CABINET
BRIEFING NOTE

ISSUE: Minister Thibeault (ENERGY) – Proposed Electricity Rate Mitigation

SUMMARY OF PROPOSAL:

- The Ministry of Energy (ENERGY) is bringing forward a package of possible electricity price mitigation initiatives:

    1) Helping the most vulnerable by enhancing electricity support programs and shifting cost onto the tax-base:
        - Rural or Remote Electricity Rate Protection (RRRP) Enhancement (Delivery Charge Relief);
        - Ontario Electricity Support Program (OESP) Expansion;
        - Local Distribution Company (LDC) Affordability Fund; and
        - On-Reserve First Nations Delivery Credit.

    2) Ongoing activities to bend the future cost curve of electricity:
        - Ontario Energy Board (OEB) – Identify opportunities for future LDC efficiencies and rates; and
        - Independent Electricity System Operator (IESO) – Modernize Ontario's electricity market through electricity Market Renewal initiatives.

    3) Smoothing the global adjustment (GA) to provide significant and immediate rate relief through cost deferral of the GA:
        - Implementation Model; and
        - Smoothing Mechanism.

- ENERGY is also considering an option of seeking Greenhouse Gas Reduction Account moneys to pay for electricity conservation costs. This proposal is not part of the February 15 Cabinet submission.

STATUS:

- This item is scheduled for consideration by Cabinet as an Information Item on February 15, 2017 and will return for a Cabinet decision at a later date.

AG SPEAKING NOTES (IF ASKED):

<u>On GA smoothing</u>:

- **In principle, refinancing the GA to spread the costs of generation and conservation assets over the useful life of the assets presents only a low risk of being a tax, as each cohort of consumers pays for a proportion of the GA cost roughly equal to the proportion of the benefit they receive from the useful**

life of the assets.

- **Legal risk arises if it becomes apparent that the Government is not spreading cost so that it is shared proportionately by future consumers who cause a need for or benefit from the generation asset, but rather is doing so in order to lower the price in the short term by increasing the price in the long term. If the proposed financing served to encumber future consumers with a premium payment to cover the GA financing in order to subsidize current ratepayers, then there would be a moderately high constitutional risk[1] that the financing proposal would result in an unconstitutional tax.**
- **Options 1 (25 % reduction) and 2 (20% reduction) in the Cabinet deck create a refinancing structure which results in future consumers paying disproportionately more of the GA cost and therefore cross-subsidizing near-term consumers. This means that it is at a moderately high constitutional risk of resulting in an unconstitutional tax.**
- **If, however, future consumers who cause the need for and benefit from this future capacity would share proportionately in the cost of financing the required assets, the proposal would pose only a low constitutional risk.[2]**
- **Option 3 (18% reduction) has been designed based on proportionate cost sharing. If it can be demonstrated that it is reasonable to assume that the bulk of the assets whose 20-year contracts are to be refinanced have a useful life of an additional 10 years beyond the life of the contract, then this option presents low constitutional risk. The risk will turn on the reasonableness of this estimate.**
- **Risk ultimately depends on the particulars of the amount that is borrowed, the term of repayment, the relevant assets, their existing contracts, and their useful life expectancy.**

On implementing an on-reserve First Nations delivery credit:

- **There is a risk that either non-status Indigenous communities without reserves or Métis could challenge the program on the grounds that it discriminates against them contrary to the right to equality under section 15 of the *Charter*. This risk is mitigated by the ameliorative purpose of the program and because targeting First Nations communities for a reserve-based program corresponds to the distinct circumstances of reserve-based communities, relative to other Indigenous communities, that affect electricity affordability.**

[1] Moderately high risk means that although it is difficult to predict the outcome because there are good arguments on both sides, a court correctly applying the relevant law would be more likely to find the proposal invalid.

[2] Low risk means that while there are credible arguments against the proposal, a court correctly applying the relevant law would very likely dismiss a constitutional challenge.

The ameliorative purpose is to seek to resolve historic grievances related to the energy sector and to increase energy affordability for on-reserve consumers. The distinct circumstances include the poor quality of housing stock on reserve, economic and social vulnerability of reserve residents, and historical grievances arising from the effects of energy development and infrastructure on reserve lands. A genuinely ameliorative program that targets some people but excludes others is shielded from a s. 15 challenge if it serves or advances the ameliorative goal.

BACKGROUND:

GA Smoothing:

- The Province continues to consider mechanisms to finance and administer GA smoothing, which could be implemented by an affiliate of Ontario Power Generation (OPG) to assume responsibility for GA smoothing. Other options considered have included using the Independent Electricity System Operator (IESO) and/or creating a new special purpose entity that would be dedicated to GA smoothing. Accounting treatment that avoids consolidation on the books of the Province is key to the viability of this option.

Changes to RRRP:

- Established under the OEBA, the RRRP is currently funded through electricity rates and addresses high costs of electricity distribution to certain geographically remote consumers. All consumers contribute towards funding RRRP costs. Hydro One R1 and R2 customers pay the highest distribution rates, however there are other relatively high-distribution cost LDCs.
- Rate mitigation could be achieved by expanding the RRRP program to include other high-distribution cost LDCs, and by moving the RRRP program from the rate base to the tax base.

Changes to the OESP:

- The OESP is an income-tested, application based rate-affordability program established under the OEBA and its regulations that lowers electricity costs of the most vulnerable consumers and provides a rebate directly on bills.
- Rate mitigation could be achieved by working to increase program participation, increasing the benefit scale by an additional 50% for eligible consumers, and by moving the program from the rate base to the tax base.

Implementing a First Nations Delivery Credit:

- On-reserve First Nations customers face unique challenges that impact electricity affordability. These challenges result in significantly higher electricity consumption

levels and costs.
- The creation of a First Nations Delivery Credit program to remove delivery charges for on-reserve First Nations customers would provide some measure of rate relief to those customers. The current proposal is to fund the credit through the tax base.

DISCUSSION:

Changes to RRRP, OESP and Implementation of a First Nations Delivery Credit:

- Each of these proposed initiatives would require new and/or amending legislation and regulations to implement. Further legal analysis will be required as the details of each initiative are developed.

GA Smoothing:

- The current GA amount paid by consumers is a regulatory charge. One of the requirements of a valid regulatory charge (as opposed to a tax) is that the person paying the charge either benefits from the regulatory scheme or causes the need for regulation.
- In principle, refinancing the GA to spread the costs of generation and conservation assets over the useful life of the assets presents only a low risk of being a tax, as each cohort of consumers pays for a proportion of the GA cost roughly equal to the proportion of the benefit they receive from the useful life of the assets.
- A proposal for refinancing the GA that appears to cross-subsidize near-term consumers at the expense of long-term consumers by back-loading costs (rather than spreading costs equally over the estimated lifespan of generation and conservation assets) presents a moderately high risk (more likely than not) of constituting a tax.
- Were the charge characterized as a tax, in the event of a challenge, it would be struck down by a court as unconstitutional and consumers would be entitled to recover their payments. This risk could be eliminated, either up front or retroactively, by the imposition of a valid tax.

GGRA Funding of Conservation Costs:

- It is difficult to quantify the legal risk of a successful constitutional challenge to the cap and trade program associated with a single initiative in isolation. The risk will depend on a holistic assessment of the amount of money deposited into the GGRA and the character of all initiatives supported by cap and trade auction proceeds.
- In principle, there should be only a low risk if the government used cap and trade auction proceeds to defray the ongoing costs of conservation programs currently funded out of the global adjustment mechanism. This is because the programs are collectively expected to reduce CO_2 emissions by hundreds of thousands of tonnes each year which seems to fit squarely within the regulatory purpose of the *Climate Change Mitigation and Low-carbon Economy Act, 2016* (CCMLcE Act).
- However, initiatives which provide a rebate on electricity attract particular scrutiny as

they tend to incent consumers to use more rather than less electricity which may frustrate the purpose of the CCMLcE Act. To the extent that funding conservation costs out of the GGRA constitutes a substantial portion of total GGRA spending, it will invite further scrutiny and will increase the legal risk of a successful challenge.

- There is a higher legal risk associated with any proposal to retroactively reimburse ratepayers for conservation costs paid in 2015 and 2016. Any GHG reduction benefits associated with the programs and initiatives funded through those charges already exist and no additional benefit would be realized through reimbursements to ratepayers.

REVIEWED BY:

Date: February 14, 2017

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