# ONTARIO FAIR HYDRO PLAN

# PILS (TAX) RELIEF

# MINISTER'S REGULATION

# ONTARIO FAIR HYDRO PLAN - PILS (TAX) RELIEF

## PURPOSE

- A Minister's regulation under the *Electricity Act, 1998* is necessary to exempt Ontario Power Generation (OPG) from tax that may arise because of the financing arrangements for the Fair Hydro Plan (Plan).

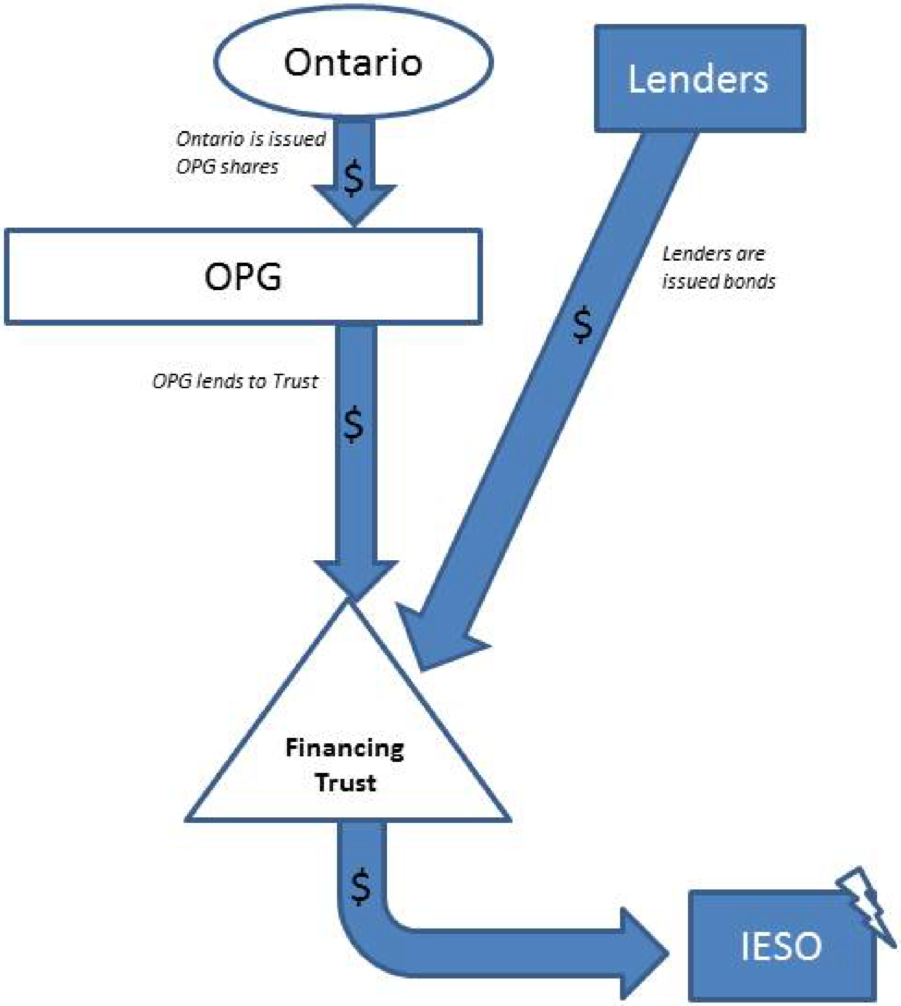
- Providing a tax exemption to OPG would:

    - remove tax as a cost that must be passed on to consumers;

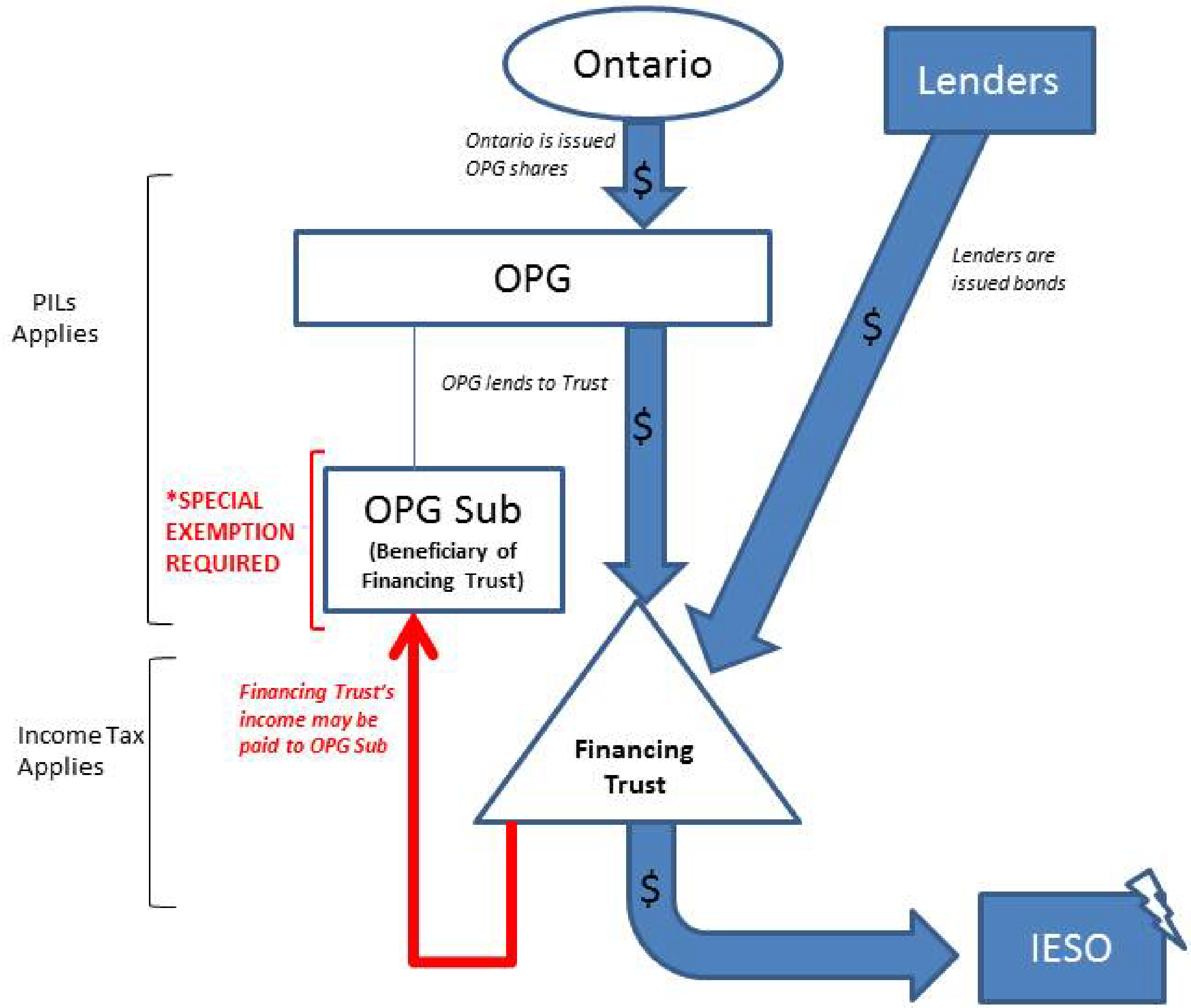
    - provide greater comfort to lenders that the loan will be repaid; and

    - be consistent with taxing only commercial activities.

## BASIC ILLUSTRATION OF THE FINANCING ARRANGEMENTS



# BASIC ILLUSTRATION OF THE PROPOSED TAX EXEMPTION FOR OPG



## APPENDIX A

## OVERVIEW OF THE ONTARIO FAIR HYDRO PLAN

- The government intends to lower consumer electricity bills by 25% for five years.
- The resulting decrease in revenue will reduce the amounts available to pay electricity generators.  The shortfall will be corrected with money from a "financing entity" established under the Plan.

## STRUCTURE OF THE PLAN

- OPG will establish a financing entity (or entities) for the purposes of the Plan.
- The first financing entity that will be established by OPG will be a trust (Trust).
- The Trust will be capitalized with funds from the Province and from capital market borrowing.
- The Trust will purchase a "regulatory asset" from the Independent Electricity System Operator (IESO).  The regulatory asset will be the right to collect amounts from electricity consumers.

# APPENDIX

## LOAN REPAYMENT AFTER THE 5-YEAR "HOLIDAY"

- After the end of the 5-year holiday, the Trust would invoke the rights under the regulatory asset and begin to collect amounts from electricity consumers equal to the borrowed money, interest and other costs. The collected amounts would be used to repay lenders.

- After the end of the 5-year holiday, consumers' electricity bills would increase to reflect the full cost of generating electricity plus the cost of paying for the regulatory asset.

## FUTURE FINANCING ACTIONS

- In the future, the financing actions described above may be repeated by the Trust, or by other financing entities that may be established under the Plan.

## APPENDIX B

### TAXATION OF THE FINANCING ENTITY

- Generally, a trust is subject to regular federal and provincial taxation and not PILs. A trust is entitled to deduct from its income for tax purposes any income paid or payable to a beneficiary of the trust.

- For purposes of the Plan, OPG or a subsidiary of OPG would be the beneficiary of the Trust.

- Amounts paid to OPG or to an OPG subsidiary would allow the Trust to minimize or eliminate the regular federal and provincial income tax the Trust would otherwise have to pay.

- OPG or an OPG subsidiary would be subject to PILs on amounts received from the Trust.

- The proposed regulation would exempt OPG or an OPG subsidiary from having to pay PILs on the amounts received or receivable from the Trust.

## APPENDIX C

### INCOME OF THE FINANCING ENTITY

- The financing entity (initially, the Trust) is not anticipated to have significant taxable income over the financing period.

- However, the timing of the Trust's income and expenses may not match. This could result in significant income in some years that would be subject to federal and provincial tax.

### BACKGROUND - PILS

- PILs tax is equivalent to regular federal and provincial income tax.

- PILs is paid by entities in the electricity industry that would otherwise be exempt from taxation, e.g., OPG and subsidiaries of OPG.

- PILs is intended to put such entities on a level playing field with private sector entities in the electricity industry.

August [date], 2017

TO:  Ontario Power Generation (OPG)

Thank you for your query and memorandum from your advisors, Torys LLP, dated May 17, 2017, regarding the Fair Hydro Plan and certain tax implications arising under the *Electricity Act, 1998* (EA) for OPG and a financing entity.

A financing entity or entities to be established by OPG has been given a mandate under the Fair Hydro Plan to acquire certain regulatory assets~~rights~~ from the Independent Electricity System Operator (IESO).  The *Ontario Fair Hydro Plan Act, 2017* (FHPA) has given OPG the right to create a "financing entity" to facilitate its objectives under the Fair Hydro Plan.

I understand that OPG will create a trust (Trust) as a financing entity under the FHPA to facilitate OPG's mandate under the Fair Hydro Plan.  The Trust would be subject to tax under the *Income Tax Act* (Canada) (ITA) and the Ontario *Taxation Act, 2007* (TA). Further, I understand that the beneficiary of the Trust will be a special purpose vehicle (SPV) that will be a corporation wholly-owned by OPG.  The SPV would be exempt from Canadian federal income tax under section 149 of the ITA and under section 27 of the TA.  The SPV would be subject to payments-in-lieu of tax (PILs) under Part VI of the EA.

**Commented [RK1]:** I thought OPG's memo (or Tory's for OPG) had OPG as the beneficiary.

A recommendation will be made to the Minister of Finance to make a regulation under the EA to ensure that amounts allocated by the Trust to the SPV will not be included in the income of the SPV for purposes of calculating PILs under the EA.

________________________

Name / Signature

PLAN TO ADDRESS WILL ADD TO LIABILITIES

To help offset rising electricity costs ~~that have risen to the highest in Canada~~in Ontario, Ontario has passed legislation (the Fair Hydro Act, 2017) that has reduced consumer rates by 25% on average in the near term~~for the next four years~~, and ensure prices remain lower than they otherwise would be for the medium term. Of the 25% reduction, 8% stems from a rebate equal to the provincial portion of the Harmonized Sales Tax from energy bills (at an estimated cost to the province of CAD1 billion in 2017/18). The remaining 17% arises from refinancing a portion of the Global Adjustment (GA), and shifting the cost of the Ontario Electricity Support Program (OESP) and Rural or Remote Rate Protection (RRRP) program from ratepayers to provincial revenues~~artificially low rates that the province has regulated for the first four years (allowing for increases only in line with inflation)~~. ~~This~~ The ~~latter reduction~~GA will be refinanced via equity injection by the Province into and debt issued by [a provincially owned power company] ~~-etc~~~~debt issued by a provincially owned power company~~. Repayment by ratepayers will begin May 1, 2021 as rates will be allowed to increase to begin to recover the costs associated with the GA refinancing. It is expected that GA refinancing will be required for the first 10 years as prices will remain lower than they otherwise would have, while debt repayment will occur across a longer time horizon.

The P~~p~~rovince had ~~forecasts~~ forecasted that the accumulated debt~~total funding requirements~~ will not exceed CAD28 billion, including interest, to be issued by a ~~crown entity~~provincially owned power company~~, resulting in an increase to the province's liabilities~~. Additionally, the Act allows for the P~~p~~rovince to provide a guarantee on the debt ~~which would enable the Province to provide guarantees to investors to~~ and protect investors from risks that cannot otherwise be mitigated.~~further link the debt to the province.~~

While the financing requirements are relatively small given the P~~p~~rovince's revenue and total debt stock, this plan is seen as credit negative for the P~~p~~rovince for a number of reasons. First, there is the direct financial impact to the P~~p~~rovince stemming from the sales tax rebate; second, the P~~p~~rovince will face increased indirect debt levels and third, there is increased political intervention in a regulated market which weakens a key component behind our self-supporting assessment of Canadian public utilities.

**Commented [SK81]:** While we say that prices will go up at the rate of inflation/2% over the next 4 years, we never say that that is the same thing as a 25% reduction over those same 4 yrs.

**Commented [GH2]:** Didn't find the public messaging on this.

**Commented [SK83]:** This was an Initial forecast about two months ago or earlier. Not sure if it's fair to use 'forecasts'

**Commented [GH4]:** Source: https://news.ontario.ca/mei/en/2017/5/ontarios-fair-hydro-act-2017-1.html

**Commented [SK85]:** Not sure why the term 'crown entity' was used here and 'provincially owned power company' was used above. Unless I'm missing a key distinction, suggest keeping consistent.

**Commented [GH6]:** I think we have been saying there's no fiscal impact.

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What guarantees do we have that without the FHP rates would only go up at the rate of inflation?

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**Commented [JK6R5]:** CMD and FTD to review this paragraph and others.

**Commented [JK7]:** Bonnie and David to address this part. The indirect debt level referred here is legislated to be ratepayer-funded, not taxpayer funded.

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To help offset rising electricity costs ~~that have risen to the highest in Canada~~in Ontario, Ontario has passed legislation (the Ontario Fair Hydro Plan Act, 2017) that has reduced residential consumer ~~rate~~bills by 25% on average, and only allowing for increases in line with inflation for the next four years, ~~and~~ ensuring~~e~~ prices remain lower than they otherwise would be for the medium term. ~~Of t~~The 25% reduction~~, 8% stems~~ includes the impact ~~from~~of the ~~a~~ rebate equal to the 8% provincial portion of the Harmonized Sales Tax ~~from~~on energy bills (at an estimated cost to the province of CAD~~1~~ 940 ~~b~~million in 2017/18). The remaining ~~17%~~amount arises primarily from refinancing a portion of the Global Adjustment (GA) cost portion of the bill~~artificially low rates that the province has regulated for the first four years (allowing for increases only in line with inflation)~~. The ~~is latter reductione~~ GA will be refinanced via ~~equity injection by the Province and debt issued by etc~~debt issued by a special purpose entity to be established by a provincially owned power company, as well as funds from the provincially-owned power company through its own debt issuances and equity from its provincial owner, financed by provincially-issued debt.~~.~~

The ~~p~~Province's initial analysis ~~forecasts~~ indicated that the accumulated debt~~total funding requirements~~ will not exceed CAD28 billion, including interest, ~~to be issued by a crown entity~~, ~~resulting in an increase to the province's liabilities.~~ Additionally, the Act allows for the ~~p~~Province to provide a guarantee on the debt which would further link the debt to the ~~p~~Province.

Repayment by ratepayers will begin May 1, 2021, as rates will be allowed to increase to begin to recover the costs associated with the GA refinancing. It is expected that GA refinancing will be required for the first 10 years as prices will remain lower than they otherwise would have, while debt repayment will occur across a longer time horizon.

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**Commented [RK1]:** While this would increase the Province's total debt, it would not increase net debt, as it would be offset by the value of its equity in OPG.

**Commented [GH2]:** Source: https://news.ontario.ca/mei/en/2017/5/ontarios-fair-hydro-act-2017-1.html

**Commented [RK3]:** See comment above.

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TORYS LLP

**MEMORANDUM**

**PRIVILEGED AND CONFIDENTIAL**

| | | | |
|---|---|---|---|
| **To** | Ontario Power Generation Inc. | **Date** | May 17, 2017 |
| **From** | Torys LLP, Toronto Tax | | |
| **Re** | Fair Hydro Plan – PILs Exemption | | |

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As part of the Fair Hydro Plan (the "Plan"), it is expected that Ontario Power Generation Inc. will act as the financial services manager and that Ontario Power Generation Inc., or a wholly-owned corporate subsidiary of Ontario Power Generation Inc. (in either case, "OPG"), will establish one or more new financing entities that will raise debt to acquire "investment assets" from the IESO. A Bill to implement the Plan has been introduced to the Provincial Legislature [1] and there is flexibility under the Bill for the new financing entity to be a corporation, a trust, a limited partnership or a partnership.

We understand that the Province would like to minimize, to the extent possible, Federal and Provincial taxes and "payments in lieu of taxes" ("PILs") under the *Electricity Act, 1998* (Ontario) (the "OEA") payable by a financing entity as the costs of any of those taxes payable by a financing entity will be passed on to ratepayers through the collection of the clean energy adjustment under the Bill and the associated regulations. Accordingly, we understand that the Province is considering the possibility of making regulation changes to exempt the income arising as a consequence of the Plan from PILs. In order to assist the Province in their consideration of this regulation change, including the scope of any such amendment, we have set out below a summary of: (i) the tax treatment of the income of the financing entity under the *Income Tax Act* (Canada) (the "ITA"), the *Taxation Act, 2007* (Ontario) (the "OTA"), and the OEA, (ii) certain matters relating to the computation of the financing entity's income for tax purposes, and (iii) our recommendations with respect to how the Province can ensure that PILs arising from the Plan are minimized.

It is also important to note that Ontario Power Generation Inc. will not bear any of the tax costs arising as a consequence of participating in the Plan. If there are any tax costs, they will be borne by ratepayers through the clean energy adjustment.

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[1] 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*, 2nd Sess, 41st Leg, Ontario, 2017 (first reading May 11, 2017).

**Tax Treatment of Income of Financing Entity**

As noted above, there is flexibility in the draft legislation to implement the Plan relating to the form of a financing entity. What follows is a summary of the tax treatment of the income of the financing entity if it is a corporation, a trust or a limited partnership/partnership, as well as the tax treatment of amounts paid or allocated to OPG as a shareholder, beneficiary or a partner, respectively, of the financing entity:

| Form of Financing Entity / OPG | Treatment of Income under ITA/OTA | Income Subject to PILs |
|---|---|---|
| Corporation | -Income of the corporation should be exempt from tax | Yes |
| OPG as shareholder of corporation[2] | -Dividends paid to OPG should be exempt from tax | Yes |
| Trust | -Income should be subject to tax, although the trust can reduce its income by the amount of its income which is paid or made payable to its beneficiaries | No |
| OPG as beneficiary of trust | -Trust income paid or made payable to OPG as a beneficiary should be exempt from tax | Yes |
| Limited Partnership/Partnership | -Limited Partnership/Partnership is not generally a "taxpayer" although income is computed at the partnership level and allocated to partners for tax purposes | No |
| OPG as partner of limited partnership/partnership | -Partnership income allocated to OPG as a partner should be exempt from tax | Yes |

As summarized, if the financing entity is a corporation, the income of this corporation would be subject to PILs, and further, any amounts paid or allocated by the financing entity to OPG, as a shareholder, beneficiary or limited partner/partner of the financing entity, would similarly be subject to PILs. Consequently, any regulation change to exempt the income of the financing entity from PILs under the OEA should be broad enough to accommodate the three possible forms of financing entity and address PILs at both the financing entity level (in the case of a corporation) and the shareholder, beneficiary and limited partner/partner level.

[2] We note that corporations are generally entitled to claim a deduction under section 112 of the ITA (and any OTA equivalent) equal to the amount of taxable dividends received from another Canadian corporation, with the result that taxable dividends are generally not subject to tax under Part I of the ITA (and any OTA equivalent). To illustrate the scope of the PILs exemption under consideration by the Province, we have ignored this deduction in preparing this chart.

**Income Computation Matters**

As part of the Plan, it is expected that the financing entity will raise debt and acquire "investment assets" from the IESO. The investment assets do not appear to be debt instruments from a commercial perspective on the date they are acquired, but rather seem to be intangible assets. Given the unique nature of the investment assets, the tax analysis that is generally relied on by a financing entity in a typical securitization transaction (which involves interest-bearing debt obligations) is not applicable. There are no specific rules in the ITA or OTA which govern the manner which the investments assets should be treated for tax purposes, such that further analysis will need to be conducted in order to determine whether the investment assets are on income or capital account to the financing entity, and that the "cost" of the investment assets are appropriately recognized as a deduction or offset in computing the income of the financing entity.

In addition to the tax implications relating to the investments assets, the following additional matters, among others, are relevant in computing the income of the financing entity:

- In order to be deductible, an expense must satisfy the requisite income earning purpose test;
- Expenses which are owing to a non-arm's length person must be paid in a timely fashion so that the expense does not give rise to an income inclusion;
- Capital losses may generally only be offset against capital gains, such that consideration must be given to the character of the assets and liabilities of the financing entity to ensure there are no mismatches;
- If the financing entity incurs foreign-currency denominated debt, any related foreign currency hedging instrument will need to be sufficiently "linked" to the underlying debt to ensure capital treatment of the hedge; for example, if the period of the hedge does l not match the period of the related debt, the financing entity will realize gains or losses on the hedge that will not be offset with realized losses or gains on the debt; and
- If the financing entity is a trust, it will be necessary for interests in the trust to "vest indefeasibly" or be structured as units where at least 95% of the units, by fair market value, are redeemable on demand by the holder to ensure that the trust is not deemed to dispose of any capital property under the "21 year" rule.

**Recommendations**

In order to ensure that the taxes arising under the Plan are minimized so that the overall cost of the Plan (over its 30 or more years of existence) to ratepayers is minimized and to ensure that Ontario Power Generation Inc. is kept whole from tax costs arising as a consequence of participating in the Plan, the following exemptions from PILs are required:

1) If the financing entity is a trust: Any income paid or made payable to OPG by the trust should be exempt from PILs. If this PILs exemption is not promulgated, the income will

not be distributed out of the trust, tax will be payable by the trust on the income and the costs of that tax payable will be passed on to ratepayers through the clean energy adjustment. This will be a significant cost.

2) If the financing entity is a corporation: The corporate financing entity should be exempt from PILs and any dividends paid to OPG should be exempt from PILs. Again, if these PILs exemptions are not promulgated, no dividends will be paid to OPG and the costs of all PILs paid by the financing entity will be passed on to ratepayers through the clean energy adjustment. This will be a significant cost.

3) If the financing entity is a partnership or limited partnership, any income allocated to OPG should be exempt from PILs.

4) If the financing entity is any other form of special purpose vehicle, the income of such entity should be exempt from PILs and any income from such special purpose vehicle allocated, paid or taxable in the hands of OPG should be exempt from PILs.

TORYS LLP

**MEMORANDUM**

**PRIVILEGED AND CONFIDENTIAL**

| | | | |
|---|---|---|---|
| **To** | Ontario Power Generation Inc. | **Date** | May 17, 2017 |
| **From** | Torys LLP, Toronto Tax | | |
| **Re** | Fair Hydro Plan – PILs Exemption | | |

As part of the Fair Hydro Plan (the "Plan"), it is expected that Ontario Power Generation Inc. will act as the financial services manager and that Ontario Power Generation Inc., or a wholly-owned corporate subsidiary of Ontario Power Generation Inc. (in either case, "OPG"), will establish one or more new financing entities that will raise debt to acquire "investment assets" from the IESO. A Bill to implement the Plan has been introduced to the Provincial Legislature [1] and there is flexibility under the Bill for the new financing entity to be a corporation, a trust, a limited partnership or a partnership.

We understand that the Province would like to minimize, to the extent possible, Federal and Provincial taxes and "payments in lieu of taxes" ("PILs") under the *Electricity Act, 1998* (Ontario) (the "OEA") payable by a financing entity as the costs of any of those taxes payable by a financing entity will be passed on to ratepayers through the collection of the clean energy adjustment under the Bill and the associated regulations. Accordingly, we understand that the Province is considering the possibility of making regulation changes to exempt the income arising as a consequence of the Plan from PILs. In order to assist the Province in their consideration of this regulation change, including the scope of any such amendment, we have set out below a summary of: (i) the tax treatment of the income of the financing entity under the *Income Tax Act* (Canada) (the "ITA"), the *Taxation Act, 2007* (Ontario) (the "OTA"), and the OEA, (ii) certain matters relating to the computation of the financing entity's income for tax purposes, and (iii) our recommendations with respect to how the Province can ensure that PILs arising from the Plan are minimized.

It is also important to note that Ontario Power Generation Inc. will not bear any of the tax costs arising as a consequence of participating in the Plan. If there are any tax costs, they will be borne by ratepayers through the clean energy adjustment.

[1] 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*, 2nd Sess, 41st Leg, Ontario, 2017 (first reading May 11, 2017).

**Tax Treatment of Income of Financing Entity**

As noted above, there is flexibility in the draft legislation to implement the Plan relating to the form of a financing entity. What follows is a summary of the tax treatment of the income of the financing entity if it is a corporation, a trust or a limited partnership/partnership, as well as the tax treatment of amounts paid or allocated to OPG as a shareholder, beneficiary or a partner, respectively, of the financing entity:

| Form of Financing Entity / OPG | Treatment of Income under ITA/OTA | Income Subject to PILs |
|---|---|---|
| Corporation | -Income of the corporation should be exempt from tax | Yes |
| OPG as shareholder of corporation[2] | -Dividends paid to OPG should be exempt from tax | Yes |
| Trust | -Income should be subject to tax, although the trust can reduce its income by the amount of its income which is paid or made payable to its beneficiaries | No |
| OPG as beneficiary of trust | -Trust income paid or made payable to OPG as a beneficiary should be exempt from tax | Yes |
| Limited Partnership/Partnership | -Limited Partnership/Partnership is not generally a "taxpayer" although income is computed at the partnership level and allocated to partners for tax purposes | No |
| OPG as partner of limited partnership/partnership | -Partnership income allocated to OPG as a partner should be exempt from tax | Yes |

As summarized, if the financing entity is a corporation, the income of this corporation would be subject to PILs, and further, any amounts paid or allocated by the financing entity to OPG, as a shareholder, beneficiary or limited partner/partner of the financing entity, would similarly be subject to PILs. Consequently, any regulation change to exempt the income of the financing entity from PILs under the OEA should be broad enough to accommodate the three possible forms of financing entity and address PILs at both the financing entity level (in the case of a corporation) and the shareholder, beneficiary and limited partner/partner level.

[2] We note that corporations are generally entitled to claim a deduction under section 112 of the ITA (and any OTA equivalent) equal to the amount of taxable dividends received from another Canadian corporation, with the result that taxable dividends are generally not subject to tax under Part I of the ITA (and any OTA equivalent). To illustrate the scope of the PILs exemption under consideration by the Province, we have ignored this deduction in preparing this chart.

**Income Computation Matters**

As part of the Plan, it is expected that the financing entity will raise debt and acquire "investment assets" from the IESO. The investment assets do not appear to be debt instruments from a commercial perspective on the date they are acquired, but rather seem to be intangible assets. Given the unique nature of the investment assets, the tax analysis that is generally relied on by a financing entity in a typical securitization transaction (which involves interest-bearing debt obligations) is not applicable. There are no specific rules in the ITA or OTA which govern the manner which the investments assets should be treated for tax purposes, such that further analysis will need to be conducted in order to determine whether the investment assets are on income or capital account to the financing entity, and that the "cost" of the investment assets are appropriately recognized as a deduction or offset in computing the income of the financing entity.

In addition to the tax implications relating to the investments assets, the following additional matters, among others, are relevant in computing the income of the financing entity:

- In order to be deductible, an expense must satisfy the requisite income earning purpose test;
- Expenses which are owing to a non-arm's length person must be paid in a timely fashion so that the expense does not give rise to an income inclusion;
- Capital losses may generally only be offset against capital gains, such that consideration must be given to the character of the assets and liabilities of the financing entity to ensure there are no mismatches;
- If the financing entity incurs foreign-currency denominated debt, any related foreign currency hedging instrument will need to be sufficiently "linked" to the underlying debt to ensure capital treatment of the hedge; for example, if the period of the hedge does l not match the period of the related debt, the financing entity will realize gains or losses on the hedge that will not be offset with realized losses or gains on the debt; and
- If the financing entity is a trust, it will be necessary for interests in the trust to "vest indefeasibly" or be structured as units where at least 95% of the units, by fair market value, are redeemable on demand by the holder to ensure that the trust is not deemed to dispose of any capital property under the "21 year" rule.

**Recommendations**

In order to ensure that the taxes arising under the Plan are minimized so that the overall cost of the Plan (over its 30 or more years of existence) to ratepayers is minimized and to ensure that Ontario Power Generation Inc. is kept whole from tax costs arising as a consequence of participating in the Plan, the following exemptions from PILs are required:

1) If the financing entity is a trust: Any income paid or made payable to OPG by the trust should be exempt from PILs. If this PILs exemption is not promulgated, the income will

**Commented [GH1]:** Historically, one of the purposes of the PILs regime was to ensure publicly-owner (aka government-owned) electricity entities would be forced to operate on equal footing with privately held companies by paying the equivalent of corporate income taxes (albeit to the OEFC rather than to the Federal and Provincial governments).

As OPG enacts new businesses (eg. bioenergy, solar, isotope sales and new markets etc), these taxes would similarly be 'PILs' and remitted to OEFC.

Providing this tax exemption for OPG would be seen as an unfair advantage for a publicly-owned corporation, particularly in the event there are any future desires to privatize. In addition as OPG is not mandated to be the financial manager, it is unclear if another financing entity would be eligible for these PILs exemption.

**Commented [SK82]:** Are there limitations in the role of the financing entity, and would it (by utilizing this PILs exemption) be able to expand its breadth into other operating businesses?

not be distributed out of the trust, tax will be payable by the trust on the income and the costs of that tax payable will be passed on to ratepayers through the clean energy adjustment. This will be a significant cost.

2) If the financing entity is a corporation: The corporate financing entity should be exempt from PILs and any dividends paid to OPG should be exempt from PILs. Again, if these PILs exemptions are not promulgated, no dividends will be paid to OPG and the costs of all PILs paid by the financing entity will be passed on to ratepayers through the clean energy adjustment. This will be a significant cost.

3) If the financing entity is a partnership or limited partnership, any income allocated to OPG should be exempt from PILs.

4) If the financing entity is any other form of special purpose vehicle, the income of such entity should be exempt from PILs and any income from such special purpose vehicle allocated, paid or taxable in the hands of OPG should be exempt from PILs.

**Commented [SK83]:** Unclear why 'the income will not be distributed out of the trust' if the PILs exemption is not promulgated. What exactly is stopping the income from being distributed to OPG?

Why can't OPG (in its capacity as a larger organization) manage its tax obligations (PILs) appropriately upon receiving income paid (or payable) by the trust?
(ie. If the financing entity/trust has less maneuverability, why can't OPG as a larger organization engage in better tax planning).

**Commented [SK84]:** What is meant by significant?

From my understanding no taxes will be paid on the 95% of the borrowings of the fund.

Furthermore there will be a benchmark on the weighted average borrowing and the trust will receive a gain/benefit/income on the 5% if it beats the benchmark.

A TRUSTED BUSINESS PARTNER DRIVING VALUE

# OPG's Financing Outlook - Debt & Equity

March 1, 2018

ONTARIO POWER GENERATION

# Financing & Liquidity Outlook

**Financing and Liquidity Outlook - Years Ended Dec 31**

| *(in millions of dollars)* | | Actual 2017 | 2018 | Business Plan 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|
| ***Opening Cash Balance*** | | **186** | **234** | **273** | **354** | **249** |
| **Net Operating Cash Inflows before the following:** | | **1,724** | **2,291** | **3,201** | **2,852** | **3,398** |
| Interest Paid (excl. Fair Hydro Trust) | | (251) | (261) | (264) | (250) | (230) |
| Nuclear Funds Contribution | | - | - | - | - | - |
| Pension Fund Contribution | | (212) | (215) | (219) | (213) | (217) |
| OPEB Payments | | (110) | (112) | (116) | (121) | (125) |
| Internally Funded Nuclear Provision Expenditures | | (208) | (235) | (219) | (202) | (184) |
| **Net Cash from Operations** | | **944** | **1,468** | **2,384** | **2,067** | **2,642** |
| **Investing Activities** | | | | | | |
| Sustaining Capital Expenditures | | (615) | (672) | (606) | (674) | (597) |
| Darlington Refurbishment | | (1,249) | (1,231) | (1,127) | (947) | (1,129) |
| Development Projects | | (62) | (179) | (125) | (160) | (103) |
| **Capital Expenditures** | | **(1,926)** | **(2,082)** | **(1,859)** | **(1,781)** | **(1,830)** |
| Pre-tax Proceeds from Sale of 700 University Ave. Property | | 484 | - | - | - | - |
| Pre-tax Proceeds from Sale of Lakeview Site | | - | 267 | - | - | - |
| Acquisition of Fair Hydro Trust Assets | | (1,179) | (2,326) | (2,557) | (2,812) | (2,741) |
| Other | | 143 | 16 | - | - | - |
| **Net Cash Outflow for Investing Activities** | | **(2,478)** | **(4,125)** | **(4,416)** | **(4,593)** | **(4,571)** |
| **Financing Activities** | | | | | | |
| General Corporate Debt | *- Debt Issuance/Refinancing* | 1,301 | 1,191 | 128 | 365 | 200 |
| | *- Debt Retirement* | (900) | (395) | (365) | (660) | (185) |
| Project Financing | *- Debt Issuance/Refinancing* | - | - | - | - | - |
| | *- Debt Retirement* | (203) | (3) | (3) | (3) | (228) |
| Fair Hydro Trust Senior Debt | *- Debt Issuance* | 601 | 1,184 | 1,302 | 1,432 | 1,397 |
| Short-Term Notes | *- Net Issuance (Repayment)* | 260 | 200 | (50) | 75 | (385) |
| Issuance of Class A Shares | | 519 | 1,022 | 1,123 | 1,235 | 1,206 |
| Dividends Paid | | - | (482) | - | - | - |
| Distribution Paid to Non-Controlling Interests | | (15) | (22) | (22) | (23) | (25) |
| Capital Contribution from Non-Controlling Interest | | 19 | - | - | - | - |
| **Net Cash from Financing Activities** | | **1,582** | **2,695** | **2,113** | **2,422** | **1,980** |
| **Net Cash Inflow (Outflow) for Period** | | **48** | **39** | **81** | **(105)** | **52** |
| ***Ending Cash Balance*** | | ***234*** | ***273*** | ***354*** | ***249*** | ***301*** |

**Debt:**

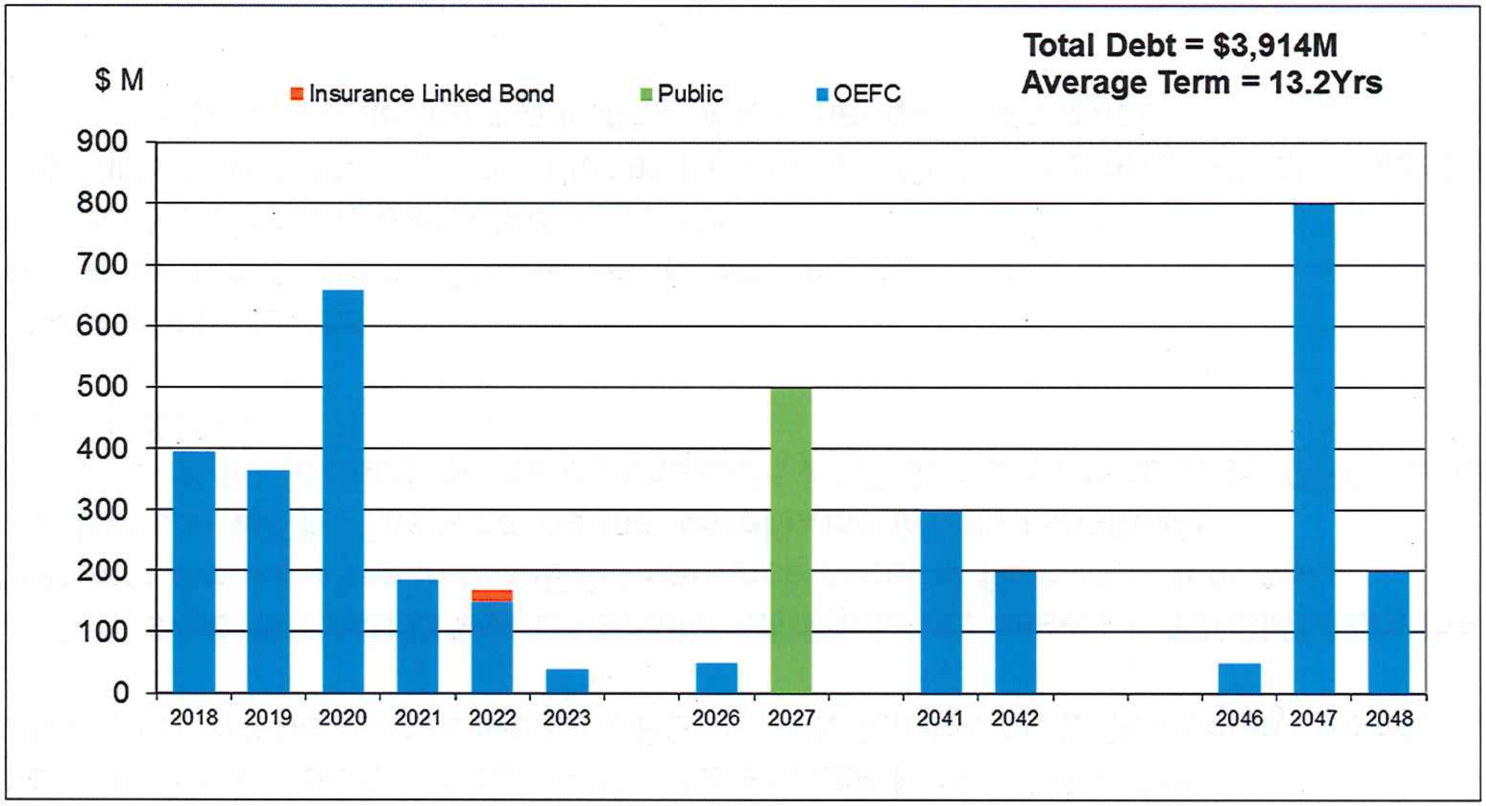
- Darlington refurbishment expenditures are expected to be ~$1.1B/yr over the next 4 years
- General corporate requirement of $1.2B in 2018
- General corporate borrowing requirement beyond 2018 is forecast to be modest, mainly due to the collection of retrospective revenue
  - Total of ~$700M for the period of 2019-2021
- $2.35B OEFC facility for 2017/2018 to refinance maturing debt and to fund Darlington refurbishment
  - $1B has been drawn
- OPG is contemplating issuing green bonds to fund Nanticoke Solar and other green initiatives

**Equity:**

- OPG will issue ~$1.1B shares per year over the next 4 years, to support its subordinated debt investment in Fair Hydro Trust (FHT)

ONTARIO POWER GENERATION

# Corporate Debt Maturities




Notes:

- Of the $395M debt maturities in 2018, $75M matured in January
- Debt maturities exclude non-recourse project debt



ONTARIO POWER GENERATION

# FHT Update - Next Issuance

- By the end of March, FHT will purchase an additional ~$600M regulatory assets from the IESO
  - Represents the projected balance of IESO variance account by the end of March
  - Senior tranche will be financed via the warehouse facility (~$300M)
  - Sub tranches will be purchased by OPG, mainly funded by OFA's equity injection (~$265M)

- In April, FHT expects to purchase an additional regulatory assets (<$200M) from the IESO
  - Represents the increase in the IESO variance account from March to April
  - Senior tranche will be financed via the warehouse facility (<$100M)
  - Incremental sub tranches will be purchased by OPG, mainly funded by OFA's equity injection (<$90M)

- April Term Debt Issuance
  - Expect to term out about ~$400M senior warehouse debt
  - The term of the debt is expected to be 20yr
  - It is consistent with MOE's Fair Allocation Amount (FAA), and also reflects investors' interest as expressed during marketing of the inaugural issuance



ONTARIO POWER GENERATION

# Appendix - FHT Senior Term Debt Offering

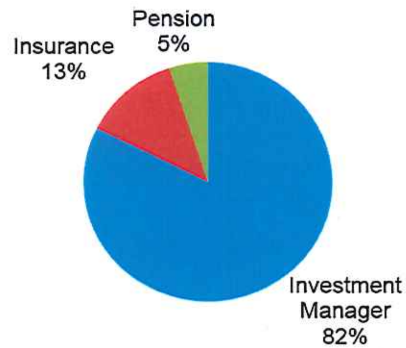
**Fair Hydro Trust**
**C$500,000,000**
Senior Notes – Series 2018-1

- Strong inaugural term debt offering with ~$1.8 billion in overall interest from 36 institutional investors across Canada
- Extensive marketing efforts (roadshows held in Toronto, Montreal, Winnipeg, and Vancouver) and clear articulation of FHT's story and objectives are key drivers for the transaction

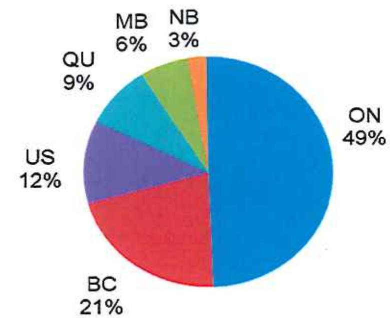
## Transaction Description

| | |
|---|---|
| Issuer: | Fair Hydro Trust |
| Settlement Date: | 09-Feb-18 |
| Ratings: | DBRS: AAA(sf)<br>Moody's: Aa2(sf) |
| Amount: | $500,000,000 |
| Coupon: | 3.357% |
| Coupon Dates: | May 15 and November 15 |
| Expected Maturity Date: | May 15, 2033 |
| Spread vs. Benchmark: | 91.9 bps |
| GoC Benchmark Yield (June 1, 2033): | 2.438% |
| Yield: | 3.357% |
| Syndicate: (*joint lead) | CIBC World Markets Inc.*, RBC Dominion Securities Inc.*, Goldman Sachs Canada Inc.*; BMO Nesbitt Burns Inc.; Morgan Stanley Canada Limited, National Bank Financial Inc., Scotia Capital Inc., TD Securities Inc., HSBC Securities (Canada) Inc., Desjardins Securities Inc., Laurentian Bank Securities Inc., Casgrain & Company Limited |

## Investor Type




## Investor Geography




| | Outstanding | | Credit Rating | |
|---|---|---|---|---|
| Term Debt (issued on February 9, 2018) | Rate | ($M) | Moody's | DBRS |
| Tranche A (51%) - Senior Debt (Capital Markets) | 3.36% | 500 | Aa2(sf) | AAA(sf) |
| Tranche B (39%) - Subordinated Debt (OPG) | 3.64% | 382 | Aa2(sf) | AA(sf) |
| Tranche C (10%) - Junior Subordinated Debt (OPG) | 3.96% | 98 | Aa2(sf) | A(sf) |
| Total (Term: 15.25 years) | | 980 | | |



ONTARIO POWER GENERATION

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Tél. (416) 326-2841
Télécopieur (416) 326-2806

**Date** : December 13, 2017

**Re :** MOF
Proposed regulation under the Electricity Act, 1998
Amending - O. Reg. 207/99
PAYMENTS IN LIEU OF CORPORATE TAXES
reg2017.0609.e06.edi

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This proposed regulation has been sealed under the authority of the Registrar of Regulations.

REGISTRAR OF REGULATIONS

**CONFIDENTIAL**
Until filed with the
Registrar of Regulations

**REG2017.0609.e**
**6.EDI-AR**

**ONTARIO REGULATION**

made under the

**ELECTRICITY ACT, 1998**

Amending O. Reg. 207/99

(PAYMENTS IN LIEU OF CORPORATE TAXES)

**1. Sections 3 and 6 of Ontario Regulation 207/99 are amended by striking out "16.1" at the end and substituting "16.2".**

**2. Subparagraph 1 ii of section 6.1 of the Regulation is amended by striking out "16.1" and substituting "16.2".**

**3. The Regulation is amended by adding the following section immediately before the heading "Returns and Payments":**

**16.2** (1) For the purposes of determining the amount of any payment required for a taxation year from a specified corporation under sections 89 and 90 of the Act, the method of calculating the amount of the payment is modified by the following rules:

1. Any income or loss or taxable capital gain or allowable capital loss in respect of property held by a specified trust that would be income or a loss or a taxable capital gain or allowable capital loss of the specified corporation under subsection 75 (2) of the Federal Act is deemed to be nil.

2. Any amount paid or payable to the specified corporation in the taxation year by a specified trust that would be included in computing the income of the specified corporation for the year under subsection 104 (13) or (16) of the Federal Act is deemed to be nil.

3. Any benefits to the specified corporation from or under a specified trust that would be included in computing the specified corporation's income for the taxation year under subsection 105 (1) of the Federal Act are deemed to be nil.

4. Any amounts that would be included in computing the specified corporation's income for the taxation year in respect of the disposition of an income interest in a specified trust under subsection 106 (2) of the Federal Act are deemed to be nil.

5. Any proceeds of disposition in respect of a disposition of all or any part of the specified corporation's capital interest in a specified trust in the taxation year are deemed to be equal to the adjusted cost base of the interest as determined under the Federal Act.

(2) The following corporations are specified corporations for the purposes of subsection (1):

1. FHP2017 Inc.

(3) The following financing entities, as defined in subsection 1 (1) of the *Ontario Fair Hydro Plan Act, 2017*, are specified trusts for the purposes of subsection (1):

1. Fair Hydro Trust.

**Commencement**

**4. This Regulation comes into force on the day it is filed.**

Made by:

……………………………………………………..
*Signature (in blue ink)*

*Minister of Finance*

Date made: ………………………………