ken Kandeepan <ken.kandeepan@ofina.on.ca>
To: "Nelms, Scott (MOF)" <scott.nelms@ontario.ca>
Cc: "Veinot, Cindy (TBS)" <cindy.veinot@ontario.ca>, "Kim, John (OFA)" <john.kim@ofina.on.ca>, "Yep, Carlos (OFA)" <carlos.yep@ofina.on.ca>, "Petsche, Nadine (TBS)" <nadine.petsche@ontario.ca>, "Manning, Mike (OFA)" <mike.manning@ofina.on.ca>, "Kwan, Ronald (OFA)" <ronald.kwan@ofina.on.ca>, John Psinas <john.psinas@ofina.on.ca>
Date: Thu, 06 Jul 2017 14:29:55 -0400

Hi Scott

I reviewed the email from Jackson Huang that you attached against E&Y's opinion (dated May 17) specifically against any mention of a management fee. Page 4 of the opinion states;" The purpose of the Trust is to allow OPG to earn a return on the Intangible Asset from the IESO by effectively managing financing to earn a spread, earn management fees, and earn interest fees. For the reasons noted above, OPG has control over the decisions to be made about the relevant activities".

It appears that E&Y conceptually envisages a management fee in addition to the spread earned by OPG on the 5% debt it funds and interest fees on the 44% funded by the Province's equity injection.

Drawing parallels between the proposed FHP structure and ONFA, is in my opinion not particularly useful. The latter manages tangible monetary assets that earn income based on specific investment decisions. Such is not the case in the latter where the asset is intangible and its attraction is the owner's ability to benefit from certain legislated revenue streams that allow the repayment of the liabilities incurred in purchasing said asset. I am cc'ing Ron Kwan on this since he may want to add to the ONFA, FHP comparison. The bottom line is there is no asset management in the FHP, rather and management fees should be conceptually a reimbursement of the costs incurred by the FSM in discharging its mandate.

I would therefore propose a spectrum of options to address the management fee:

On the narrow end of the spectrum it can be argued that the act of lending the 44% equity funding to the Trust constitutes the "interest fees" referred to above in the opinion. Any spread that OPG includes in the rate charged to the Trust – we understand that OPG will indeed include a spread on the basis that this debt is defined as subordinate – can represent the management fee.

The middle of the spectrum can be represented by a spread component, over and above what OPG includes to address the sub debt issue, that constitutes the management fee. And at the broader end of the spectrum OPG can include a specific spread not just on the 44% funded via the equity injection but also on the 5% it funds through its own borrowings.

Finally your attached email proposes the following: pls see my comments in red

(i) inversely in relation to the weighted-average interest rate (for example, weighted by dollar amount of each funding obligation) of all new funding obligations incurred during a calendar year; and/or. Not sure what "inversely" means in this context, if the idea is to include a simple spread on the weighted average borrowing rate this is no different from what we have proposed above.

(ii) as a percentage [fixed under regulation or determined by OEB] of the "surplus" (where present value of all funding obligations discounted at a fixed rate [to be prescribed or determined by OEB] > actual present value of all funding obligations) or "deficit" during a period
[Note: this most closely tracks the adjustment mechanism in ONFA and creates a direct relationship

between the FSM fees and the dollar effect of FSM's management; a period can be more than one calendar year which means the FSM fees payable for a calendar year would not change until a triggering event]. This is very confusing; what is “actual present value”

Thanks and happy to discuss.

Ken k

-----Original Message-----
From: Nelms, Scott (MOF) [mailto:Scott.Nelms@ontario.ca]
Sent: Wednesday, July 05, 2017 4:36 PM
To: Ken Kandeepan <Ken.Kandeepan@ofina.on.ca>; Veinot, Cindy (TBS) <Cindy.Veinot@ontario.ca>; John Kim <John.Kim@ofina.on.ca>; Carlos Yep <Carlos.Yep@ofina.on.ca>; Nadine Petsche (MOF) <Nadine.Petsche@ontario.ca>
Subject: FW: FHP - OPG Performance Fee

Fee note as discussed. The note focuses on OEB role, but perhaps we should revisit the quantum of the fee. Let me know if you have comments.

Sent with BlackBerry Work
(www.blackberry.com)

From: Calwell, Carolyn (ENERGY/MEDEI/MRI) <
Carolyn.Calwell@ontario.ca<mailto:Carolyn.Calwell@ontario.ca >>
Date: Wednesday, Jul 05, 2017, 1:20 PM
To: Nelms, Scott (MOF) < Scott.Nelms@ontario.ca<mailto:Scott.Nelms@ontario.ca >>, McKinlay, Tom (ENERGY) < Tom.McKinlay@ontario.ca<mailto:Tom.McKinlay@ontario.ca >>
Cc: Montgomery, Kaitlin (MOF) < Kaitlin.Montgomery@ontario.ca<mailto:Kaitlin.Montgomery@ontario.ca >>
Subject: RE: FHP - OPG Performance Fee

I think we are aligned. Does OFA have some suggestions about how to structure the fee? Feel free to float the “option 2” from the note and see if they have suggestions about how to make it better. I haven’t yet sent that note up, as I am trying to work in some research that Jackson did (attached for your reference).

From: Nelms, Scott (MOF)
Sent: July-05-17 12:15 PM
To: Calwell, Carolyn (ENERGY/MEDEI/MRI); McKinlay, Tom (ENERGY)
Cc: Montgomery, Kaitlin (MOF)
Subject: FW: FHP - OPG Performance Fee

Fyi – more complications on the fee issue.

From: Ken Kandeepan [mailto:Ken.Kandeepan@ofina.on.ca]
Sent: July 5, 2017 11:59 AM
To: Nelms, Scott (MOF)
Cc: Kwan, Ronald (OFA); Yep, Carlos (OFA); Monroe, Graham (OFA); Manning, Mike (OFA); Devine, James (OFA); Veinot, Cindy (TBS)
Subject: FHP - OPG Performance Fee

Hi Scott

I am writing this to you as an FYI since there may be some push back from OPG. I am cc’ing Cindy as well given the accounting implications raised by OPG. As you may be aware, OPG provided us with the proposed methodology for computing the performance fee. Both the benchmark and the actual include the 44% debt issued by OPG to the Trust which is in turn fully funded by the Province's equity injection.

Given that there are no capital market decision-making associated with this component of the debt, we are reluctant to sign off on OPG's methodology in its current form. OPG is not particularly happy with our response and posits that the accounting treatment requires a performance fee. While I agree that the E&Y opinion does refer to a performance fee I am a little doubtful that E&Y specified that all of the debt should be part of the computation. I have requested that OPG provide me with any specific reference by E&Y on the performance fee methodology. If E&Y does require that the benchmark and actual include the total debt issuance, we can reconsider our stance.

Finally, the performance fee methodology computes the fee for a particular year by applying the difference between the benchmark and the actual on the 5% that is borrowed by OPG. We requested and obtained confirmation that the performance fee will be limited to new borrowings by OPG and not apply to any refinancing. OPG finds this acceptable and it also ensures that the performance fee will be capped at $1.2 million or so per annum.

Thanks

Ken k
