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Motion Number(s) 9 + OPG + IESO + OEB

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Preliminary Draft for Discussion Purposes Only

"Fair Hydro" – Part V.2

Article 1 – Purpose[1]

IESO has entered into Power Contracts with Generators. The agreed-upon reference prices and quantities set out therein were determined based on commitments made by IESO to provide Generators with long-term price certainty, so as to encourage the construction and development of facilities for the purpose of long-term operation

[1] Consider the scope and breadth of the Purpose section. This text is considered to be useful to establish the legislative basis for the statute, which text will be useful in the event of a challenge.

and generation of electricity using sustainable, lower carbon-based technologies such as new gas-fired generation, renewable facilities, energy from waste and biomass, including under the Province's various procurement, standard offer and feed in tariff programs (the "Green Generation Initiative"). [The terms of the Power Contracts were intended to approximate the anticipated useful life of the related generation assets]; however, it has been determined that the useful life of many of these

assets will be well in excess of the actual term of the related Power Contracts and will extend over more than one generation of ratepayers. The long-term benefits of the Green Generation Initiative accrue over time and have benefited and will benefit present and future ratepayers of the Province. Currently, market prices for electricity are less than the reference prices set out in the Power Contracts, leaving a gap in funding which is funded by charging consumers a "Global Adjustment" (part of which is

available to IESO to pay this shortfall).

Each month, the IESO determines the Global Adjustment payable by consumers for the consumption of electricity in the Province. A component of the Global Adjustment is the amount by which the reference prices in the Power Contracts exceed the market price for electricity for the quantities of electricity specified under the Power Contracts for

the relevant period[2]. The relationship between the past, present and future benefits to Ratepayers from the Green Generation Initiative, on the one hand, and the costs of the Green Generation Initiative borne by past, present and future Ratepayers through their respective allocations of the Global Adjustment, on the other hand, do not necessarily reflect an equitable allocation of such benefits and costs over time, with

[2] Consider modifying this to also refer to gas contracts and hydroelectric contracts, which provide for mechanics that are not based on contracts for differences.

the result that an adjustment may be appropriate to address inter-generational fairness considerations. Such an adjustment should reflect principles and parameters that can be applied from time to time in order to establish a reasonable basis for measuring and allocating the relative costs and benefits of the Green Generation Initiative across present and future Ratepayers. A plan to allocate such costs and benefits equitably across present and future Ratepayers may be

developed based on those principles and parameters (a "Fair Allocation Plan").

If a Fair Allocation Plan determines that the equitable allocation of the Global Adjustment to the Ratepayers of a particular time period in respect of the Power Contracts should be reduced below the amount otherwise determined, the amount payable by such Ratepayers to Electricity Distributors in respect of such period, and in turn by the Electricity Distributors to the

IESO, would, in the aggregate, be less than the amount payable by the IESO to the Generators under the Power Contracts in respect of such period. If the difference is greater than any net Power Contract surpluses available to IESO from earlier periods, IESO will have a funding shortfall.[3] In order for IESO to cover such a funding shortfall for a period, IESO will need to obtain funding from another source, which could include funding from

[3] Confirm whether any RPP forecasting variance is to be included in (i) a funding shortfall; and (ii) related IESO financing costs to be included in Transition Charges.]

third party sources operating in public and private capital markets. If a funding obligation is incurred in order to enable the IESO to cover a funding shortfall during one period, the repayment of such funding obligation will be required in a future period, and any related repayments, finance costs, hedging costs and other transaction costs will be incurred and may become payable in one or more other periods.

It will be necessary to provide a reliable and committed source of cash flows to enable IESO to

repay such funding obligations and to pay related funding costs with certainty when the funding obligations become due and payable. This Part imposes irrevocable and non-bypassable financial obligations of Ratepayers to pay amounts incurred in respect of such funding obligations when they become due and payable and establishes a right to invoice and collect such amounts . The right and interest in and to collect such financial obligations, which will take the form of the Regulatory

Asset contemplated in this Part and will constitute property rights and interests. The Regulatory Asset will be sold and absolutely assigned and will belong to one or more newly created financing entities, which in turn will finance their purchase of such Regulatory Asset by incurring funding obligations. The incurrence and payment of such funding obligations will be administered on behalf the financing entities by an administrative agent (initially OPG), under the Financing Plan contemplated in this Part. The

Financing Plan will seek to reasonably match the payment obligations arising under funding obligations and borne by the future Ratepayers of the period in which such payment obligations become due, with the costs and benefits of the Green Generation Initiative charged to such future Ratepayers under the Fair Allocation Plan.

The purpose of this Part is to establish the basis upon which intergenerational fairness can be achieved by charging the costs and benefits of the Green

Generation Initiative to present and future Ratepayers on an equitable and cost effective basis.

Article 2 - Definitions

In this Part:

"Absolute Assignee" means a person to whom a Regulatory Asset Owner effects a Disposition.

"Actual" means, in relation to costs, expenses or payments in respect of Funding Obligations during a Reference Period, the actual amount of

such costs, expenses or payments paid or made (net of any Finance Reserve Withdrawals applied to pay such amounts), which amounts shall be recorded by the Administrative Agent whose records shall be determinative for the purposes of this Part in the absence of a manifest calculation error.

"Additional Funding Charges" means, for a Reference Period, the fees, charges, expenses, costs, indemnities, reimbursements and other

amounts (including any applicable tax amounts) that are or become payable by the Regulatory Asset Owners during the Reference Period and that were incurred or committed to directly or indirectly in connection with the incurrence of Funding Obligations under the Financing Plan (whether at the time of such incurrence or over the term of the Funding Obligation and whether directly or indirectly), including (without duplication and without

limitation): (a) any payment required under an ancillary agreement entered into by, or by the Administrative Agent on behalf of, a Regulatory Asset Owner under the Financing Plan; (b) any federal, provincial or local taxes, payments in lieu of taxes, franchise fees or license fees imposed on a Regulatory Asset Owner or incurred by on behalf of a Regulatory Asset Owner under any obligation to pay tax gross-up amounts to counterparties under Funding Obligations; (c)

any amounts payable to the Administrative Agent, including amounts payable to its advisors and outside counsel; (d) any amounts incurred to prepare, confirm, amend and implement the Financing Plan; (e) any amounts payable to any Alternative Collection Agent or Alternative Servicer, including amounts payable to each's advisors and outside counsel; (f) any amounts incurred to make the calculations, determinations or confirmations to be made by or

on behalf of a Regulatory Asset Owner; (g) any servicing fees and expenses; (h) any trustee fees and expenses; (i) any legal fees, expenses and disbursements; (j) any accounting fees and expenses; (k) any administrative fees and expenses; (l) any manager of director fees; (m) any registration fees and expenses; (n) any placement fees, underwriting fees, fees and related issuing expenses; (o) any rating agency fees; and (p) any other related fees,

charges, expenses, costs, indemnities, reimbursements and other amounts that are approved in good faith for recovery and payment under the Financing Plan.

"Administrative Agent" means [OPG] or, following any Replacement Event, such other person or persons who may be appointed as the administrative agent of the Regulatory Asset Owner under the Financing Plan in compliance with the requirements set out in Schedule 2.

"Allocation Factor" means, in respect of a Ratepayer for a Reference Period, the number (expressed as a percentage) determined in respect of the Ratepayer by [IESO] based on the application of the Attribution Methodology in respect of the Reference Period.[4]

"Alternative Collection Agent" means a person appointed under Section 5(11) and in compliance with the

[4] Consider basing this on forecast volumes of demand (like RPP). To the extent amounts do not get recovered due to differences between forecast and actual, those would be identified and rolled into the True-Up.

requirements set out in Schedule 2 to assume the collection activities and activities of any Electricity Distributor or IESO under Article 5, as agent for and on behalf of the Regulatory Asset Owners.

"Alternative Servicer" means a person appointed under Section 4(8) to assume the obligations of the Servicer under Article 4, as agent for and on behalf of the Regulatory Asset Owners.

"Attribution Methodology"[5] means the methodology specified in the Fair Allocation Plan for allocating the Period Transition Charges for a Reference Period to the individual Ratepayers of the applicable Ratepayer Group based on its Allocation Factor.

"Bypass Charge" means [To be developed].[6]

"Collected Amount Adjustment" means, in respect of a

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[5] A key question will be how the overall costs will be spread across the rate base. For example, the allocation may be volumetric or not, or some combination of a flat amount and a volumetric charge. This will also impact any discussion regarding any bypass (e.g., grid exit) charge in connection with the bypass discussion.

[6] Consideration needs to be given to any amount that will be charged to a ratepayer who successfully bypasses (e.g., leaves the grid). In allocating Transition Charges, considerations would include whether to reserve Bypass Charges and spread them over the life of the program, and correspondingly how to factor those into the calculation of Transition Charges.

Reference Period, the amount (which may be a negative amount) calculated by the Servicer or the Administrative Agent, as applicable, equal to (a) the Estimate of the Finance Amount for the True-Up Period, minus (b) the sum of all Transition Charge Collections for the True-Up Period.[7]

"Collective Rights Agreement" means an agreement among all of the Regulatory Asset Owners (including each

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[7] This would pick up adjustments based on actual collection experience, changes in the Consumer Base, changes in the actual costs (versus earlier estimates) included in the Transition Charge calculation, etc.

Absolute Assignee) and each Pledgee that governs the enforcement of their respective rights and interests in, to and under the Regulatory Asset on a coordinated and collective basis.

"Disposition" means an assignment, transfer, conveyance, sale, contribution, set-over, exchange or other disposition of all or a specified portion (including a specified portion on a divided basis or by way of an undivided interest) of a Regulatory Asset Owner's

right, title and interest in, to and under the Regulatory Asset to an Absolute Assignee pursuant to a Disposition Document.

"Disposition Document" means the agreement, deed, conveyance, instrument or other document under which a Regulatory Asset Owner effects a Disposition to an Absolute Assignee.

"Electricity Distributor" means, in respect of a Service Area, the distributor licensed by the

OEB in respect of such Service Area.

"Electricity Distributor Remittances" means, for an Electricity Distributor on a Remittance Date, all Transition Charge Collections received by the Electricity Distributor prior to the Remittance Date and that have not otherwise been remitted to IESO or if applicable the Alternative Collection Agent in accordance with Section 5(3) , including the proceeds of any enforcement action undertaken by the

Electricity Distributor or if applicable the Alternative Collection Agent to recover payment of Transition Charges in accordance with Article 5.

"Electricity Invoice" means an invoice issued by an Electricity Distributor (or in its stead, an Alternative Servicer) or by the Servicer in respect of electricity charges and related services and amounts incurred, assessed or charged in respect of connectivity to a distribution network in the Electricity

Distributor's designated Service Area.

"Estimate" means, in relation to costs, expenses or payments in respect of Funding Obligations or any Finance Amount for a Reference Period, the estimated amount of such costs, expenses or payments determined by the Administrative Agent having regard to the applicable principles and parameters set out in Schedule 1, which estimated amounts shall be determinative as the applicable

estimate for the purposes of this Part in the absence of a manifest calculation error.

"Fair Allocation Plan" [has the meaning given in Article 1].

"Finance Amount" means, in respect of a Reference Period, the sum (without duplication) of the following amounts for the Reference Period: (a) Repayments; (b) Funding Costs; (c) Redemption Amounts; (d) Finance Reserve Deposits; and (e) Additional Funding Charges.

"Finance Receipts" means, for a Reference Period, all amounts received by or on behalf of the Regulatory Asset Owners during the Reference Period in respect of a Funding Obligation, including from any reimbursement of standby commitment fees or charges paid by a lender, any reimbursement of credit enhancement fees or charges paid by any credit enhancer, any reimbursement of liquidity fees or charges paid by any liquidity provider, any amounts

(including any termination payments) paid to the Regulatory Asset Owners under derivatives and any withdrawal made or required to be made from a debt service reserve account or other account established under any indenture, ancillary agreement or other financing document relating to a Funding Obligation.

"Finance Reserve Deposits" means, for a Reference Period, the amount by which (a) deposits made or to be made

during the Reference Period in order to pre-fund, collateralize, over-collateralize or establish reserves for the ultimate payment of Funding Obligations or for related contingencies specified in the Financing Plan, exceed (b) any Finance Reserve Withdrawals.

"Finance Reserve Withdrawals" means, for a Reference Period, the amount withdrawn during the Reference Period from deposits previously made to pre-fund, collateralize, over-collateralize or establish

reserves for the payment of Funding Obligations or to pay amounts in respect of related contingencies that had been specified in the Financing Plan.

"Financing Entity" means an entity established in accordance with the Financing Plan to acquire all or an interest in the Regulatory Asset as an Absolute Assignee and to enter into Funding Obligations to finance such acquisition.[8]

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[8] OPG has suggested that the legislation provide that any Financing Entity that is a wholly-owned subsidiary of OPG (1) would not be subject to Part VI of the *Electricity Act* (Ontario) and (2) in the case of any Financing Entity that is a trust, any

"Financing Plan" means the written plan [prepared by the Administrative Agent] in compliance with Article 8 to set forth the basis upon which, among other things: (a) any Disposition may be made or effected; (b) any Funding Obligations may be incurred in order to fund a Funding Shortfall, including any Refinancing; (c) any Pledge may be given or effected; (d) any Funding Obligations may

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income of such trust (for purposes of the *Income Tax Act* (Canada) or the *Taxation Act, 2007* Ontario)) which is paid or made payable to OPG or a wholly-owned subsidiary of OPG as a beneficiary of such trust will not be taken into account in calculating the amount of a payment required to be made by OPG (or such subsidiary) by section 89 or 90 of the Electricity Act. These raise issues for consideration by the stakeholders.

be redeemed, prepaid, repurchased, amended or otherwise effected; (e) any obligations for Additional Funding Charges may be incurred and paid; (f) any Repayments, Funding Costs and Redemption Amounts may be paid or provided for; (g) any Finance Reserve Deposits may be made; (h) the establishment and operation of any Financing Entity; and (i) the cash flows arising from time to time or otherwise derived from the

Regulatory Asset may otherwise be applied.

"Funding Costs" means, for a Reference Period, the amount by which (a) the aggregate of all interest and other periodic finance charges accruing due and becoming payable or paid by or on behalf of the Regulatory Asset Owner during the Reference Period in respect of all Funding Obligations, including any standby commitment fees or charges paid to any lender, credit enhancement fees or

charges paid to any credit enhancer, liquidity fees or charges paid to any liquidity provider, amounts (including any termination payments) paid under derivatives and any deposit amount made or required to fund or replenish a debt service reserve account or other account established under any indenture, ancillary agreement or other financing document relating to a Funding Obligation, exceeds (b) the aggregate of all Finance

Receipts for the Reference Period.

"Funding Obligation" means each payment obligation (including principal, interest and other financing charges, indebtedness, payment obligations arising under or in respect of derivatives, payment obligations owing to service providers, administrative agents, finance entity intermediaries, capital markets intermediaries, advisors, lenders, credit enhancement providers, liquidity providers,

disbursement counterparties, regulatory agencies and rating agencies and all taxes payable in connection with the foregoing) incurred by or on behalf of a Regulatory Asset Owner under the Financing Plan in order to fund a Funding Shortfall for a Reference Period, including any Refinancing of another such payment obligation.[9]

"Funding Shortfall" means, for a Reference Period, (a) the

[9] OPG has asked whether this should include IESO finance arrangements.

amount, if any, by which (i) the IESO Power Contract Net Payment for the Reference Periods, exceeds (ii) the GA Power Contract Contribution for Reference Period, minus (b) the IESO Applied Surplus for the Reference Period.[10]

"GA Power Contract Contribution" means, for a Reference Period, the aggregate of the payments to be made by the applicable

[10] Consider whether to simplify by referring to the calculations of GA, with vs. without Fair. The issue would be that Fair is then linked into the GA calculation specifically, rather than to the specific assets that are subject to revised amortization under Fair. The constitutional position requires a clear nexus to the assets. Also, confirm whether RPP forecasting variances are to be included.

Ratepayer Group in respect of the portion of the Global Adjustment [attributable to the Power Contracts] in accordance with the Fair Allocation Plan.[11]

"Generator" means a generator of electricity that is subject to [this Act][12].

"Global Adjustment" means the amount calculated from time to time under [Section • of the

19.33

[11] IESO to confirm its ability to allocate a shortfall in a given month between what it receives and what it owes under the GA, in order to calculate (a) existing volume-based variances which are rolled into subsequent month GA and trued-up every 6 months under RPP, (b) existing variances attributable to OREC which are funded by the Province, and (c) new variances attributable to Fair Hydro program.]

[12] Revise once determine whether this will be a standalone Act or remain part of the *Electricity Act*. "Generator is a defined term in other legislation (OEB Act, Electricity Act) so this should ultimately be a distinct term such as "FH Generator" to avoid confusion.

Electricity Act], which includes among other things an amount determined in respect of the costs associated with the Green Generation Initiative, including amounts attributable to the Power Contracts.[13]

"Green Generation Initiative" [has the meaning given in Article 1].

"IESO" means the Independent Electricity System Operator created pursuant to [insert].

PART

[13] Note that if adjustments for Fair Hydro program are to be applied after existing GA adjustments, then this may need a new name (such as "FH Adjustment").

"IESO Applied Surplus" means, for a Reference Period, the lesser of (a) the amount, if any, by which (i) the IESO Power Contract Net Payment for the Reference Period, exceeds (ii) the GA Power Contract Contribut
Period
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day o
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Issue re IESO Power Contract Net Payment → currently measures diff between IESO cont payments & gens to IESO - should be marked to HOEP

"IESO Power Contract Net Payment" means, for a Reference Period, the amount by which (a) the sum of

amounts payable by IESO to the Generators under all Power Contracts for the Reference Period, exceeds (b) the sum of amounts payable by the Generators to IESO under all Power Contracts for the Reference Period.

"IESO Power Contract Net Receipt" means, for a Reference Period, the amount by which (a) the sum of amounts payable by the Generators to IESO under all Power Contracts for the Reference Period, exceeds (b)

the sum of amounts payable by IESO to the Generators under all Power Contracts for the Reference Period.

"IESO Remittances" means, for a Settlement Date, all Electricity Distributor Remittances received by IESO or if applicable the Alternative Collection Agent prior to the Settlement Date and that have not otherwise been remitted to the Regulatory Asset Owners (each with respect to its Regulatory Asset) in accordance with Section 5(6),

including the proceeds of any enforcement action undertaken by IESO or if applicable the Alternative Collection Agent to recover payment of amounts payable by Electricity Distributors to IESO in accordance with Article 5.

"IESO Successor" means the entity appointed by the Province to succeed to the rights and obligations of IESO as the entity responsible for [managing the Province's power system].

"IESO Unapplied Surplus" means, at a particular time, the amount, if any, by which (a) the sum of (i) all IESO Power Contract Net Receipts for Reference Periods occurring prior to the time, and (ii) all GA Power Contract Contributions for Reference Periods occurring prior to the time, exceeds (b) the sum of (i) all IESO Power Contract Net Payments for Reference Periods occurring prior to the time, and (ii) all IESO Applied Surpluses for Reference

Periods occurring prior to the time.

"Period Transition Charge" means, for a Reference Period, the sum of (a) the Estimate of the Finance Amount and (b) the True-Up Amount in respect of the immediately preceding Reference Period.

"Pledge" means a lien, mortgage, charge or security interest granted to or in favour of a Pledgee by a Regulatory Asset Owner in, to and over all or a specified portion (including

a specified portion on a divided basis or by way of an undivided interest) of the Regulatory Asset.

"Pledgee" means a person to whom a Regulatory Asset Owner grants a Pledge.

"Power Contracts" means long-term power contracts entered into by IESO with certain Generators, under which IESO has agreed to pay such Generators amounts, determined in respect of quantities of electricity over

specified periods, to the extent that applicable market prices for such quantities of electricity during a specified period are less than specified reference prices for such quantities of electricity, and, correspondingly, Generators have agreed to pay IESO amounts if the market prices for such quantities exceed the applicable reference prices for such quantities.[14]

[14] Consider expanding to include PPAs that are not contracts for differences. Should this contemplate the possibility of additional or amended power contracts?

"Province" means the Province of Ontario.

"Ratepayer" means present and future [retail] consumers of electricity [in the Province] who are [RPP][or OREC-eligible] consumers, which shall include all such retail consumers who are connected, directly or indirectly and whether a customer of an Electricity Distributor or not, to the transmission and distribution system assets located in the Province and who are taking electric delivery service within

the Province, whether or not such retail consumers produce their own electricity or purchase electric generation services from a provider of electric generation services other than the owner of the Province's transmission and distribution system assets and whether or not the transmission and distribution system assets continue to be owned or operated by Electricity Distributors or operated by IESO.[15]

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[15] Need to describe consumers in a fashion that is broad and not weakened by a bypass risk. Consider terminology to align with the

"Ratepayer Group" means, in relation to a Reference Period, the Ratepayers who receive Electricity Invoices[16] during the Reference Period.

"Redemption Amount" means the amount payable by or on behalf of a Regulatory Asset Owner to redeem, prepay or repurchase a Funding Obligation, including any premium, make-whole or other additional amount becoming

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description of the eligible customer class provided by the Ministry, e.g., same as OREC-eligible consumers except for consumers served by Independent Power Authorities (who do not pay GA). Also, consider use of the word "retail", to avoid limiting to customers of retailers and confirm removal of reference to transmission-connected customers.

[16] Expand to include eligible consumers who are not customers of Electricity Distributors (e.g., suite-metered customers).

payable under the Funding Obligation to give effect to such redemption, prepayment or repurchase.

"Reference Period" means (a) the period from (and including) the [Legislation Implementation Date] to (and including) June 30, 2017, (b) each six month period commencing [May 1st and November 1st] thereafter and (c) any other period specified as such in the Fair Allocation Plan.

"Refinancing" means that a Funding Obligation is repaid or repurchased for cancellation by or on behalf of a Regulatory Asset Owner by applying the net proceeds obtained by the Regulatory Asset Owner incurring one or more other Funding Obligations.

"Regulatory Asset" means the property right and interest described in Section 6(1), or if the context requires, a specified portion or undivided interest in such property right and interest that is described in

the applicable Disposition Document.

"Regulatory Asset Account" means (a) for an Electricity Distributor, any bank account into which the Electricity Distributor deposits or receives Transition Charge Collections; (b) for the Servicer, any bank account into which the Servicer deposits or receives Transition Charges, Electricity Distributor Remittances or IESO Remittances; and (c) if applicable, for the Alternative Collection Agent, any bank

account into which the Alternative Collection Agent deposits or receives Transition Charge Collections, Electricity Distributor Remittances or IESO Remittances.

"Regulatory Asset Owner" means each of (a) IESO, to the extent that it has retained any ownership interest in, to or under the Regulatory Asset and (b) each Absolute Assignee, to the extent that it has acquired and owns any ownership interest (including a specified portion on a divided

basis or by way of an undivided interest) in, to or under the Regulatory Asset, and "Regulatory Asset Owners" means collectively all of the Regulatory Asset Owners, who together own the entirety of the Regulatory Asset and are required to exercise their individual rights of ownership in accordance with Section 6(7). For greater certainty, where one Regulatory Asset Owner owns the entirety of the Regulatory Asset, "Regulatory

Asset Owners" refers to this Regulatory Asset Owner.

"Related Generation Assets" means the [facilities, plants and equipment] constructed, acquired or developed in connection with the Green Generation Initiative.

"Related Rights" means, with respect to a Regulatory Asset Owner's Regulatory Asset, all rights of any kind (whether in tort, contract or otherwise) that attach or are attendant or incidental to any of the other

property rights or interests that comprise such Regulatory Asset.

"Remittance Date" means, in respect of an Electricity Distributor, each day on which it is required to remit Electricity Distribution Remittances to IESO or if applicable the Alternative Collection Agent in accordance with any Funding Obligation or, if no such day is specified in relation to any Funding Obligation, then the Business Day preceding each Settlement Date.

"Repayment Obligation" means an obligation to repay, redeem or repurchase, or to provide for the repayment, redemption or repurchase (including by making a Finance Reserve Deposit) of, all or a portion of the amount advanced to the Regulatory Asset Owner under a Funding Obligation.

"Repayment" means a payment by a Regulatory Asset Owner made to satisfy a Repayment Obligation, other than to the extent that the

payment is made by applying the proceeds of a Refinancing.

"Replacement Event" means any event specified as such in a Funding Obligation.

"Service Area" means, in respect of an Electricity Distributor, the geographic area or region in which it is licensed to distribute electricity in accordance with [this Act[17]].

"Servicer" means [To be determined], as agent for and on behalf of the Regulatory

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[17] Revise once determine whether this will be a standalone Act or remain part of the *Electricity Act*.

Asset Owner [To be determined – collective invoicing agent, and consider expanding].

"Settlement Date" means the [last Business Day of any month].

"Transition Charge" means, for a Ratepayer in respect of a Reference Period, the sum of (a) [one-sixth] of the Period Transition Charge multiplied by its Allocation Factor and (b) any Bypass Charge charged to

the Ratepayer in respect of the Reference Period.

"Transition Charge Collection" means any amount received or deemed by this Part to have been received upon the collection of a Transition Charge paid by or on behalf of a Ratepayer, including any proceeds arising from the exercise and enforcement of any related rights and interests under or in respect of the Regulatory Asset.

Need definition for Treasury Rate

"True-Up Amount" means, in respect of a Reference Period, the amount (which may be a negative amount) calculated by the Administrative Agent equal to (a) the Estimate of the Finance Amount for the related True-Up Period, minus (b) the Actual Finance Amount for such related True-Up Period, plus (c) the Collected Amount Adjustment.

"True-Up Period" means, in relation to a Reference Period, the period from and including the [30th] day immediately

preceding the first day of the Reference Period, to but excluding the [30th] day immediately preceding the last day of the Reference Period.

"Undertaking of the Lieutenant Governor in Council" means the undertaking of the Lieutenant Governor in Council given under Section 10(2).

"Unrecovered Transition Costs" means the [unrecovered][unamortized] costs incurred in connection with the creation, adoption and

implementation of the Green Generation Initiative, including any negative value of the Power Contracts and [other].[18]

Article 3 – Transition Charges

(1) Ratepayer Obligation to Pay a Transition Charge – Each Ratepayer shall pay each Transition Charge charged to it in any Electricity Invoice issued to such Ratepayer by its Electricity Distributor or by an Alternative Servicer under

[18] Note that this is the term that describes the "asset" that we are amortizing over a longer period of time.

Section 4(1), in each case on the terms of payment specified in the related Electricity Invoice.

(2) Indebtedness of Ratepayers – Until paid, a Transition Charge charged to a Ratepayer in an Electricity Invoice shall, together with any applicable late payment fees and finance charges arising under the terms of the Electricity Invoice with respect to such Transition Charge, constitute non-bypassable indebtedness of the Ratepayer

to the Regulatory Asset Owners (each with respect to its Regulatory Asset). Such indebtedness shall constitute a single and separate debt obligation owing by the Ratepayer, which subject to Article 5 may be enforced independently from any other payment obligation or indebtedness owing by the Ratepayer under the Electricity Invoice or otherwise.[19]

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[19] Torys suggests that we not create a debtor/creditor relationship between ratepayers and regulatory asset owners. Instead, ratepayers would only have relationships with electricity distributors and the Fair program would rely on consumers paying distributors and distributors to collecting those amounts and remitting them to IESO. The current draft goes further to bridge the investors more directly with ratepayers. There are differences in the approaches, including reliance from a credit perspective on the LDCs (rather than an ability to replace the individual LDCs with the investors choice). This depends on the credit analysis, and comfort that a later requirement will not be accommodated without a change in the legislation. Torys has also suggested that deemed conditions of licenses for distributors, retailers and unit

(3) No Set-Off or Reduction – A Ratepayer may not set-off or reduce (by counterclaim, defense or otherwise) the amount payable by it in respect of any Transition Charge, including any set-off against or in respect of any amount owing or becoming payable to such Ratepayer by its Electricity Distributor, any Regulatory Asset Owner or any other person.

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sub-metering providers, could be included as conditions, to require them to collect and remit amounts in accordance with this legislation. Consideration should be given to whether that achieves the same direct relationship and whether the effectiveness of the current regulatory licensing regime should be suggested as the basis for a market-based credit decision.

(4) Allocation of Ratepayer Payments – If an Electricity Distributor receives a payment made by or on behalf of a Ratepayer in respect of amounts due and payable under one or more Electricity Invoices that is less than the total amount payable thereunder, such payment shall be allocated on a *pro rata* basis to the payment of related Transition Charges and other invoiced amounts and the amount so allocated as a payment of related Transition

Charges shall be deemed to constitute a Transition Charge Collection.

(5) Transition Charges are Irrevocable – The Transition Charges arising under or in respect of Funding Obligations incurred under the Financing Plan (including any adjustments based on modifications to such Funding Obligations made in compliance with the Financing Plan or as a result of amendments to the Financing Plan made in accordance with

Section 8(3)) are deemed to be irrevocable, final and effective without any further action, in the absence of manifest calculation error. For greater certainty, a Transition Charge may include Finance Amounts for a Reference Period whether or not the payment of such Finance Amounts are inconsistent with the Fair Allocation Plan applicable at the time such payments are due and payable whether or not the related Funding Obligation was properly

incurred under the Financing Plan. In no case shall a Funding Obligation incurred under the Financing Plan be affected by a subsequent amendment to the Fair Allocation Plan.

(6) [Anti-avoidance; No-by-pass – Transition Charges charged to a Ratepayer in respect of any Finance Amount incurred under with the Financing Plan applicable at the time the related Funding Obligation was incurred may

not be avoided and shall be [non-by-passable].]

Article 4 – Invoicing of Transition Charges[20]

(1) Inclusion of Transition Charges in Electricity Invoices – Each Electricity Distributor and if applicable any Alternative Servicer shall, as an agent of the Regulatory Asset Owners, specify the Transition Charge to be charged to a Ratepayer

[20] Details concerning Invoicing of Transition Charges (Article 4) and Collections and Remittances (Article 5) are complex. Consider how much of this can be addressed through regulations, or if acceptable based on existing OEB license conditions/codes, IESO market rules/manuals, etc.

pursuant to Section 4(4) in respect of a related Reference Period in each Electricity Invoice issued by the Electricity Distributor or if applicable by the Alternative Servicer to the Ratepayer in respect of such Reference Period. Upon the inclusion of a Transition Charge in an Electricity Invoice, the obligation to pay such amount shall be binding on the applicable Ratepayer.

(2) Calculation of the Period Transition Charge – Not later than [35] days prior to the first

day of a Reference Period, each Regulatory Asset Owner (or the Administrative Agent on its behalf) shall provide the Servicer with written notice of each Estimate of a Finance Amount payable by it or on its behalf in respect of the Reference Period. Not later than one month prior to the first day of a Reference Period, the Servicer or if applicable the Alternative Servicer[21] shall calculate the Period Transition Charge applicable to the

[21] Should this be a designated government official, rather than an agent appointed by investors?

Reference Period based on the calculations and information set forth in such written notices received from the Regulatory Asset Owners, which shall be determinative in the absence of manifest calculation error or misstatement.

(3) **Calculation and Attribution of Transition Charges** – Not later than 25 days prior to the first day of a Reference Period, the Servicer or if applicable the Alternative Servicer shall apply the Attribution Methodology to determine the Allocation Factor

for each Ratepayer of the applicable Ratepayer Group.

(4) Notice of Transition Charges – Not later than 20 days prior to the first day of a Reference Period, the Servicer or if applicable the Alternative Servicer shall inform each Electricity Distributor and if applicable any Alternative Servicer of the Transition Charges to be specified in the Electricity Invoices to be issued to each Ratepayer of the applicable Ratepayer Group who has a billing address in the

Electricity Distributor's Service Area.

(5) Adjustments – The amount of any Transition Charge charged to a Ratepayer by the Servicer and specified as such in an Electricity Invoice shall be determinative of the amount of indebtedness thereby and owing of such Transition in the absence manifest calculation

could a Unit consumer be given more than one invoice - one per LDC, & one per "Servicer"?

(6) Success ctricity Distributor cessor

of an Electricity Distributor shall be bound by the requirements of Article 4 and shall perform and satisfy all duties and obligations of such Electricity Distributor under Article 4 in the same manner and to the same extent as such Electricity Distributor, including the obligation under Article 4 to impose, attribute, charge, bill and invoice the Transition Charges.

(7) IESO Successor – Any IESO Successor shall be bound by the requirements of

Article 4 and shall perform and satisfy all duties and obligations of IESO under Article 4 in the same manner and to the same extent as IESO, including the obligation to calculate and provide notice of Transition Charges.

(8) **Appointment of an Alternative Servicer** – If a Replacement Event occurs in respect of any Electricity Distributor, the Regulatory Asset Owners shall, in accordance with the Collective Rights Agreement, be

permitted, by an instrument in writing, to appoint an Alternative Servicer to perform some or all of the obligations and duties required to be undertaken by such Electricity Distributor under this Article 4, as and to the extent specified in such appointment. Upon acceptance of such appointment, the Alternative Servicer shall become obligated to perform such assumed obligations in replacement of such Electricity Distributor. Any Electricity

Distributor that is replaced under this Section 4(8) shall promptly transfer all rights, powers, privileges and property interests in its possession or within its control in the performance of such obligations and duties to the Alternative Servicer and shall take such further actions, including the execution of instruments, necessary to give full and final effect to such transfer and to permit the Alternative Servicer to perform such obligations and duties on

behalf of the Regulatory Asset Owners.

(9) Regulatory Asset Owners have Standing – The Regulatory Asset Owners may bring actions against any Electricity Distributor, IESO, the Servicer, Alternative Servicer or any other person who may be authorized to issue Electricity Invoices to Ratepayers for a failure to impose, attribute, charge, bill or invoice Transition Charges. Any court of the Province [and the OEB] shall have jurisdiction

over any actions brought before it by the Regulatory Asset Owners in relation to any such failure.[22]

(10) No Set-Off or Reduction – No Servicer or Electricity Distributor may set off or reduce (by counterclaim, defence or otherwise) the amount payable by it pursuant to this Article 4.

(11) Regulations – Regulations may be enacted for the

[22] Consider having such matters first go through the OEB, particularly if the obligation to bill, collect or remit is deemed to be a condition of license for distributors, IESO, retailers and unit sub-metering providers, which would be enforceable provisions under the OEB Act and within OEB jurisdiction to enforce.

purpose of specifying further rights, powers, privileges, duties and obligations that shall apply to IESO, any Electricity Distributor, any Alternative Servicer or any [Alternative Collection Agent] to ensure that Transition Charges are properly charged to Ratepayers and specified as such in Electricity Invoices.

Article 5 – Collections and Remittances

(1) **Duty to Collect as Agent** – Electricity Distributors or if

applicable any Alternative Collection Agent shall, as an agent of the Regulatory Asset Owners, undertake [diligent efforts] to collect amounts owing by Ratepayers in respect of Transition Charges charged to such Ratepayers in Electricity Invoices issued by the Electricity Distributor or if applicable such Alternative Collection Agent.

(2) **Segregation of Transition Charge Collections** – An Electricity Distributor or if applicable any Alternative

Collection Agent shall promptly segregate Transition Charge Collections from other payments received by it from Ratepayers and deposit such Transition Charge Collections into its Regulatory Asset Account. Prior to and following a deposit of Transition Charge Collections having been made into its Regulatory Asset Account, the Electricity Distributor or if applicable any Alternative Collection Agent shall hold such amounts in

trust for each Regulatory Asset Owner.

(3) **Electricity Distributor Remittances** – On each [applicable Remittance Date], an Electricity Distributor shall remit all Transition Charge Collections received by it from Ratepayers in respect of the related Reference Period to or to the account of IESO or if applicable, the Alternative Collection Agent.

(4) **Duty to Collect Electricity Distributor Remittances** –

IESO, or if applicable, any Alternative Collection Agent shall, as an agent of the Regulatory Asset Owners, undertake [diligent][reasonable] efforts to accept and collect Electricity Distributor Remittances from Electricity Distributors and Transition Charge Collections from Ratepayers that pay their Electricity Invoices directly to the Servicer.[23]

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[23] Consider building this obligation into a deemed condition of licence for the IESO.

(5) **Segregation of Electricity Distributor Remittances** – IESO and if applicable the Alternative Collection Agent shall [promptly] segregate Electricity Distributor Remittances from other payments received or held by it and deposit such Electricity Distributor Remittances into its Regulatory Asset Account. Prior to and following a deposit of Electricity Distributor Remittances having been made into its Regulatory Asset Account, IESO or if applicable

any Alternative Collection Agent shall hold such amounts in trust for each Regulatory Asset Owner.

(6) **IESO Remittances** – On each [Settlement Date][24], IESO and if applicable the Alternative Collection Agent shall remit all amounts on deposit in its Regulatory Asset Account to or to the account of the Regulatory Asset Owner.

(7) **Successors of Electricity Distributors** – Any successor

[24] Consider frequency of remittances in light of rating requirements.

of an Electricity Distributor shall be bound by the requirements of Article 5 and shall perform and satisfy all duties and obligations of such Electricity Distributor under Article 5 in the same manner and to the same extent as such Electricity Distributor, including the obligation under Article 5 to collect Transition Charges and make remittances of Electricity Distributor Remittances.

(8) **Successors of IESO** – Any successor of IESO shall be bound by the requirements of

Article 5 and shall perform and satisfy all duties and obligations of IESO under Article 5 in the same manner and to the same extent as IESO, including the obligation to collect Transition Charge Collections, Electricity Distributor Remittances and to remit IESO Remittances.

(9) **Owners of Distribution Assets** - If any person other than an Electricity Distributor acquires distribution system assets in the Province or invoices or collects electricity

distribution rates in the Province[25], then such person shall, if requested by the Regulatory Asset Owners, be obligated to act diligently to (a) facilitate the invoicing and collection of any Transition Charges applicable to Ratepayers in its applicable service area, including all consumers connected to the electricity distribution system assets and taking electric delivery service located within

[25] This is in anticipation of a possible future restructuring of the distribution system. Also, this would cover any OREC-eligible customer (market participant) of IESO.

such service area; (b) allocate partial payments by Ratepayers as provided in this Part; (c) terminate service to non-paying Ratepayers on the same basis as termination of service is permitted for non-payment of electricity transmission and distribution rates; (d) exercise all enforcement rights of the Regulatory Asset Owners or Pledgee for the benefit of a Regulatory Asset Owner or Pledgee; and (e) remit any Transition Charge Collections

to the Regulatory Asset Owner or Pledgee, as applicable, each in accordance with its Regulatory Asset.

(10) **Regulatory Asset Owners have Standing** – The Regulatory Asset Owners and any Pledgee may bring actions against any Electricity Distributor, IESO, Alternative Servicer, any owner of electricity distribution system assets in the Province or any other person who may be authorized to collect electricity distribution and use charges

from Ratepayers for a failure to collect Transition Charges, remit or collect Electricity Distributor Remittances or remit IESO Remittances, as and to the extent applicable under Article 5. Any court of the Province [and the OEB] shall have jurisdiction over any actions brought before it by the Regulatory Asset Owners in relation to any such failure.[26]

(11) Appointment of an Alternative Collection Agent

[26] Consider having such matters first go through the OEB, particularly if the obligation to bill, collect or remit is deemed to be a condition of license for distributors, IESO, retailers and unit sub-metering providers, which would be enforceable provisions under the OEB Act and within OEB jurisdiction to enforce.

– If a Replacement Event occurs in respect of any Electricity Distributor or IESO, the Regulatory Asset Owners shall, in accordance with the Collective Rights Agreement, be permitted, by an instrument in writing, to appoint an Alternative Collection Agent to perform some or all of the collection, segregation and remittance obligations otherwise required to be undertaken by such Electricity Distributor or IESO, as applicable, under Article 5, as

and to the extent specifi such appointment. Upon acceptance of such appointment, the Alternative Collection Agent shall become obligated to perform such assumed obligations in replacement of such Electricity Distributor or IESO, as applicable. Any Electricity Distributor or IESO, as applicable, that is replaced under this Section 5(11) shall promptly transfer all rights, powers, privileges and property interests in its possession or

within its control in, to and over the Regulatory Asset, including its Regulatory Asset Account, to the Alternative Collection Agent and shall take such further actions, including the execution of instruments, necessary to give full and final effect to such transfer and to permit the Alternative Collection Agent to enforce the Regulatory Asset on behalf of the Regulatory Asset Owners.

(12) **No Set-off, etc.** - The Regulatory Asset, including rights in Transition Charges,

Transition Charge Collections, and the interests of a Regulatory Asset Owner, an Absolute Assignee and a Pledgee therein, may not be setoff or reduced (including by counterclaim, surcharge or defense) by any Ratepayer, any Electricity Distributor, IESO, Alternative Collection Agent or any owner of distribution system assets in the Province or any other person or in connection with any default, bankruptcy, reorganization or other

insolvency proceeding of any Electricity Distributor, IESO, Alternative Collection Agent or any owner of distribution system assets in the Province, any affiliate or successor thereof or any other entity or otherwise.[27]

(13) **Sequestration** – If any Electricity Distributor, IESO, Alternative Collection Agent or any owner of distribution system assets in the Province or any other person or entity

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[27] Consider whether it makes sense to create a "deemed collection" payment obligation on Electricity Distributors to the extent a Ratepayer reduces its payment of Transition Charges, despite this language, and same for Electricity Distributor Remittances and IESO Remittances.

authorized to collect Transition Charges, defaults on any required remittance of Transition Charge Collections, Electricity Distribution Remittances or IESO Remittances under Article 5, any court in the Province, upon application by the Regulatory Asset Owners or Pledgee and without limiting any other remedies available to the applying party, shall order the sequestration and payment of the Transition Charge Collections, Electricity

Distribution Remittances and IESO Remittances, as applicable, for the benefit of the Regulatory Asset Owners or Pledgee, each with respect to its Regulatory Asset.

(14) Regulations – Regulations may be enacted for the purpose of specifying further rights, powers, privileges, duties and obligations that shall apply to IESO, any Electricity Distributor or any Alternative Collection Agent to ensure that rights, interests, entitlements, benefits and proceeds in, to,

under and from the Regulatory Asset are of fully realized by the Regulatory Asset Owner.

Article 6 – The Regulatory Asset

(1) **Composition** – The Regulatory Asset shall constitute an existing, present property right and interest consisting, collectively, of the following rights and interests of a Regulatory Asset Owner in the following (without duplication):

a. the right of a Regulatory Asset Owner to record its portion of the Regulatory Asset in its accounts;

b. the right to impose, bill, invoice, collect and receive Transition Charges from Ratepayers, including the right to determine the amount of Transition Charges in accordance with this Part;

c. the right to enforce the obligations and indebtedness of each Ratepayer to pay the

Transition Charges charged to the Ratepayer from time to time in accordance with Article 2, together with all related late payment fees or interest charges arising in respect thereof under the related Electricity Invoices;

d. the right to enforce the duties and obligations of each Electricity Distributor and if applicable the Alternative Servicer to impose, attribute, charge, bill and invoice the Transition Charges in accordance with Article 4;

e. the right to enforce the duties and obligations of each Electricity Distributor and if applicable the Alternative Collection Agent to collect, receive and remit amounts received by it in respect of Transition Charges as Electricity Distributor Remittances to or to the account of IESO or if applicable the Alternative Collection Agent in accordance with Article 5, including all collections and the proceeds of any

enforcement action undertaken by the Electricity Distributor or if applicable the Alternative Collection Agent to recover payment of Transition Charges in accordance with Article 4;

f. the right to enforce the duties and obligations of IESO and if applicable the Alternative Collection Agent to collect and receive Electricity Distributor Remittances and to remit IESO Remittances to or to the accounts of the Regulatory Asset Owners,

each with respect to its Regulatory Asset, in each case in accordance with Article 5, including all collections and the proceeds of any enforcement action undertaken by it to recover payment of Electricity Distributor Remittances in accordance with Article 4;

g. the right to receive and collect all Transition Charge Collections, all Electricity Distributor Remittances and all IESO Remittances in accordance with Article 5;

h. all rights and entitlements under each Regulatory Asset Account and all amounts on deposit in any such Regulatory Asset Account;

i. all Related Rights; and

j. all revenue, collections, claims, payments, money and proceeds of or derived from the rights described in (a) through (i), regardless of whether such revenue, collections, claims, payments and proceeds are imposed, invoiced, collected and

maintained together with or commingled with other revenue, collections, claims, payments, money and proceeds.

A Regulatory Asset and the property rights and interests therein shall exist whether or not Transition Charges have been imposed, charged, invoiced, accrued or collected and notwithstanding that the imposition, attribution, invoicing and collection of Transition Charges will depend on further

actions that may not have occurred.

(2) **Validity of Dispositions** – Despite any limitations or restrictions on a Disposition that may arise by contract or by operation of any applicable law of the Province [or any consent requirement applicable to a Disposition that may arise by contract or by operation of any applicable law of the Province], a Disposition by a Regulatory Asset Owner made under the Financing Plan pursuant to a Disposition Document shall be

permitted and when made shall be valid and enforceable in accordance with its terms and shall be effective to confer upon the Absolute Assignee a valid property right and interest in, to and under the Regulatory Asset (or relevant portion thereof) in accordance with the terms of such Disposition, provided that the parties to the applicable Disposition Document have expressly stated therein that such Disposition is a sale or other absolute transfer. Without

limiting the foregoing, any Disposition that by its terms is intended to constitute a sale or absolute transfer shall be treated for all purposes as a true sale and absolute transfer of the Regulatory Asset Owner's applicable right, title, and interest in, to and under the Regulatory Asset (or relevant portion thereof), and not merely as a Pledge thereof. [A Disposition shall not be subject to recharacterization or challenge on any other basis and the validity of a Disposition

shall not be affected or impaired by: (a) the commingling of Transition Charge Collections or other proceeds from Transition Charges with other amounts; (b) the retention of any interest (including any partial, residual or subordinated interest, whether direct or indirect) in the Regulatory Asset by the transferring Regulatory Asset Owner; (c) any right to repurchase the Regulatory Asset in favour of the transferring Regulatory Asset

Owner; (d) any recourse that an Absolute Assignee may have against the transferring Regulatory Asset Owner; (e) any indemnification rights or obligations provided by the transferring Regulatory Asset Owner; (f) any obligation of the transferring Regulatory Asset Owner to collect and remit Transition Charge Collections on behalf of an Absolute Assignee, including but not limited to, any retention by the transferring Regulatory Asset Owner to bare legal title for the

purpose of collecting Transition Charges; or (g) the ascribed or intended treatment of the Disposition by the transferring Regulatory Asset Owner or the Absolute Assignee on any different basis including for tax, financial reporting or other purposes.][28]

(3) **Perfection and Priority of Dispositions** – Any Disposition of an interest in a Regulatory Asset shall be vested, valid, binding and

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[28] Consider if helpful to investors, or delete.

perfected from the time when such Disposition is made. Such Disposition shall be perfected, vested, valid and binding as against the transferring Regulatory Asset Owner and all other persons who have claims of any kind (whether in tort, contract or otherwise) against the transferring Regulatory Asset Owner, irrespective of whether such persons have notice of the Disposition and the property rights and interests acquired by the Absolute Assignee under

such Disposition shall be free and clear of any liens in favour of such other persons.

(4) **Validity of Pledges** – Despite any limitations or restriction on a Pledge that may arise by contract or by operation of any applicable law of the Province [or any consent requirement applicable to a Pledge that may arise by contract or by operation of any applicable law of the Province], a Pledge by a Regulatory Asset Owner may be made to secure any Funding Obligation

and when made shall be valid and enforceable in accordance with its terms and shall be effective to confer upon the Pledgee a valid security interest in, to and in respect of the Regulatory Asset in accordance with the terms of the Pledge. Other than as required by the Financing Plan, no consent of any person shall be required to give effect to a Pledge made to secure any Funding Obligation.

(5) **Perfection and Priority of Pledges** - Any Pledge made by

a Regulatory Asset Owner in respect of a Funding Obligation incurred under the Financing Plan shall be perfected, valid and binding from the time when the Pledge is made and shall be valid and binding as against the Regulatory Asset, the Regulatory Asset Owner making the Pledge and all other persons who have claims of any kind (whether in tort, contract or otherwise) against the Regulatory Asset or the pledging Regulatory Asset Owner, irrespective of whether

such persons have notice of the Pledge and the security interests of the Pledgee under such Pledge shall have priority over any liens in favour of such other persons. All proceeds of the Regulatory Asset that are subject to such a Pledge that are received by the Regulatory Asset Owner shall immediately be subject to the such Pledge, and the security interest in such proceeds shall be perfected, without any physical delivery thereof, registration of any financing statement with

respect thereto pursuant to the [PPSA] or any other further act.[29] A Pledge shall be a continuously perfected security interest and shall have priority over any other lien, created by operation of law or otherwise, that may subsequently attach to the property rights and interests in the Regulatory Asset subject to the Pledge unless the Pledgee has otherwise agreed in writing. Any Pledgee shall have a

[29] Consider whether to simply leave this and have a financing statement be filed under the PPSA. This would normalize the security interest and reduce any adverse suggestion that security would not otherwise arise.

perfected security interest in Transition Charge Collections or other related proceeds that are deposited in any Regulatory Asset Account or other account of any Electricity Distributor, IESO, Alternative Collection Agent or other person who may have commingled such Transition Charge Collections or such other proceeds with other funds. [A Pledgee shall cause a financing statement to be filed in respect of a Pledge on the basis that the Regulatory

Asset is "intangible" property, for informational purposes only under the [PPSA].

(6) **Enforcement of Property Rights** – The rights of any Regulatory Asset Owner to collect and enforce its rights and interests in, to or in respect of the Regulatory Asset shall be exercised in the manner set forth in Article 5.

(7) **Owners of a Specified Portion of the Regulatory Asset** – A Regulatory Asset Owner may effect a Disposition

to an Absolute Assignee of a specified portion of its rights and interests in the Regulatory Asset, including by way of a Disposition of a divided or an undivided interest therein. In no circumstance may the specified portions of the rights and interests in the Regulatory Asset owned by all Regulatory Asset Owners be greater than all of the rights and interests that comprise the Regulatory Asset in the aggregate.

(8) **Collective Action Required** – If a Regulatory Asset

Owner's right and interest in the Regulatory Asset comprises less than the entire property right and interest constituted by the Regulatory Asset, such Regulatory Asset Owner shall only enforce such right and interest on a collective [and joint] basis with each other Regulatory Asset Owner in accordance with the Collective Rights Agreement.[30]

[30] This is necessary to ensure that if there are multiple regulatory asset owners and pledgees, they will be coordinated in the application of their rights of enforcement, etc.

Article 7 – Establishment of the Fair Allocation Plan[31]

(1) Adoption of the Fair Allocation Plan – The [Minister of Energy][32] may by written order designate and adopt a Fair Allocation Plan in compliance with Article 7. The Fair Allocation Plan so designated and adopted shall be the Fair Allocation Plan for all purposes of this Part, [except if amended, amended

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31 The idea is that the Fair Allocation Plan will be set once at the outset based on the principles and parameters described here, all applied based on information available and the reasonable expectations and discretion of the delegate at such time. If the expectations are not fulfilled (e.g., generators may choose to retire their facilities at the end of their current Power Contracts and not invest in extending service lives to secure further power contracts), the Fair Allocation Plan will be unaffected, unless it is specifically amended (assuming amendments will be permitted by the legislation).

32 Input required. If the MOE is given this power, conform to applicable authorities (e.g., plans and directives).

and restated or terminated by a further written order issued by the Minister of Energy in compliance with Section •].

(2) Principles and Parameters[33] – A Fair Allocation Plan shall seek to allocate Unrecovered Transition Costs across present and future Ratepayer Groups on a basis that the Minister of Energy, in its sole and absolute discretion, determines to be equitable,

[33] Consideration will be given as to whether these details should be included in the Regulation.

having regard to the following principles and parameters[34]:

1. Unrecovered Transition Costs should be allocated over a period not to exceed the later of (a) the estimated remaining useful life of the Related Generating Assets and (b) the remaining term of IESO's commitments under the Power Contracts.

2. The Fair Allocation Plan should specify the Reference

[34] We have provided a few examples of what could be the basic principles. These will depend on market considerations, the Province's decision on the required amount of detail and the ability to sustain the legal basis for the program. These examples are not meant to suggest the appropriate balance – just illustrative to advance a discussion among the stakeholders.

Periods (e.g., 6 month periods), for the purpose of identifying applicable Ratepayer Groups and allocating among them responsibility to bear the Unrecovered Transition Costs on a relative basis over time.

3. The share of Unrecovered Transition Costs allocable to a particular Ratepayer Group in respect of a Reference Period should be proportionate to a reasonable assessment of

the benefits of the Green Generation Initiative to the Ratepayer Group over such Reference Period.

4. The estimated Unrecovered Transition Costs to be allocated to a Ratepayer Group and any future Ratepayer Group at a particular time should not exceed the estimated value of the Related Generating Assets based on their remaining useful lives or terms, measured in respect

of the period following such particular time.

5. No future Ratepayer Group should bear an unreasonably disproportionate share of the Unrecovered Transition Costs. Except in exceptional circumstances or in the case of any backward-looking adjustment made as contemplated in 7, below, the share of the Unrecovered Transition Costs to be allocated under a Fair Allocation Plan to any future Ratepayer Group should

have regard to [Insert formula if a year-over-year maximum amount is determined to be appropriate][35].

6. A reasonable estimate of the rate of inflation should be applied to equate the relative values of the nominal amount of Unrecovered Transition Costs to be allocable to Ratepayer Groups over time.

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[35] Consider if a quantitative limit needs to be included in the legislation.

7. Backward-looking adjustments to a Fair Allocation Plan may be made to achieve a fair distribution among Ratepayers of the benefits of the Green Generation Initiative.

(3) Attribution Methodology – The Fair Allocation Plan [shall] specify an objective methodology (the "Attribution Methodology") for the purposes of allocating the Period Transition Charges across all of the Ratepayers of a particular Ratepayer Group.

The Attribution Methodology shall result in an attribution of such Transition Charges that are considered by the Minister of Energy to be equitable, and may have regard to such principles and parameters as may be further set forth in a Regulation.

(4) [Confirmation][Review] of the Fair Allocation Plan – [OEB?][36]

Article 8 – The Financing Plan[37]

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[36] Any approvals or consents by the OEB will be obtained before any Funding Obligation that is dependent on such approval or consent is incurred. Any such approval or consent will be irrevocable and non-appealable. Any regulatory action occurring after any incurrence will not affect the related Funding Obligation or underlying rights in the Regulatory Asset.

(1) Power to Prepare and Implement the Financing Plan – In compliance with a [written order][***MOE to confirm process.***] of the Minister of Energy, the Administrative Agent shall prepare and propose the adoption of a Financing Plan. If the Administrative Agent is unwilling or unable to prepare and propose the adoption of a Financing Plan, the Minister of Energy may by written order designate one or more other

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[37] Consideration will be given as to whether these details should be included in the Regulation.

persons to prepare and implement such a Financing Plan.

(2) Required Terms and Conditions of the Financing Plan – The Financing Plan shall establish the basis for funding decisions that have the effect of allocating the Unrecovered Transition Costs across present and future Ratepayer Groups on a basis that is consistent with the Fair Allocation Plan. The Financing Plan shall be consistent with the principles, parameters

requirements and conditions set forth in Schedule 3 and such other conditions and requirements as may be specified in a written order of the Minister of Energy [or in accordance with the Regulation].

(3) Power to Review and Approve the Financing Plan – The Minister of Energy may, by written order, designate one or more persons to review the Financing Plan and to review and assess the consistency of the Funding Obligations

incurred with such Financing Plan, and the Minister of Energy may specify requirements in respect of such review in such written order. The Administrative Agent, or such other person(s) as may be designated by written order of the Minister of Energy made pursuant to Section 8(1), shall make any such amendments to the Financing Plan, and submit a revised Financing Plan to the designated reviewer for approval within [the time period specified in such written

order]/[[●] days of such written order].[***Consider periodic amendments to the Financing Plan following an annual review; provided that amendments cannot affect the existing Funding Obligations. Consider the level of oversight the MoE/OEB will have over this process?***]

(4) Approval of Financing Plan – The **[OEB]** shall have the power to and shall approve or disapprove of the Financing Plan based solely on whether

the Financing Plan is consistent with (i) the principles, parameters, requirements and conditions set forth in Schedule 3, (ii) such other conditions and requirements as may be specified in a written order of the Minister of Energy [or in accordance with the Regulation] [and (iii) the Fair Allocation Plan]. If the **[OEB]** approves the Financing Plan, then such Financing Plan shall be implemented by the Administrative Agent. If the

OEB disapproves of the Financing Plan or otherwise fails to approve the Financing Plan, then the Administrative Agent shall re-submit the Financing Plan with such amendments as the Administrative Agent shall consider necessary for the Financing Plan to be approved by the OEB.[38]

(5) Consistency with the Fair Allocation Plan - Funding

[38] Once the Financing Plan is reviewed and approved there would be no further OEB review. If there is opportunity for further review, such review will have no impact on prior issued debt. Any further financings would be put on hold until such review is completed (during which time the IESO would again need to fund the shortfall on an interim basis and obtain necessary funding).

Obligations should only be incurred if Repayments and Funding Costs would be borne by present and future Designated Ratepayers on a basis that is [generally] consistent with their respective allocations of the costs and benefits of the Green Generation Initiative contemplated in the Fair Allocation Plan. In that regard, at the time of setting the Fair Allocation Plan for any particular period, the aggregate amount payable during future

Reference Periods on account of Funding Obligations incurred on or before the date on which a new Funding Obligation is incurred should not exceed the allocation of the costs and benefits of the Green Generation Initiative to the applicable Ratepayer Group contemplated in the Fair Allocation Plan. If, despite the foregoing, the Administrative Agent determines that the anticipated amount of any Repayment (together with payments of other Finance

Amounts) to be made in respect of a Reference Period would materially exceed the allocation of the costs and benefits of the Green Generation Initiative to the applicable Ratepayer Group under the then current Fair Allocation Plan, the Financing Plan shall require the Administrative Agent to make diligent efforts to determine whether a Refinancing or deferral of such Repayment may be reasonably and cost-effectively effected based on

then prevailing market terms, conditions an circumstances, if such a Refinancing or deferral is determined to be available the Financing Plan shall require the Administrative Agent to make diligent efforts to implement such Refinancing or deferral on a basis that is consistent with the Fair Allocation Plan.

(6) Establishment of Special Purpose Entities – If the implementation of the Financing Plan contemplates the establishment of one or

more special purpose finance entities to incur Funding Obligations as a Financing Entity under the Financing Plan, as an Absolute Assignee and on a basis that limits the recourse for the payment of such Funding Obligations to such Absolute Assignee's interest in, to and under the Regulatory Asset, the Administrative Agent shall have regard to the characteristics specified in Schedule 4 in establishing such special purpose entity.]

(7) Obligation to Apply IESO Remittances – The Administrative Agent shall ensure that amounts transferred to it under Article 5, as agent for and on behalf of the Regulatory Asset Owners, or otherwise in respect of or as proceeds from the Regulatory Asset shall only be applied or used to pay Finance Amounts when they are due and payable and for no other purpose.[39]

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[39] We need to work in the idea that there may be Finance Reserve Deposits or other amounts that remain after paying Finance Amounts. Those surplus amounts should be credited back to Ratepayers.

(8) Non-Recourse – The Financing Plan shall be implemented so that Funding Obligations incurred shall be without recourse to or to any assets of the Electricity Distributors, IESO, any Alternative Servicer, and Alternative Collection Agent, the Administrative Agent, the OEB, the Province or the Lieutenant Governor in Council, other than if and to the extent that such persons or entities are liable for the performance of obligations or

duties arising under this Part or expressly pursuant to any Funding Obligation or obligation in relation to a Finance Amount. [All Funding Obligations shall contain a statement to the following effect: "Neither the full faith and credit nor the taxing power of the Province of Ontario is pledged to the payment of the principal of, or interest on, this [obligation].]

(9) Incurrences are Binding – Despite any failure to adhere to the Financing Plan or to

comply with any requirement of this Part, all amounts payable or becoming due and payable by or on behalf of a Regulatory Asset Owner under or in connection with any obligation purporting to be a Funding Obligation, shall be binding for the purposes of this Part, including in determining the amount of Transition Charges, despite any impairment or defect resulting from such failure.

Article 9 – Compliance Matters[40]

(1) Right of the [OEB] to Inspect Books and Records - For the purpose of investigating compliance with the provisions of this Part, the [OEB] shall have the right, jurisdiction, power and authority to examine the books and records of any person who is or may become obligated or have duties that arise under

[40] As noted above, the outcome of any regulatory action undertaken by the OEB will not affect Funding Obligations that have been incurred under the Financing Plan. This Article is under consideration.

this Part or any Funding Obligation.

(2) Power to Investigate Compliance and Impose Regulatory Sanctions - Subject to the limitations set forth regarding the irrevocability of Transition Charges and the Undertaking of the Lieutenant Governor in Council, nothing in this Part shall (a) prevent or preclude the [OEB] from investigating the compliance of any person who is or may become obligated or have duties that

arise under this Part [or any Funding Obligation] with the terms and conditions of this Part and requiring compliance by such person therewith; or (b) prevent or preclude the [OEB] or any successor regulator from imposing regulatory sanctions against any person who is or may become obligated or have duties that arise under this Part for its failure to comply with the terms and conditions of this Part[41].

[41] Consider scope of OEB regulation and whether a Financing Entity should be subject to this sort of provision in any

(3) [Other Rating Settings – When setting other rates for or in respect of any person who is or may become obligated or have duties that arise under this Part, including any Electricity Distributor, IESO, Generator or the Administrative Agent, nothing in this Part shall prevent the [OEB] or any successor regulator from taking into account the collection by or attribution to such person of administrative or servicing fees in excess of the actual

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event.

incremental costs incurred by such person of providing administrative or servicing services.][42]

Article 10 – Undertaking of the Lieutenant Governor in Council[43]

(1) No Action to limit, alter, or impair or terminate Transition Charges, the Regulatory Asset or Collections – The [Lieutenant Governor in Council] shall not

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[42] OPG has indicated that the risks and cost consequences to OPG of being an Administrative Agent or of consolidating a Financing Entity for accounting purposes should not be considered by the OEB in setting the regulated payment amounts for OPG. To be discussed.]

[43] Under consideration.

in any way take or permit any action to reduce, impair, postpone or terminate the obligation of Ratepayers to pay Transition Charges or impair the Regulatory Asset or the collection or recovery of Transition Charge Collections, either directly or indirectly[,including through the introduction of any bill or the passing of any legislation or regulation]. The amount of Transition Charges determined hereunder shall not be subject in any way to reduction,

impairment, postponement or termination as a result of any action taken or failure by the Lieutenant Governor in Council[,including through the introduction of any bill or the passing of any legislation or regulation].

(2) Undertaking and Agreement – The Lieutenant Governor in Council shall not in any way take or permit any action that limits, alters or impairs the value of the Regulatory Asset or, except as required by the estimates and

adjustments made in determining the True-up Amount, reduce, alter or impair Transition Charges that are imposed, collected and remitted for the benefit of the Regulatory Asset Owners, including any Absolute Assignee from time to time, and any Pledgee from time to time[,including through the introduction of any bill or the passing of any legislation or regulation].

[If IESO becomes insolvent or otherwise incapable of

performing its obligations under this Part, an IESO Successor will be established that is capable of performing such obligations in order that the Regulatory Asset Owners may appoint the IESO Successor as an Alternative Servicer or Alternative Collection Agent. Regulatory Asset Owners shall be fully compensated for any failure by the Lieutenant Governor in Council to comply with its undertakings and agreements in this Article 10(2) for any loss suffered by the

Regulatory Asset Owner as a result of such failure.[44]]

(3) References to the Undertaking and Agreement – Any non-confidential reference to the Undertaking of the Lieutenant Governor in Council, including in marketing materials and other documentation authorized for use by the Administrative in connection with any Funding Obligation, may be made

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[44] Requested by Torys. For discussion.

provided that [*Add conditions to protect the Province*].

Article 11 – Regulations

Regulations may be made under this Part for the purposes described in Sections •,•,• and • and may be promulgated for any of the following purposes:

(a) to set standards and measures regarding the commercially reasonable requirements of the Province associated with a Regulatory Asset Owner incurring Funding Obligations or

becoming obligated to pay any Finance Amount, including to establish guidelines regarding all-in funding costs; permitted Additional Funding Costs; required maturities and redemption and termination rights of Funding Obligations; liquidity requirements, in each case to a Financing Plan that is consistent in its effect with the Fair Allocation Plan;

(b) to establish and empower one or more regulated

entities to undertake decision-making activities with respect to this Part;

(c) to set out reasonable requirements regarding the appointment or retention of advisors, agents, service providers, contract counterparties, including in relation to 'market terms and conditions' parameters;

(d) to provide for audit and compliance standards applicable to those persons who are or may become

obligated or have duties that arise under this Part [or under any Funding Obligation];

(e) to provide for any pre-vetting and approval requirements in relation to any incurrence by a Regulatory Asset Owner of any Funding Obligation or obligation to pay any Finance Amount; and

(f) to provide for appeal and due process considerations in connection with the

establishment, adoption, implementation and review of the Fair Allocation Plan or the Financing Plan.

Article 12- Miscellaneous[45]

(1) Choice of law – The law governing, as applicable, the validity, enforceability, attachment, perfection, priority and exercise of remedies with respect to the transfer of an interest or right or creation of a security interest in the

[45] OPG would like the specific amendments related to OPG to be included in the Bill.]

Regulatory Asset, any Transition Charge or the Undertaking of the Province shall be the laws of the Province.

(2) Conflict of law – In the event of conflict between this Part and any other law of the Province regarding the attachment, assignment or perfection, or the effect of perfection, or priority of any Disposition or Pledge, this Part shall govern to the extent of the conflict.

(3) No further acts or approvals required - Notwithstanding any provisions of any law of the Province to the contrary, no approvals, notices or authorizations other than those specified in this Part shall be required with respect to the actions to be taken in compliance with this Part, including under the Financing Plan or in relation to the establishment of the Fair Allocation Plan, and the transactions and contracts authorized in or contemplated

by this Part or the Financing Plan, including the incurrence of any Funding Obligation, any Disposition, any Pledge or in the payment and performance of any attendant or incidental contract and any related expenses incurred to facilitate the preparation and implementation of the Financing Plan.

(4) Effect of invalidity after the Incurrence of any Funding Obligation - Effective on the date that a Funding Obligation is incurred under this Part, if

any provision of this Part is held to be invalid or is invalidated, superseded, replaced, repealed or expires for any reason, that occurrence shall not affect any action allowed under this Part that is taken by any person who is or may become obligated or have duties that arise under this Part and any such action shall remain in full force and effect.

(5) Severability - If any Article, Section, paragraph or subparagraph of this Part or the application thereof to any

person, circumstance or transaction is held by a court of competent jurisdiction to be unconstitutional or invalid, the unconstitutionality or invalidity shall not affect the constitutionality or validity of any other Article, Section, paragraph or subparagraph of this act or its application or validity to any person, circumstance or transaction, including the irrevocability of Transition Charges, the validity of the Regulatory Asset, the incurrence of any Funding

Obligation, any Disposition, any Pledge, or the collection and recovery of Transition Charge Collections. To these ends, the Legislature hereby declares that the provisions of this Part are intended to be severable and that the Legislature would have enacted this Part even if any Article, Section, paragraph or subparagraph of this Part held to be unconstitutional or invalid had not been included in this Part.

Schedule 1

Guidelines for Estimates

[To be considered.]

Schedule 2

Requirements Applicable to Alternative Invoicing Agent/ Alternative Collection Agent

[To be considered.]

Schedule 3

Principles, Parameters, Requirements and Conditions for Establishing the Financing Plan

The Financing Plan shall have regard to the following principles, parameters, requirements and conditions:[***Consider others.***]

(1) the Financing Plan shall, in respect of each Reference Period, describe the allocations of Unrecovered Transition Costs to each Reference

Group as contemplated by the Fair Allocation Plan;

(2) the Administrative Agent shall make a good faith estimate of the Funding Shortfalls for each Reference Period, based on the terms of the Power Contracts and assumptions considered to be reasonable respecting forward market prices for electricity;

(3) the Administrative Agent shall describe alternative funding arrangements considered to be suitable for

the purpose of funding the estimated Funding Shortfalls, including by reference to short term and/or long term Funding Obligations that could reasonably be incurred by the Regulatory Asset Owners for such purpose;

(4) such Funding Obligations shall reflect quantities, maturities, payment obligations, prepayment or redemption rights and such other features so that the effect of incurring such Funding Obligations would be that the

payments made thereunder in respect of each Reference Period (including the anticipated Finance Amounts becoming payable in relation to such Funding Obligations) would reasonably correspond to the allocations of Unrecovered Transition Costs to the applicable Reference Group under the Fair Allocation Plan;

(5) the Financing Plan shall reflect the outcome of a financial model that incorporates the assumptions

and requirements specified in any contemplated Funding Obligation (e.g., any limit on the maximum amount of Transition Charges charged to a hypothetical Ratepayer relative to his or her monthly electricity bill, as prescribed by any rating agency that ascribes its credit rating to or in respect of the Funding Obligation having regard to the application of the Allocation Methodology); [***Consider what outputs from OPG will be tested by the OEB and when.***

The modelling in the Financing Plan may permit the OEB to check progress against the model from time to time, which may provide a basis for the MoE/OEB to require a review/amendment to the Financing Plan if the ongoing operation of the program results in significant deviation from the model. Consider whether this flexibility is desirable.]

(6) the Administrative Agent, for and on behalf of each Regulatory Asset Owner, shall

seek to incur Funding Obligations from time to time on the best terms available at such time for a financing transaction of the size and type contemplated, and having regarding to the following parameters:

a. whether the Regulatory Asset Owners will require committed access to short term liquidity to cover estimated Funding Shortfalls prior to incurring fixed term Funding Obligations, and the amount and repayment

terms of any such required liquidity; provided that any Repayment required to be made under the terms of such short-term liquidity would not obligate a Regulatory Asset Owner to repay an amount in relation to a Reference Period that would have the effect of the Financing Plan permitting incurrences of Funding Obligations payable in such Reference Period that would exceed the allocations of Unrecovered Transition

Costs to the applicable Reference Group under the Fair Allocation Plan;

b. the basis upon which the Administrative Agent will select the term to maturity of any other Funding Obligations; provided that any Repayments required to be made under the terms of such Funding Obligations shall not obligate a Regulatory Asset Owner to repay an amount in relation to a Reference Period that would have the effect of the

Financing Plan permitting incurrences of Funding Obligations payable in such Reference Period that would exceed the allocations of Unrecovered Transition Costs to the applicable Reference Group under the Fair Allocation Plan;

c. the basis upon which the interest rates applicable to such Funding Obligations would be determined;

d. the reference capital or finance market in which such

Funding Obligation would be incurred, including markets outside of Canada if considered by the Administrative Agent to be appropriate in the circumstances;

e. the currency of payments under such Funding Obligations and, if the Funding Obligations are denominated in a currency other than Canadian dollars, the basis upon which the Administrative Agent shall cause the applicable

Regulatory Asset Owner to enter into hedging transactions to mitigate currency risk, including acceptable minimum and maximum coverage levels, having regard to the availability of related derivatives having notional amounts corresponding to the repayment and maturity profile of such Funding Obligations;

f. the basis upon which the Administrative Agent will select counterparties under

any transaction to be entered into by a Regulatory Asset Owner, including any paying agent, servicer, cash manager, liquidity provider, hedge counterparty, account bank, lender, note trustee, security trustee, paying agent, registrar/transfer agent, financial services agent, arranger or manager;

g. the basis upon which the Administrative Agent will manage counterparty risk, including by providing for maximum counterparty

exposure limits having regard to concentration, credit and other identified risks with respect to individual counterparties or countries;

h. the basis upon which the Administrative Agent will negotiate and settle Finance Amounts, including the amount of any Redemption Amounts, Finance Reserve Deposits and Additional Funding Charges;

(7) the basis upon which Funding Obligations may be redeemed, prepaid, repurchased or otherwise affected, having regard for the need to minimize debt service charges and other Funding Costs, and the need to maintain a stable funding platform to finance the Funding Shortfall from time to time on a basis that is consistent with the allocations of Unrecovered Transition Costs to applicable Reference Groups under the Fair Allocation Plan;

(8) the basis upon which any Repayments, Funding Costs and Redemption Amounts will be paid, including any defeasance, sinking fund or through other reserves or liquidity facilities;

(9) the basis upon which fees, charges, expenses, costs, indemnities, reimbursements and other amounts payable to or for the benefit of the Administrative Agent and other agents and service providers to the Regulatory Asset Owners

may be determined, allocated and paid;

(10) the timing and basis upon which Finance Reserve Deposits and Finance Reserve Withdrawals may be made;

(11) the basis upon which any obligations for any other Additional Funding Charges may be incurred and paid;

(12) the basis upon which the cash flows arising from time to time or otherwise derived from the Regulatory Asset may otherwise be applied, including

in relation to any counterparty enforcement and realization scenario;

(13) the transmittal to [the IESO] of information related to the amounts to be included in the determination of the Period Transition Charge for a Reference Period;

(14) the basis upon which any Disposition may be made or effected by a Regulatory Asset Owner, including parameters for determining the purchase price for the interest in the

Regulatory Asset that is the subject matter of such Disposition, and any consents and releases that may be usefully obtained in connection with such Disposition;

(15) a description of each special purchase entity that will purchase the Regulatory Asset from the IESO, including proposed capitalization, governance, and restrictions on their powers and activities having regard to the parameters in Schedule 4; and

(16) the basis on which any Pledge may be given or effected.

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Preliminary Draft for Discussion Purposes Only

Schedule 4

Creation of any Special Purpose Entity to become a Regulatory Asset Owner]

(1) Powers and Abilities:

a. No part of the revenue or assets of a Regulatory Asset Owner shall enure to the benefit or be distributable to its trustees, officers or directors, as the case may be, or any other private persons, except as may be

provided for actual services rendered;

b. Each Regulatory Asset Owner shall be authorized to:

i. incur the Funding Obligations contemplated by a Financing Plan and use the proceeds thereof to purchase or acquire, and to own, hold and use the Regulatory Asset;

ii. contract for servicing of the Restructuring Asset and any bonds

contemplated by a Financing Plan and for administrative services; and

iii. pledge the Regulatory Asset to secure the Funding Obligations incurred by the Regulatory Asset Owner;

c. So long as any Funding Obligations contemplated under a Financing Plan are outstanding, a Regulatory Asset Owner shall not be authorized to merge or

consolidate, directly or indirectly, with any person or entity;

d. a Regulatory Asset Owner shall not have the power or authority to incur or guarantee or otherwise become obligated to pay any debt or obligations other than what is contemplated under a Financing Plan;

e. a Regulatory Asset Owner shall cause the proceeds obtained by incurring any Funding Obligation to be

placed in one or more separate accounts and used only to purchase the Regulatory Asset and pay any costs as provided for in a Financing Plan; and

f. so long as the Regulatory Asset is pledged to secure Funding Obligations, the Regulatory Asset Owner must apply revenues from the collection of Transition Charges only to repay such Funding Obligations and other costs as provided for in a Financing Plan.

(2) Governance of Regulatory Asset Owner – A Regulatory Asset Owner shall be created having regard to the following principles:[***OPG to confirm if SPE will be a trust or another type of entity.***]

a. **[Number of trustees]**

b. **[Replacement of trustees; vacancies; appointment of successors]**

c. **[Removal of trustees for neglect of duty or misconduct]**

ONTARIO POWER GENERATION

February 27, 2017

Mr. Serge Imbrogno
Deputy Minister,
Ministry of Energy
4th Floor, Hearst Block
900 Bay Street
Toronto, Ontario
M7A 2E1

Dear Deputy:

Below is a summary of OPG's preliminary views on the implementation of the Province's proposed Global Adjustment Smoothing Account and financing structure. These views are contingent on the proposed terms and conditions that were sent to the Ministry of Energy on February 21, 2017.

Understanding that the finalization of the legal terms, the Trust indentures, financing structure and other detailed terms will take several months and will involve collaboration between legal counsel, input from capital markets, parties involved and other stakeholders, this letter is intended to provide the guideline and framework which could form the foundation of the plan.

Please do not hesitate to contact me if you have any questions regarding this summary.

Sincerely,

Mr. Ken Hartwick
Chief Financial Officer and Senior Vice President, Finance
Ontario Power Generation
W: 416-592-6985
C: 647-544-6985
ken.hartwick@ opg.com

cc. Jeff Lyash, President and CEO, OPG

Background:

The Province has indicated that it will take steps to reduce electricity bills in the near term. It has identified reductions in the Global Adjustment Charge (GAC) charged to electricity customers as a means to achieve its policy goals. The Province is proposing to temporarily reduce the amount of the GAC charged to electricity customers (primarily RPP-eligible customers). The exact quantum and duration of the program is still not known but based on discussions with the Province GAC charges of approximately $2-5B per year for the next 5-10 years would be deferred and collected over future periods commencing after the deferral period. A combination of senior debt and subordinated debt (mainly sourced by additional equity from the shareholder) would be issued to fund the amount deferred. The financing cost of the debt and other costs of running the program would form part of the amounts recovered from customers over the term of the program.

The Province has requested that OPG administer the GAC deferral, because of OPG's participation in the market, regulatory knowledge and the potential ability to consolidate the activity and accounting with OPG. Given the significant amount of financing required for the GAC deferral, OPG has developed a financing structure (depicted below) to:

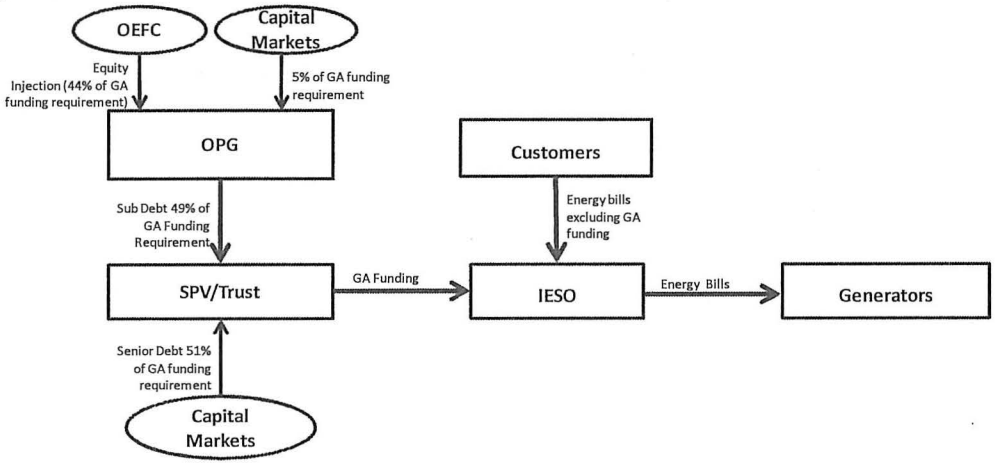
- restrict the risk to OPG;

- maximize the cost-effectiveness of the Trust or the Special Purpose Vehicle ("SPV") financing vehicle; and
- allow for consolidation into OPG financial statements.

The success of this structure is dependent on achieving a number of objectives which are reviewed in the following sections:

A. Ability to Recognize an Asset and Record Revenue
B. Ability to Consolidate the SPV into OPG
C. Ability to Finance
D. External Assessment
E. Risk Summary

All of the percentages shown in the graphic below are indicative and will be highly dependent on the legislation that the Province will enact:



Process:

The IESO will effectively sell the 'right to collect' deferred future revenue from ratepayers (GA Recovery Right asset) to the SPV in return for cash proceeds. In order for the SPV to purchase this asset the SPV will obtain the financing from two key sources: 51% directly from capital markets and 49% as subordinated debt from OPG. OPG will obtain 44% of this financing as an equity injection from the Province and 5% from capital markets.

A. Ability to Recognize an Asset and Record Revenue

Accounting Requirements under International Financial Reporting Standards (IFRS)

1) It is our understanding that the IESO and KPMG have concluded that the sale of this 'right to collect' future revenue (or regulatory asset) is not a financing transaction and will not be recorded as a financial liability. Based on that conclusion, the right to collect will be accounted for as an intangible asset in the SPV.

2) In order to the SPV to record this right as an intangible asset, the right must meet the following conditions:
   - The intangible asset must be separable and arise from a contractual or legal right (i.e. mandated by the Legislation and SPV Indenture Agreement).
   - The SPV must have the control and power to obtain future economic benefits from the intangible asset.
   - The SPV must be able to demonstrate that the intangible asset is purchased at fair value.

3) In order for the SPV to recognize appropriate revenue to offset any ongoing costs, the Legislation must require interest, carrying and administrative costs to be paid to the SPV on a monthly basis. This may result in additional amounts to be deferred to achieve the desired customer impact. Payment of revenue to the SPV is also important to service the interest expenses of the debt.

B. Ability to Consolidate the SPV into OPG under IFRS

OPG 'Control' of the SPV - Accounting Requirements

1) 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 SPV, or whether it has the ability to affect the returns of the SPV through its power over the SPV. Rather, all facts and circumstances are considered when assessing whether an entity has control over another entity. Based on the relevant accounting guidance under IFRS, OPG has proposed terms necessary to demonstrate that OPG has control over the SPV. OPG's external auditors, Ernst & Young, has provided their concurrence that based on the information provided to them to date that the following conditions should permit consolidation of the SPV by OPG.

Directive:

1. The SPV must be undertaken by OPG as a business initiative on its merits. A Shareholder Directive is to be limited to direct OPG to investigate the option of establishing a SPV vehicle to administer, finance and operate the Global Adjustment plan. The control, risk and rewards of that SPV will determine its consolidation into OPG as a business enterprise.

SPV:

2. The SPV should not operate in a predetermined way such that OPG does not have decision-making authority over the SPV's ongoing activities after its formation (i.e. should not operate on 'autopilot').
3. 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 SPV.
4. The Province cannot have the right to veto OPG's decisions about the relevant activities of the SPV. OPG must have the power over the relevant activities of the SPV and be compensated. The relevant activities of the SPV 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 SPV.
5. OPG must have the power to determine or change operating and financing policies of the SPV, which will affect the variability of risks and returns.
6. The Province or its agencies must not directly or indirectly fund (through debt or equity) more than 50% of the following:
    - The SPV
    - Any of OPG's investments in the most subordinated debt of the Trust
7. OPG must own greater than 50% of the most subordinated debt and targeted to be no less than 5%[1] of the total debt of the SPV. Such ownership must be financed entirely by OPG through operating cash flows or external debt, without assistance from Provincial sources. A quantitative analysis should be performed at a later date to corroborate the appropriateness of the 5% threshold to support that the 5% subordinated debt investment is sufficient to absorb most of the expected variability in the SPV.
8. OPG must have the ability to earn variable returns by exercising its authority, which shall be accomplished as follows:

[1] While the rest of the letter refers to a 10% investment in the most junior subordinated debt with OPG owning 5%, it should be noted that OPG should own more than 50% of the most subordinate debt. For simplicity, the degree to which OPG's ownership beyond 50% is not shown in this letter.

a. The cash flow from the restructured asset shall include interest determined based on a relevant benchmark that is appropriate relative to the restructured asset, plus an appropriate margin consistent with the relevant market and other risks
b. OPG shall have the authority to determine the financing strategy, which will vary the financing costs with the objective of enabling the SPV to achieve a more favourable return compared to the return from the restructured asset
c. The SPV shall establish classes of liabilities (senior, subordinated and the most subordinated). The classes would allow the SPV 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.
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.
e. OPG should participate in the detailed design of the above and the SPV 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.

Nothwithstanding the above, under certain 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), the OEFC may provide bridge financing beyond the designated percentage for a defined period. The relevant terms should ensure that this temporary measure does not detract from the rights of OPG to direct all of the relevant activities of the SPV. Additionally, OPG should not be protected from risk of loss by the OEFC with respect to its subordinated investment, nor should it lose its right to derive the residual returns should such bridge financing be required.

Legislation

9. The Legislation must require interest, carrying and administrative costs to be paid to the SPV on a monthly basis, so that the SPV is able to recognize appropriate revenue to offset any ongoing costs.
10. The Legislation must dictate the manner in which the restructured 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 Trustees.
11. The Legislation must be written to avoid legal or constitutional challenges and be irrevocable to reduce the cost of borrowing and with a specific formula which determines the deferral amount. As irrevocability would be difficult under Canadian law one mitigation would be to provide a Provincial guarantee which only applies with cancellation or amendment of the legislation.
12. The spirit of the above terms should be reflected in the SPV Indenture Agreement as well as Legislation, wherever possible.

2) The Trust is expected to be financed as follows:
   - 51% senior secured debt from external markets
   - 39% senior subordinated debt from OPG (via Province equity injection into OPG)

- 10% junior subordinated debt from OPG (5% from external markets and 5% from Province equity injection into OPG).

When assessing control, an investor shall consider the nature of its relationship with other parties and whether those parties are acting on the investor's behalf (i.e. they are 'de facto agents'). If OPG is assessed to be a 'de facto agent' of the Province, it will compromise the ability for OPG to consolidate the Trust. The split above is to meet the following conditions to ensure that OPG is not considered a 'de facto agent' of the Province:

- The Province or its agencies must not directly or indirectly fund (through debt or equity) more than 50% of the following:
  - The Trust
  - Any of OPG's investments in the most subordinated debt of the Trust
- OPG must own greater than 50% of the most subordinated debt and targeted to own no less than 5% of the total debt of the Trust. Such ownership must be financed entirely by OPG through operating cash flows or external debt, without assistance from Provincial sources.

3) The Province will need to conclude on whether OPG still meets the definition of a Government Business Enterprise as defined under Public Sector Accounting Board standards in order to obtain the preferred consolidation treatment after the transaction. We also recommend that the Province to undertake the analysis deemed necessary to confirm the accounting treatment in its consolidated Public Accounts, including if the recognition of the intangible asset would result in an offsetting liability in the Public Accounts.

C. Ability to Finance

Property Right or Right to Collect
Legislative Requirements for Financing
The GA Recovery Right must be structured to encompass the following elements:

- Right to recover from and bill Ontario electricity customers for (1) the principal amount of GA that is being deferred, (2) all interest and other financing costs incurred in respect of the deferral of the GA, (3) all fees, expenses and other administrative costs associated with such financing;
- Repayment/amortization schedule as agreed by the IESO and any purchaser of such GA Recovery Right (or pursuant to a pre-defined schedule/formula that covers all of the purchaser's principal, interest and ongoing financing costs on a monthly basis);
- Repayment/amortization schedule must include a true up mechanism to ensure all costs associated with the deferral can be recovered from customers;
- IESO may dispose of the GA Recovery Right, provided that any such disposition shall be a true sale and absolute transfer to the purchaser of the IESO's right, title and interest in and to the GA Recovery Right;
- Purchaser will have the right to require the IESO (or any successor) to collect the principal amount of GA Recovery Right, together with interest, financing and administration costs, on the agreed repayment/amortization schedule;
- Right must be irrevocable and, if amended by future governments, debt holders have the right of action against the government to recover the amount outstanding including interest, fees, expenses and any damages resulting from the amendment;
- GA Recovery Right will not be subject to any set-off, counterclaim or other defence by the IESO or any successor or affiliated entity; and
- Make certain amendments to the Electricity Act to allow OPG to implement the SPV financing structure (e.g. allowing OPG to create subsidiaries and holding companies, and to have a beneficial interest in the SPV, etc). This would provide flexibility to accommodate possible variations to the financing structure that may be desirable over time.

Detailed legislative requirements are specified in the attachments as follows:

Attachment 1 Legislative requirements to allow deferral of global adjustment amounts to be financeable

Attachment 2 Statutory amendments

The proposed financing structure for the SPV is:

	Risk Profile	Source	% of Total Funding Requirements
Tranche A Senior Debt	The least risky	Capital Markets	51%
Tranche B Sub Debt	In between A&C	OPG via OEFC	39%
Tranche C Sub Debt)	The most risky	OPG via OEFC	5%
		OPG via Capital Markets	5%

SPV structure is used to accomplish the following:

- SPV holds right to charge customers for the benefit of debt holders;
- Allows the financing vehicle to be ring-fenced from OPG as an SPV structure is set up as generally single purpose entities with no other operations that could add risk to the SPV, dilute debt holder rights, allow parties from other operations to claim rights to the future recovery from customers or allow these other parties to initiate bankruptcy proceedings;
- Enables SPV to potentially get a higher credit rating than OPG;
- Supports consolidation with OPG provided accounting requirements are satisfied;

This approach supports a number of objectives of the GA Recovery Right:

- 51% external senior debt supports separation of the SPV from the Province
- 5% junior subordinated debt establishes OPG's "at risk" equity which supports separation of the SPV from the Province
- Subordinated debt provides flexibility to the financing structure and additional credit support to external debt holders
- Subordinated debt sourced from OPG (mainly funded by equity injection from the Province) minimizes impact on OPG credit metrics reducing risk of an OPG rating downgrade that could result in the SPV being consolidated directly with the Province as the SPV would be considered an arm of the Province.

Recent transactions used as precedents are:

Duke Energy Florida Project Finance LLC
June 2016
5 series of bonds totalling USD$1.3B
Weighted average life from 2 to 19 years with interest rates from 1.2% to 3.1%
Credit rating AAA

Utility Debt Securitization Authority
Sponsored by Long Island Power Authority
March 2016
Amount issued USD$0.6B
Weighted average life of 12 years and weighted average yield of 2.7%

August 2016
Amount issued USD$0.5B
Weighted average life of 7 years and weighted average yield of 2.0%

Credit rating AAA

Cumulative outstanding (including previous issuances): USD$4.2B

D. External Assessment

Shakerhill Partners, an external advisor, identified the following items in an assessment of the structure and financeability of the structure:

- The structure is financeable however there are a number of significant risks to the structure:
  - Canadian and Ontario law does not provide the same protection to property right as exists in the US federal and state constitutions to limit the ability of governments to adversely impair contracts to the detriment of the holder;
  - Legislation could mitigate some of the risks – deferred recovery asset to be "uncapped", regular semi-annual true up to ensure recovery, Province provides sufficient committed liquidity to the IESO so that temporary shortfall in recovery does not affect payments to SPV, term of the deferral recovery substantially exceeds the longest maturity of debt of the SPV and that true-up mechanism take account of potential for currency, interest rate and duration mis-match between the debt of the SPV and the recovery mechanism;
  - Size of the program may be too large for Canadian securitization market requiring access to the US securitization market;
- Final maturity of debt should not exceed 30 years from inception of the program
- True up mechanism should be designed such that the forecast of recovery is less than 10% of the customer bill under downside scenarios to limit growth of the deferral balance as a higher portion of the customer bill increases the political risk to debt holders which could result in a lower credit rating and potential impact on financeability
- Securitized debt products are specialized and price at a premium to other fixed rate instruments however a successful program supported by a strong credit rating this premium could shrink over time to a minor spread over Provincial debt
- OPG's credit rating should be maintained provided sufficient equity is injected to maintain credit metrics
- While the structure is not expected to impact the Province there are risks that the program could negatively impact the rating agencies view of the Province's financial management.

E. Risk Summary

i. Consolidation

- Elements of the proposed structure were established to support consolidation of the SPV into OPG. These items may not be sufficient to establish OPG as risk owner of the SPV and the SPV may need to be consolidated directly with the Province.

ii. Financeability

- The legislation establishing the structure and the property right for recovering the financing and associated costs may not be adequate for financing purposes resulting in more expensive financing or an inability to obtain the required external financing.

iii. Cost of Financing

- Future governments may enact legislation that changes the right of the SPV to recover amounts from customers.
- The right to recover amounts from future customers must be irrevocable and subject to full recovery from the government in the event that future governments reduce or eliminate the recovery. A legal structure that is weaker than the precedent US transactions increases the risk to debt holders and the cost of financing.
- Interest rates on bonds in the securitization market are higher than equivalent rated bonds. Rate for a AAA securitization credit is about 50 bps higher than GOC (rated AAA) for a 5 year term. This difference is attributable to the specialized structure of the bond, smaller investor pool for this bond, smaller size of the market and higher perceived risks of the bond.
- Any regulator involvement must not be seen to modify any terms of debt issued or the property right securing the debt as this would increase risk to debt holders.

- It may not be possible to issue debt to match the terms of the deferred asset so shorter term debt would be used which raises risk to re-finance the maturing debt as the market may no longer be interested in this product. As well, underlying reference interest rates may be higher and the market may require a higher spread to invest in this product.
- With the GA Recovery Right program continuing for 10 years, debt issued over this period is subject to changes in both the underlying reference interest rates and appetite of the market for this product.

iv. OPG Credit Rating

- Minimizing the impact of significant additional debt on OPG's credit rating is dependent on higher EBITDA arising from earned income on the GA Recovery Right in excess of external debt. Ability of the SPV to record revenue reflecting the growth in asset value.
- Potential OPG credit rating downgrade if legislative structure is not adequate to support long term recoverability, inability to record revenue from growth in asset value or agencies view equity injection as debt.
- OPG credit rating downgrade could result in loss of GBE status or result in SPV being consolidated directly with the Province.

Attachment 1

LEGISLATIVE REQUIREMENTS TO ALLOW DEFERRAL OF GLOBAL ADJUSTMENT AMOUNTS TO BE FINANCEABLE

The IESO currently has a right to collect GA monthly from ratepayers through provisions in the *Electricity Act, 1998*. It is proposed that collection of a certain portion of the monthly GA be deferred for collection in the future, and that the right to recover the deferred GA from ratepayers be used as a basis for structured financing/securitization.

The current proposal is for a trust to be created as a financing vehicle (the "**Trust**") in connection the deferred GA. The Trust will finance the deferral of the GA by purchasing the right to recover such deferred GA from the IESO for the principal amount of the GA being deferred. For example, if the amount of GA that is being deferred is $200 million in a given month, the Trust will purchase from the IESO the right to future recovery of the deferred GA and the associated financing costs (including interest and transaction costs) for $200 million in cash.

The Trust is expected to finance these purchases from the IESO through a combination of senior secured financing raised in the capital markets and subordinated financing from OPG (the funding for which will mostly be from equity injections from the OEFC/Province).

For accounting purposes, OPG will need to have the ability to direct the activities of the Trust, through a services agreement and/or through the Trust's constating document.

Based on securitized financing raised by utilities in the US (backed by utility cost recovery orders) and the current regulatory framework in Ontario, the legislation in Ontario would need to be amended to provide the following, at a minimum:

1. The IESO will be empowered to create an asset (the "**Regulatory Asset**") consisting of all right, title and interest in and to:

   (a) right to recover from and bill Ontario electricity ratepayers for:

   (i) the principal amount of GA that is being deferred for collection;
   (ii) all interest and other financing costs incurred in respect of the deferral of the GA (whether through senior debt raised in the public markets or subordinated debt raised from OPG or others); and
   (iii) (subject to the comments in paragraph 5 below in respect of OPG's internal administrative costs only) all fees, expenses and other administrative costs associated with such financing, including up-front and ongoing financing costs and any indemnity payments;

all on such repayment/amortization schedule as agreed by the IESO and any purchaser of such right (or pursuant to a pre-defined schedule/formula in the legislation that covers all of the purchaser's principal, interest and ongoing financing costs on a monthly basis); and

(b) all revenues, collections, claims, rights to payments, money or proceeds arising from the rights and interests set out in paragraph (a) above, regardless of whether such revenues, collections, claims, rights to payments, money or proceeds are imposed, billed, received, collected or maintained together with or commingled with other revenues, collections, rights to payments, payments, money or proceeds.

2. The IESO may dispose of the Regulatory Assets created from time to time on such terms as the IESO determines in accordance with the terms of directives to be issued to the IESO from time to time by the Minister, provided that any such disposition shall be a true sale and absolute transfer of the IESO's right, title and interest in and to a Regulatory Asset to the purchaser of the Regulatory Asset.

3. The Regulatory Assets will not be subject to any set-off, counterclaim or other defence by the IESO or any successor or affiliated entity thereof.

4. The legislation will need to recognize the Regulatory Assets as amounts that may be recovered by the IESO (e.g. it could be designated as a "GA Deferral" and would be included in the amounts collectible by the IESO through the GA collection mechanism, and would include interest and financing costs).

5. The purchaser of the Regulatory Asset will have the right to require the IESO (or any successor) to collect the principal amount of GA deferred, together with interest, financing and administration costs, on the agreed repayment/amortization schedule. **[NTD: In the LIPA securitization rate order, if the entity that is authorized to collect rates to service the bonds ends up defaulting, there is the ability to request a court to order "sequestration" and payments of amounts owing to the owner of the Regulatory Asset. Consider whether to include a similar right here. Alternatively, consider whether a security interest over the moneys collected by the IESO could be provided to the purchaser.]**

OEB would be provided with oversight over the internal administrative costs collected by the Financing Trust. This could be accomplished by (a) providing the purchaser of the Regulatory Asset with the right to require

the IESO or a successor to collect only the principal amount of GA together with interest and financing costs and third party fees and expenses, and (b) requiring the IESO to collect amounts through the global adjustment and make payments to the purchaser of the Regulatory Asset with respect to the internal administrative costs incurred by the purchaser in connection with the purchase and management of the Regulatory Asset and the Financing Trust, in accordance with the order of the OEB then in effect. Under this mechanism, the OEB would be required to review the purchaser's internal administrative costs through a streamlined process and issue such orders in accordance with rules to be prescribed under a new regulation under the OEB Act, which would clearly limit the OEB's scope of review and could establish the basis for the purchaser to receive an appropriate fee for its services.

6. In the event that any action is taken or permitted by the Province or any regulatory authority that limits, alters, or impairs the value of a Regulatory Asset or reduces the ability of the IESO or the purchaser of the Regulatory Asset to collect or recover the costs associated therewith, the owner of the Regulatory Asset and the holders of any bonds or other securities issued to finance the purchase of the Regulatory Asset, will have a right of action against the Province for any damages suffered as a result of such amendment.

Attachment 2

STATUTORY AMENDMENTS

The following is preliminary and is based on our current understanding of the proposed structure and objectives. For example, we have assumed that the structure will not entail the insertion of a new Holdco between OPG and the Province. As these aspects are refined, some of the suggested amendments described below may not be needed and other aspects that we are not aware of may need to be considered. Accordingly, these suggested amendments are provided for discussion purposes and are subject to change. We would welcome the opportunity to work with OPG and the Ministry on refining the scope and substance of required legislative and regulatory amendments.

A. Amendments to Implement Structure

Certain *Electricity Act, 1998* amendments would be needed to implement the anticipated structure (which we understand, as noted above, would not include a Holdco), as follows:

- **Section 53.1(1):** Amend to permit owning and operating generation facilities through subsidiaries (not only directly through OPG). In addition, amend to permit OPG to administer, manage, loan moneys to and have a beneficial interest in, if applicable, Financing Trust.

- **Section 53.2:** Amend to permit the Minister to acquire, hold, dispose of or otherwise deal with securities or debt obligations of, or any other interest in, OPG or any subsidiaries. This is to accommodate possible variations to the financing structure that may be desirable over time.

- **Section 53.■ (new):** New statutory section to permit the Minister to enter into arrangements relating to an exercise of powers under 53.2.

- **Section 53.■ (new)**: New statutory section providing that creditors of Financing Trust have no recourse to the assets of OPG or any of its subsidiaries (other than Financing Trust, if applicable). In addition, consideration should be given as to whether the Act should be amended so that the Financing Trust cannot be wound up or liquidated.

B. Miscellaneous Corporate Items to Address

- **OPG Articles:** Amend the OPG's articles to remove the private company restrictions.

- **MOA with Province:** Consider whether any amendments to OPG's MOA with the Province are required to contemplate the Financing Trust.

C. Amendments Under Electricity Act to Implement GA Smoothing

Based on our understanding that the global adjustment smoothing mechanism is intended to benefit residential and small business customers only and that the Minister will be responsible for determining how much global adjustment smoothing is to be applied in a given month, if any, amendments to the *Electricity Act, 1998* and Ontario Regulation 429/04 (Adjustments Under Section 25.33 of the Act) would be needed to implement the mechanism, as follows:

(i) Electricity Act:

- **Section ■ (New):** Establish a new power for the Minister to make directives to the IESO in relation to the global adjustment smoothing mechanism and, particularly, for purposes of establishing global adjustment smoothing amounts from time to time (expected to be monthly). To the extent possible, the directive power should be drafted so as to limit the ability for a future Minister to require the IESO to do anything that would materially and adversely affect the Financing Trust or its lenders. **[NTD: While our understanding is that the Minister would direct this, we note from other materials we have seen that OPG may instead be recommending a formula approach. It is not clear what the formula would look like, where it would be set out or how it would be applied and by whom]**

- **Paragraph 25.33(1):** This section says that IESO shall make adjustments in accordance with the regulations to ensure that, over time, payments by prescribed classes of market participants reflect amounts paid to OPG, OEFC and distributors, as well as amounts paid to entities with whom IESO has a procurement contract. Add new subsection (c) so as to require IESO to ensure that, over time, payments by prescribed classes of market participants also reflect amounts paid to Financing Trust. **[NTD: Not certain this is needed if only to benefit residential and small business consumers, who are not market participants. May be needed in reference to payments from distributors and retailers]**

- **Paragraph 25.33(2):** This section says that distributors and retailers shall make adjustments in accordance with the regulations to ensure that, over time, payments by prescribed classes of consumers reflect amounts paid to OPG, OEFC and distributors, as well as amounts paid to entities with whom IESO has a procurement contract. Add new subsection (c) so as to require distributors and retailers to ensure that, over time, payments by prescribed classes of consumers also reflect amounts paid to Financing Trust.

- Note: As described below, the regulation will need to include new requirements for the IESO to record the global adjustment smoothing amounts in one or more variance accounts and to use those amounts to offset amounts otherwise recorded in the variance accounts under Section 25.33(3) of the Act. For context, we note:

    - Section 25.33(3) says that adjustments under (1) or (2) relating to electricity consumed by consumers whose rates are determined by

the OEB under s. 79.16 of the OEB Act (i.e. RPP Customers) shall instead be made in accordance with the regulations to one or more variance accounts established and maintained by the IESO.

- Section 25.33(4) says IESO, distributors and retailers shall make and receive such payments, set-offs and credits as may be required or permitted by the regulations with respect to consumers described in (3), i.e. RPP Customers.

- Section 25.33(5) says that IESO shall establish and maintain such variance accounts as may be needed to record all amounts payable or receivable by it under 25.33.

(ii) O. Reg. 429/04 (Adjustments Under Section 25.33 of the Act):

- **Section 1(1):** Consider adding definitions for "Financing Trust" and "global adjustment smoothing amount" or such other terms as may be preferred.

- **Section 1.2(1) (New):** Add section providing that, for the purposes of this Regulation, the global adjustment smoothing amount for a month is the amount determined by the IESO in accordance with a directive from the Minister under section ■ of the Electricity Act in respect of the month. **[NTD: See above note re use of Minister directives]**

- **Section 1.2(2) (New):** Consider adding a section providing that the IESO shall publish the global adjustment smoothing amount for a month by no later than the 10th business day of the following month [to align with general publication requirements for global adjustment under s. 1.1(2)].

- **Section 10(1):** Amend formula for calculating Class B GA rate by subtracting the global adjustment smoothing amount for a month from "M", which is the total amount of the global adjustment for the month. The global adjustment smoothing amount could be designated as "X", such that the formula would be (M-X-N)/(P-Q). Define "X" as the global adjustment smoothing amount for the month as determined by the IESO in accordance with the Minister's directive under section ■ of the Electricity Act for the month. **[NTD: See above note re use of Minister directives]**

- **Section 10.1 (New):** Add new section to deal with adjustments under subsection 25.33(3) of the Act, i.e. in respect of RPP consumers. This section should require the IESO to establish, within the variance account(s) it maintains pursuant to subsection 25.33(3) of the Act, one or more subaccounts in which it shall record the global adjustment smoothing amounts applicable to the classes of consumers described in subsection 25.33(3) of the Act. This section must also specify that the IESO shall apply the amounts recorded in the subaccounts against the balances in the variance accounts for purposes of section 79.16(3) of the OEB Act.

- **Note:** This is a key aspect because, when the OEB determines RPP rates, it must take into account the balances in the variance accounts established by the IESO under s. 25.33 of the Electricity Act and make adjustments with a view to eliminating the balances within 12 months. This proposed new section 10.1 causes the IESO to reduce (in the near term) the variance account balances by the global adjustment smoothing amounts, as provided by Financing Trust, thereby enabling the OEB to determine RPP rates that, despite being lower for RPP consumers in the near term, still eliminate the relevant variance account balances within 12 months.

- **Paragraph 11(2)2.ii:** Amend the formula for calculating the allocation of global adjustment for a month to a licensed distributor that is a market participant by subtracting the global adjustment smoothing amount for a month from "M", which has the same meaning as under section 10(1). The global adjustment smoothing amount could be designated as "X", such that the formula would be [(M-X-N) x (R+S-T)]/(P-Q). Define "X" as suggested under section 10(1).

- **Paragraph 11(2)3:** Amend the formula for calculating the allocation of global adjustment for a month to each Class B market participant by subtracting the global adjustment smoothing amount for a month from "M", which has the same meaning as under section 10(1). The global adjustment smoothing amount could be designated as "X", such that the formula would be [(M-X-N) x U]/(P-Q). Define "X" as suggested under section 10(1).

- **Paragraph 16(7)4:** Consider amending the description of "Global Adjustment" that is required to be included on certain invoices so as to inform consumers that their portion of the global adjustment for the month (i) may have been reduced by the application of a global adjustment smoothing amount from the Financing Trust, or (ii) may include amounts payable to the Financing Trust in respect of global adjustment smoothing amounts previously applied.

- **Section 20(1):** This section establishes an obligation for the Ontario Electricity Financial Corporation and every licensed distributor that is a market participant to give the IESO such information as the IESO may require for the purposes of the Regulation in the form specified by the IESO and before the expiry of the period specified by the IESO. Consider amending to extend this obligation to the Financing Trust.

- **Section 20(6):** This section provides that on request by the OEB, the IESO, a licensed distributor, an embedded generator, a retailer or the OEFC shall give the OEB such information relating to this Regulation as the OEB may require, in the form and within the period specified by the OEB. Consider amending to extend this obligation to the Financing Trust.

D. Amendments Under OEB Act to Implement Cost Recovery for Financing Trust

Amendments to the *Ontario Energy Board Act*, including amendments to O. Reg. 95/05 (Classes of Consumers and Determination of Rates) and the introduction of a new regulation, would be needed to implement a cost recovery process for the Financing Trust in relation to the global adjustment smoothing mechanism, potentially with limited OEB oversight, as follows:

(i) Ontario Energy Board Act:

- **Section 78(3.3):** This provision establishes an obligation for the OEB, when determining rates for the retailing of electricity, to take into account balances in variance accounts established under section 25.33 of the Electricity Act and to make adjustments "with a view to eliminating those balances within 12 months or such shorter time periods as the Minister may direct." Consider whether any amendments are needed, and confirm this works with the framework being proposed.

- **Section 78.7 (New):** We understand that the Province may want the OEB to have an oversight role. One possible approach would be to establish a new statutory section establishing that the IESO shall make payments to the Financing Trust with respect to the internal administrative costs incurred by the Financing Trust in connection with the purchase and management of the Regulatory Asset and the Financing Trust. Such payments by the IESO would need to be made in accordance with the order of the OEB then in effect, which orders shall be made by the OEB in accordance with rules prescribed under a new regulation.

    - The new regulation would need to be clear that the OEB does not have jurisdiction to consider the principal amount or any interest, financing costs, third party fees or expenses. Rather, OEB's role would be limited to considering the internal administrative costs of the Financing Trust and ensuring the Financing Trust receives an appropriate fee for its services, all of which would be recovered by the Financing Trust from the IESO, which would collect those amounts in the global adjustment. Note that, if this approach is accepted, the IESO and distributors and retailers would need the authority to collect such amounts as part of the GA and IESO would need the authority to pay such amounts to the Financing Trust. As such, additional amendments would be needed under O. Reg. 429/04.

- **Note:** Section 79.16 of the OEB Act does not require changes, but the significance of this provision should be understood.

    - Section 79.16 gives the OEB responsibility for determining electricity commodity prices for eligible consumers. Eligibility is determined under Reg. 95/05 (Classes of Consumers and Determination of Rates), which is also known as the Regulated Price Plan (RPP) Regulation.
    - Section 4(2) of the RPP Regulation defines RPP-eligible consumers as low volume consumers (i.e. those who annually use less than 150,000 kWh

or such other amount as prescribed), consumers with demand of 50 kW or less, residential consumers that have accounts with distributors, consumers who annually use 150,000 to 250,000 kW of electricity, and consumers who have accounts with distributors if in the farming business.

- Paragraph 6(1)3 of the RPP Regulation provides that "In determining the rates (for RPP-eligible consumers), the Board shall forecast the cost of electricity to be consumed by the consumers to whom the rates apply, taking into consideration adjustments required under section 25.33 of the *Electricity Act, 1998* and shall ensure that the rates reflect those costs."
- The Ontario Energy Board has developed a Regulated Price Plan Manual (revised February 16, 2016) to describe the processes and methodologies it uses for determining electricity commodity prices that are charged to RPP consumers pursuant to Section 79.16 of the OEB Act and paragraph 6(1)3 of the RPP Regulation.

(ii) O. Reg. 95/05 (Classes of Consumers and Determination of Rates)

- **Paragraph 6(1)3:** Amend so as to require the Board, when forecasting the cost of electricity to be consumed by the consumers to whom the rates apply, to take into consideration not only the adjustments required under section 25.33 of the Electricity Act but also the application or prior application of global adjustment smoothing amounts determined by the IESO in accordance with Minister directives under section ■ of the Electricity Act, and to ensure that the RPP rates reflect those amounts. **[NTD: See above note re use of Minister directives]**

(iii) New Regulation (Payments to the Financing Trust)

- If the OEB is to be given the role of reviewing and approving the recovery of OPG's internal administrative costs for the Financing Trust under the potential section 78.7 (see above), then this regulation should describe the process and criteria pursuant through which the OEB would determine the amounts that the IESO would be required to collect through the global adjustment, in accordance with section 25.33 of the Electricity Act, and pay to the Financing Trust in respect of the provision of global adjustment smoothing amounts. This part of the regulation should establish:

    - any reporting requirements from the Financing Trust and/or the IESO to the OEB in connection with the global adjustment smoothing mechanism;
    - the frequency of the OEB making determinations under this part of the regulation;
    - the process through which the OEB shall make these determinations, which should be a streamlined administrative process rather than a public hearing process or, if a hearing is needed, then the scope of the proceeding should be clearly and narrowly constrained so as to deter intervenor involvement, lengthy proceedings and reduce/eliminate risk to recovery by Financing Trust;

- the basis for the OEB's determinations as to the payments that shall be made to the Financing Trust, which should specify that:
  - the Financing Trust shall recover its prudently incurred internal administrative costs on a forecast basis each year;
  - the Financing Trust shall receive an appropriate fee each year (with some guidance as to what would be appropriate); and
  - the approved payment amounts shall be collected by the IESO through the global adjustment and paid to the Financing Trust in accordance with the order of the OEB then in effect. Note that O. Reg. 429/04 would likely need amendments to permit IESO (and distributors and retailers) to collect these amounts through the global adjustment.

ONTARIO POWER GENERATION

February 27, 2017

Mr. Serge Imbrogno
Deputy Minister,
Ministry of Energy
4th Floor, Hearst Block
900 Bay Street
Toronto, Ontario
M7A 2E1

Dear Deputy:

Below is a summary of OPG's preliminary views on the implementation of the Province's proposed Global Adjustment Smoothing Account and financing structure. These views are contingent on the proposed terms and conditions that were sent to the Ministry of Energy on February 21, 2017.

Understanding that the finalization of the legal terms, the Trust indentures, financing structure and other detailed terms will take several months and will involve collaboration between legal counsel, input from capital markets, parties involved and other stakeholders, this letter is intended to provide the guideline and framework which could form the foundation of the plan.

Please do not hesitate to contact me if you have any questions regarding this summary.

Sincerely,

Mr. Ken Hartwick
Chief Financial Officer and Senior Vice President, Finance
Ontario Power Generation
W: 416-592-6985
C: 647-544-6985
ken.hartwick@ opg.com

cc. Jeff Lyash, President and CEO, OPG

Background:

The Province has indicated that it will take steps to reduce electricity bills in the near term. It has identified reductions in the Global Adjustment Charge (GAC) charged to electricity customers as a means to achieve its policy goals. The Province is proposing to temporarily reduce the amount of the GAC charged to electricity customers (primarily RPP-eligible customers). The exact quantum and duration of the program is still not known but based on discussions with the Province GAC charges of approximately $2-5B per year for the next 5-10 years would be deferred and collected over future periods commencing after the deferral period. A combination of senior debt and subordinated debt (mainly sourced by additional equity from the shareholder) would be issued to fund the amount deferred. The financing cost of the debt and other costs of running the program would form part of the amounts recovered from customers over the term of the program.

The Province has requested that OPG administer the GAC deferral, because of OPG's participation in the market, regulatory knowledge and the potential ability to consolidate the activity and accounting with OPG. Given the significant amount of financing required for the GAC deferral, OPG has developed a financing structure (depicted below) to:

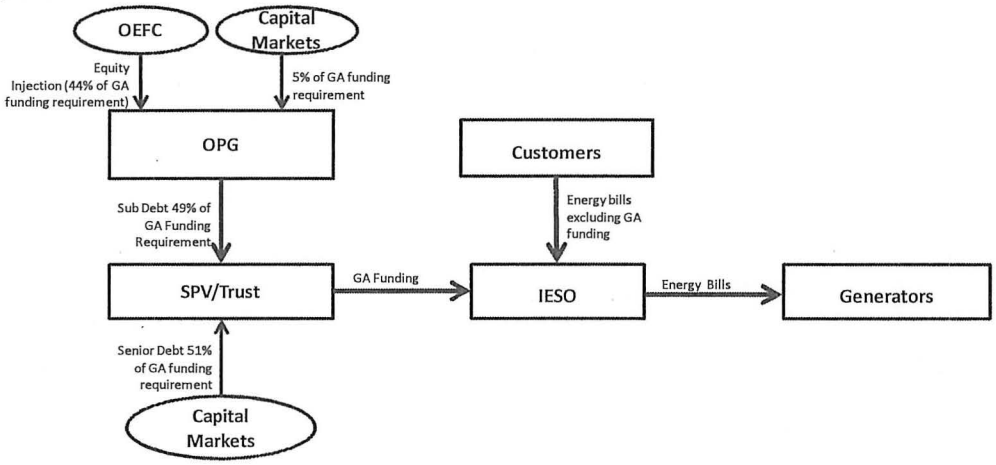
- restrict the risk to OPG;

- maximize the cost-effectiveness of the Trust or the Special Purpose Vehicle ("SPV") financing vehicle; and
- allow for consolidation into OPG financial statements.

The success of this structure is dependent on achieving a number of objectives which are reviewed in the following sections:

A. Ability to Recognize an Asset and Record Revenue
B. Ability to Consolidate the SPV into OPG
C. Ability to Finance
D. External Assessment
E. Risk Summary

All of the percentages shown in the graphic below are indicative and will be highly dependent on the legislation that the Province will enact:



Process:

The IESO will effectively sell the 'right to collect' deferred future revenue from ratepayers (GA Recovery Right asset) to the SPV in return for cash proceeds. In order for the SPV to purchase this asset the SPV will obtain the financing from two key sources: 51% directly from capital markets and 49% as subordinated debt from OPG. OPG will obtain 44% of this financing as an equity injection from the Province and 5% from capital markets.

A. Ability to Recognize an Asset and Record Revenue

Accounting Requirements under International Financial Reporting Standards (IFRS)

1) It is our understanding that the IESO and KPMG have concluded that the sale of this 'right to collect' future revenue (or regulatory asset) is not a financing transaction and will not be recorded as a financial liability. Based on that conclusion, the right to collect will be accounted for as an intangible asset in the SPV.

2) In order to the SPV to record this right as an intangible asset, the right must meet the following conditions:
   - The intangible asset must be separable and arise from a contractual or legal right (i.e. mandated by the Legislation and SPV Indenture Agreement).
   - The SPV must have the control and power to obtain future economic benefits from the intangible asset.
   - The SPV must be able to demonstrate that the intangible asset is purchased at fair value.

3) In order for the SPV to recognize appropriate revenue to offset any ongoing costs, the Legislation must require interest, carrying and administrative costs to be paid to the SPV on a monthly basis. This may result in additional amounts to be deferred to achieve the desired customer impact. Payment of revenue to the SPV is also important to service the interest expenses of the debt.

B. Ability to Consolidate the SPV into OPG under IFRS

OPG 'Control' of the SPV - Accounting Requirements

1) 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 SPV, or whether it has the ability to affect the returns of the SPV through its power over the SPV. Rather, all facts and circumstances are considered when assessing whether an entity has control over another entity. Based on the relevant accounting guidance under IFRS, OPG has proposed terms necessary to demonstrate that OPG has control over the SPV. OPG's external auditors, Ernst & Young, has provided their concurrence that based on the information provided to them to date that the following conditions should permit consolidation of the SPV by OPG.

Directive:

1. The SPV must be undertaken by OPG as a business initiative on its merits. A Shareholder Directive is to be limited to direct OPG to investigate the option of establishing a SPV vehicle to administer, finance and operate the Global Adjustment plan. The control, risk and rewards of that SPV will determine its consolidation into OPG as a business enterprise.

SPV:

2. The SPV should not operate in a predetermined way such that OPG does not have decision-making authority over the SPV's ongoing activities after its formation (i.e. should not operate on 'autopilot').
3. 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 SPV.
4. The Province cannot have the right to veto OPG's decisions about the relevant activities of the SPV. OPG must have the power over the relevant activities of the SPV and be compensated. The relevant activities of the SPV 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 SPV.
5. OPG must have the power to determine or change operating and financing policies of the SPV, which will affect the variability of risks and returns.
6. The Province or its agencies must not directly or indirectly fund (through debt or equity) more than 50% of the following:
    - The SPV
    - Any of OPG's investments in the most subordinated debt of the Trust
7. OPG must own greater than 50% of the most subordinated debt and targeted to be no less than 5%[1] of the total debt of the SPV. Such ownership must be financed entirely by OPG through operating cash flows or external debt, without assistance from Provincial sources. A quantitative analysis should be performed at a later date to corroborate the appropriateness of the 5% threshold to support that the 5% subordinated debt investment is sufficient to absorb most of the expected variability in the SPV.
8. OPG must have the ability to earn variable returns by exercising its authority, which shall be accomplished as follows:

[1] While the rest of the letter refers to a 10% investment in the most junior subordinated debt with OPG owning 5%, it should be noted that OPG should own more than 50% of the most subordinate debt. For simplicity, the degree to which OPG's ownership beyond 50% is not shown in this letter.

a. The cash flow from the restructured asset shall include interest determined based on a relevant benchmark that is appropriate relative to the restructured asset, plus an appropriate margin consistent with the relevant market and other risks
b. OPG shall have the authority to determine the financing strategy, which will vary the financing costs with the objective of enabling the SPV to achieve a more favourable return compared to the return from the restructured asset
c. The SPV shall establish classes of liabilities (senior, subordinated and the most subordinated). The classes would allow the SPV 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.
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.
e. OPG should participate in the detailed design of the above and the SPV 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.

Nothwithstanding the above, under certain 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), the OEFC may provide bridge financing beyond the designated percentage for a defined period. The relevant terms should ensure that this temporary measure does not detract from the rights of OPG to direct all of the relevant activities of the SPV. Additionally, OPG should not be protected from risk of loss by the OEFC with respect to its subordinated investment, nor should it lose its right to derive the residual returns should such bridge financing be required.

Legislation

9. The Legislation must require interest, carrying and administrative costs to be paid to the SPV on a monthly basis, so that the SPV is able to recognize appropriate revenue to offset any ongoing costs.
10. The Legislation must dictate the manner in which the restructured 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 Trustees.
11. The Legislation must be written to avoid legal or constitutional challenges and be irrevocable to reduce the cost of borrowing and with a specific formula which determines the deferral amount. As irrevocability would be difficult under Canadian law one mitigation would be to provide a Provincial guarantee which only applies with cancellation or amendment of the legislation.
12. The spirit of the above terms should be reflected in the SPV Indenture Agreement as well as Legislation, wherever possible.

2) The Trust is expected to be financed as follows:
   - 51% senior secured debt from external markets
   - 39% senior subordinated debt from OPG (via Province equity injection into OPG)

- 10% junior subordinated debt from OPG (5% from external markets and 5% from Province equity injection into OPG).

When assessing control, an investor shall consider the nature of its relationship with other parties and whether those parties are acting on the investor's behalf (i.e. they are 'de facto agents'). If OPG is assessed to be a 'de facto agent' of the Province, it will compromise the ability for OPG to consolidate the Trust. The split above is to meet the following conditions to ensure that OPG is not considered a 'de facto agent' of the Province:

- The Province or its agencies must not directly or indirectly fund (through debt or equity) more than 50% of the following:
  - The Trust
  - Any of OPG's investments in the most subordinated debt of the Trust
- OPG must own greater than 50% of the most subordinated debt and targeted to own no less than 5% of the total debt of the Trust. Such ownership must be financed entirely by OPG through operating cash flows or external debt, without assistance from Provincial sources.

3) The Province will need to conclude on whether OPG still meets the definition of a Government Business Enterprise as defined under Public Sector Accounting Board standards in order to obtain the preferred consolidation treatment after the transaction. We also recommend that the Province to undertake the analysis deemed necessary to confirm the accounting treatment in its consolidated Public Accounts, including if the recognition of the intangible asset would result in an offsetting liability in the Public Accounts.

C. Ability to Finance

Property Right or Right to Collect
Legislative Requirements for Financing
The GA Recovery Right must be structured to encompass the following elements:

- Right to recover from and bill Ontario electricity customers for (1) the principal amount of GA that is being deferred, (2) all interest and other financing costs incurred in respect of the deferral of the GA, (3) all fees, expenses and other administrative costs associated with such financing;
- Repayment/amortization schedule as agreed by the IESO and any purchaser of such GA Recovery Right (or pursuant to a pre-defined schedule/formula that covers all of the purchaser's principal, interest and ongoing financing costs on a monthly basis);
- Repayment/amortization schedule must include a true up mechanism to ensure all costs associated with the deferral can be recovered from customers;
- IESO may dispose of the GA Recovery Right, provided that any such disposition shall be a true sale and absolute transfer to the purchaser of the IESO's right, title and interest in and to the GA Recovery Right;
- Purchaser will have the right to require the IESO (or any successor) to collect the principal amount of GA Recovery Right, together with interest, financing and administration costs, on the agreed repayment/amortization schedule;
- Right must be irrevocable and, if amended by future governments, debt holders have the right of action against the government to recover the amount outstanding including interest, fees, expenses and any damages resulting from the amendment;
- GA Recovery Right will not be subject to any set-off, counterclaim or other defence by the IESO or any successor or affiliated entity; and
- Make certain amendments to the Electricity Act to allow OPG to implement the SPV financing structure (e.g. allowing OPG to create subsidiaries and holding companies, and to have a beneficial interest in the SPV, etc). This would provide flexibility to accommodate possible variations to the financing structure that may be desirable over time.

Detailed legislative requirements are specified in the attachments as follows:

Attachment 1 Legislative requirements to allow deferral of global adjustment amounts to be financeable

Attachment 2 Statutory amendments

The proposed financing structure for the SPV is:

	Risk Profile	Source	% of Total Funding Requirements
Tranche A Senior Debt	The least risky	Capital Markets	51%
Tranche B Sub Debt	In between A&C	OPG via OEFC	39%
Tranche C Sub Debt)	The most risky	OPG via OEFC	5%
		OPG via Capital Markets	5%

SPV structure is used to accomplish the following:

- SPV holds right to charge customers for the benefit of debt holders;
- Allows the financing vehicle to be ring-fenced from OPG as an SPV structure is set up as generally single purpose entities with no other operations that could add risk to the SPV, dilute debt holder rights, allow parties from other operations to claim rights to the future recovery from customers or allow these other parties to initiate bankruptcy proceedings;
- Enables SPV to potentially get a higher credit rating than OPG;
- Supports consolidation with OPG provided accounting requirements are satisfied;

This approach supports a number of objectives of the GA Recovery Right:

- 51% external senior debt supports separation of the SPV from the Province
- 5% junior subordinated debt establishes OPG's "at risk" equity which supports separation of the SPV from the Province
- Subordinated debt provides flexibility to the financing structure and additional credit support to external debt holders
- Subordinated debt sourced from OPG (mainly funded by equity injection from the Province) minimizes impact on OPG credit metrics reducing risk of an OPG rating downgrade that could result in the SPV being consolidated directly with the Province as the SPV would be considered an arm of the Province.

Recent transactions used as precedents are:

Duke Energy Florida Project Finance LLC
June 2016
5 series of bonds totalling USD$1.3B
Weighted average life from 2 to 19 years with interest rates from 1.2% to 3.1%
Credit rating AAA

Utility Debt Securitization Authority
Sponsored by Long Island Power Authority
March 2016
Amount issued USD$0.6B
Weighted average life of 12 years and weighted average yield of 2.7%

August 2016
Amount issued USD$0.5B
Weighted average life of 7 years and weighted average yield of 2.0%

Credit rating AAA

Cumulative outstanding (including previous issuances): USD$4.2B

D. External Assessment

Shakerhill Partners, an external advisor, identified the following items in an assessment of the structure and financeability of the structure:

- The structure is financeable however there are a number of significant risks to the structure:
  - Canadian and Ontario law does not provide the same protection to property right as exists in the US federal and state constitutions to limit the ability of governments to adversely impair contracts to the detriment of the holder;
  - Legislation could mitigate some of the risks – deferred recovery asset to be "uncapped", regular semi-annual true up to ensure recovery, Province provides sufficient committed liquidity to the IESO so that temporary shortfall in recovery does not affect payments to SPV, term of the deferral recovery substantially exceeds the longest maturity of debt of the SPV and that true-up mechanism take account of potential for currency, interest rate and duration mis-match between the debt of the SPV and the recovery mechanism;
  - Size of the program may be too large for Canadian securitization market requiring access to the US securitization market;
- Final maturity of debt should not exceed 30 years from inception of the program
- True up mechanism should be designed such that the forecast of recovery is less than 10% of the customer bill under downside scenarios to limit growth of the deferral balance as a higher portion of the customer bill increases the political risk to debt holders which could result in a lower credit rating and potential impact on financeability
- Securitized debt products are specialized and price at a premium to other fixed rate instruments however a successful program supported by a strong credit rating this premium could shrink over time to a minor spread over Provincial debt
- OPG's credit rating should be maintained provided sufficient equity is injected to maintain credit metrics
- While the structure is not expected to impact the Province there are risks that the program could negatively impact the rating agencies view of the Province's financial management.

E. Risk Summary

i. Consolidation

- Elements of the proposed structure were established to support consolidation of the SPV into OPG. These items may not be sufficient to establish OPG as risk owner of the SPV and the SPV may need to be consolidated directly with the Province.

ii. Financeability

- The legislation establishing the structure and the property right for recovering the financing and associated costs may not be adequate for financing purposes resulting in more expensive financing or an inability to obtain the required external financing.

iii. Cost of Financing

- Future governments may enact legislation that changes the right of the SPV to recover amounts from customers.
- The right to recover amounts from future customers must be irrevocable and subject to full recovery from the government in the event that future governments reduce or eliminate the recovery. A legal structure that is weaker than the precedent US transactions increases the risk to debt holders and the cost of financing.
- Interest rates on bonds in the securitization market are higher than equivalent rated bonds. Rate for a AAA securitization credit is about 50 bps higher than GOC (rated AAA) for a 5 year term. This difference is attributable to the specialized structure of the bond, smaller investor pool for this bond, smaller size of the market and higher perceived risks of the bond.
- Any regulator involvement must not be seen to modify any terms of debt issued or the property right securing the debt as this would increase risk to debt holders.

- It may not be possible to issue debt to match the terms of the deferred asset so shorter term debt would be used which raises risk to re-finance the maturing debt as the market may no longer be interested in this product. As well, underlying reference interest rates may be higher and the market may require a higher spread to invest in this product.
- With the GA Recovery Right program continuing for 10 years, debt issued over this period is subject to changes in both the underlying reference interest rates and appetite of the market for this product.

iv. OPG Credit Rating

- Minimizing the impact of significant additional debt on OPG's credit rating is dependent on higher EBITDA arising from earned income on the GA Recovery Right in excess of external debt. Ability of the SPV to record revenue reflecting the growth in asset value.
- Potential OPG credit rating downgrade if legislative structure is not adequate to support long term recoverability, inability to record revenue from growth in asset value or agencies view equity injection as debt.
- OPG credit rating downgrade could result in loss of GBE status or result in SPV being consolidated directly with the Province.

Attachment 1

LEGISLATIVE REQUIREMENTS TO ALLOW DEFERRAL OF GLOBAL ADJUSTMENT AMOUNTS TO BE FINANCEABLE

The IESO currently has a right to collect GA monthly from ratepayers through provisions in the *Electricity Act, 1998*. It is proposed that collection of a certain portion of the monthly GA be deferred for collection in the future, and that the right to recover the deferred GA from ratepayers be used as a basis for structured financing/securitization.

The current proposal is for a trust to be created as a financing vehicle (the "**Trust**") in connection the deferred GA. The Trust will finance the deferral of the GA by purchasing the right to recover such deferred GA from the IESO for the principal amount of the GA being deferred. For example, if the amount of GA that is being deferred is $200 million in a given month, the Trust will purchase from the IESO the right to future recovery of the deferred GA and the associated financing costs (including interest and transaction costs) for $200 million in cash.

The Trust is expected to finance these purchases from the IESO through a combination of senior secured financing raised in the capital markets and subordinated financing from OPG (the funding for which will mostly be from equity injections from the OEFC/Province).

For accounting purposes, OPG will need to have the ability to direct the activities of the Trust, through a services agreement and/or through the Trust's constating document.

Based on securitized financing raised by utilities in the US (backed by utility cost recovery orders) and the current regulatory framework in Ontario, the legislation in Ontario would need to be amended to provide the following, at a minimum:

1. The IESO will be empowered to create an asset (the "**Regulatory Asset**") consisting of all right, title and interest in and to:

   (a) right to recover from and bill Ontario electricity ratepayers for:

   (i) the principal amount of GA that is being deferred for collection;
   (ii) all interest and other financing costs incurred in respect of the deferral of the GA (whether through senior debt raised in the public markets or subordinated debt raised from OPG or others); and
   (iii) (subject to the comments in paragraph 5 below in respect of OPG's internal administrative costs only) all fees, expenses and other administrative costs associated with such financing, including up-front and ongoing financing costs and any indemnity payments;

all on such repayment/amortization schedule as agreed by the IESO and any purchaser of such right (or pursuant to a pre-defined schedule/formula in the legislation that covers all of the purchaser's principal, interest and ongoing financing costs on a monthly basis); and

(b) all revenues, collections, claims, rights to payments, money or proceeds arising from the rights and interests set out in paragraph (a) above, regardless of whether such revenues, collections, claims, rights to payments, money or proceeds are imposed, billed, received, collected or maintained together with or commingled with other revenues, collections, rights to payments, payments, money or proceeds.

2. The IESO may dispose of the Regulatory Assets created from time to time on such terms as the IESO determines in accordance with the terms of directives to be issued to the IESO from time to time by the Minister, provided that any such disposition shall be a true sale and absolute transfer of the IESO's right, title and interest in and to a Regulatory Asset to the purchaser of the Regulatory Asset.

3. The Regulatory Assets will not be subject to any set-off, counterclaim or other defence by the IESO or any successor or affiliated entity thereof.

4. The legislation will need to recognize the Regulatory Assets as amounts that may be recovered by the IESO (e.g. it could be designated as a "GA Deferral" and would be included in the amounts collectible by the IESO through the GA collection mechanism, and would include interest and financing costs).

5. The purchaser of the Regulatory Asset will have the right to require the IESO (or any successor) to collect the principal amount of GA deferred, together with interest, financing and administration costs, on the agreed repayment/amortization schedule. **[NTD: In the LIPA securitization rate order, if the entity that is authorized to collect rates to service the bonds ends up defaulting, there is the ability to request a court to order "sequestration" and payments of amounts owing to the owner of the Regulatory Asset. Consider whether to include a similar right here. Alternatively, consider whether a security interest over the moneys collected by the IESO could be provided to the purchaser.]**

OEB would be provided with oversight over the internal administrative costs collected by the Financing Trust. This could be accomplished by (a) providing the purchaser of the Regulatory Asset with the right to require

the IESO or a successor to collect only the principal amount of GA together with interest and financing costs and third party fees and expenses, and (b) requiring the IESO to collect amounts through the global adjustment and make payments to the purchaser of the Regulatory Asset with respect to the internal administrative costs incurred by the purchaser in connection with the purchase and management of the Regulatory Asset and the Financing Trust, in accordance with the order of the OEB then in effect. Under this mechanism, the OEB would be required to review the purchaser's internal administrative costs through a streamlined process and issue such orders in accordance with rules to be prescribed under a new regulation under the OEB Act, which would clearly limit the OEB's scope of review and could establish the basis for the purchaser to receive an appropriate fee for its services.

6. In the event that any action is taken or permitted by the Province or any regulatory authority that limits, alters, or impairs the value of a Regulatory Asset or reduces the ability of the IESO or the purchaser of the Regulatory Asset to collect or recover the costs associated therewith, the owner of the Regulatory Asset and the holders of any bonds or other securities issued to finance the purchase of the Regulatory Asset, will have a right of action against the Province for any damages suffered as a result of such amendment.

Attachment 2

STATUTORY AMENDMENTS

The following is preliminary and is based on our current understanding of the proposed structure and objectives. For example, we have assumed that the structure will not entail the insertion of a new Holdco between OPG and the Province. As these aspects are refined, some of the suggested amendments described below may not be needed and other aspects that we are not aware of may need to be considered. Accordingly, these suggested amendments are provided for discussion purposes and are subject to change. We would welcome the opportunity to work with OPG and the Ministry on refining the scope and substance of required legislative and regulatory amendments.

A. Amendments to Implement Structure

Certain *Electricity Act, 1998* amendments would be needed to implement the anticipated structure (which we understand, as noted above, would not include a Holdco), as follows:

- **Section 53.1(1):** Amend to permit owning and operating generation facilities through subsidiaries (not only directly through OPG). In addition, amend to permit OPG to administer, manage, loan moneys to and have a beneficial interest in, if applicable, Financing Trust.

- **Section 53.2:** Amend to permit the Minister to acquire, hold, dispose of or otherwise deal with securities or debt obligations of, or any other interest in, OPG or any subsidiaries. This is to accommodate possible variations to the financing structure that may be desirable over time.

- **Section 53.■ (new):** New statutory section to permit the Minister to enter into arrangements relating to an exercise of powers under 53.2.

- **Section 53.■ (new)**: New statutory section providing that creditors of Financing Trust have no recourse to the assets of OPG or any of its subsidiaries (other than Financing Trust, if applicable). In addition, consideration should be given as to whether the Act should be amended so that the Financing Trust cannot be wound up or liquidated.

B. Miscellaneous Corporate Items to Address

- **OPG Articles:** Amend the OPG's articles to remove the private company restrictions.

- **MOA with Province:** Consider whether any amendments to OPG's MOA with the Province are required to contemplate the Financing Trust.

C. Amendments Under Electricity Act to Implement GA Smoothing

Based on our understanding that the global adjustment smoothing mechanism is intended to benefit residential and small business customers only and that the Minister will be responsible for determining how much global adjustment smoothing is to be applied in a given month, if any, amendments to the *Electricity Act, 1998* and Ontario Regulation 429/04 (Adjustments Under Section 25.33 of the Act) would be needed to implement the mechanism, as follows:

(i) Electricity Act:

- **Section ■ (New):** Establish a new power for the Minister to make directives to the IESO in relation to the global adjustment smoothing mechanism and, particularly, for purposes of establishing global adjustment smoothing amounts from time to time (expected to be monthly). To the extent possible, the directive power should be drafted so as to limit the ability for a future Minister to require the IESO to do anything that would materially and adversely affect the Financing Trust or its lenders. **[NTD: While our understanding is that the Minister would direct this, we note from other materials we have seen that OPG may instead be recommending a formula approach. It is not clear what the formula would look like, where it would be set out or how it would be applied and by whom]**

- **Paragraph 25.33(1):** This section says that IESO shall make adjustments in accordance with the regulations to ensure that, over time, payments by prescribed classes of market participants reflect amounts paid to OPG, OEFC and distributors, as well as amounts paid to entities with whom IESO has a procurement contract. Add new subsection (c) so as to require IESO to ensure that, over time, payments by prescribed classes of market participants also reflect amounts paid to Financing Trust. **[NTD: Not certain this is needed if only to benefit residential and small business consumers, who are not market participants. May be needed in reference to payments from distributors and retailers]**

- **Paragraph 25.33(2):** This section says that distributors and retailers shall make adjustments in accordance with the regulations to ensure that, over time, payments by prescribed classes of consumers reflect amounts paid to OPG, OEFC and distributors, as well as amounts paid to entities with whom IESO has a procurement contract. Add new subsection (c) so as to require distributors and retailers to ensure that, over time, payments by prescribed classes of consumers also reflect amounts paid to Financing Trust.

- Note: As described below, the regulation will need to include new requirements for the IESO to record the global adjustment smoothing amounts in one or more variance accounts and to use those amounts to offset amounts otherwise recorded in the variance accounts under Section 25.33(3) of the Act. For context, we note:

    - Section 25.33(3) says that adjustments under (1) or (2) relating to electricity consumed by consumers whose rates are determined by

the OEB under s. 79.16 of the OEB Act (i.e. RPP Customers) shall instead be made in accordance with the regulations to one or more variance accounts established and maintained by the IESO.

- Section 25.33(4) says IESO, distributors and retailers shall make and receive such payments, set-offs and credits as may be required or permitted by the regulations with respect to consumers described in (3), i.e. RPP Customers.

- Section 25.33(5) says that IESO shall establish and maintain such variance accounts as may be needed to record all amounts payable or receivable by it under 25.33.

(ii) O. Reg. 429/04 (Adjustments Under Section 25.33 of the Act):

- **Section 1(1):** Consider adding definitions for "Financing Trust" and "global adjustment smoothing amount" or such other terms as may be preferred.

- **Section 1.2(1) (New):** Add section providing that, for the purposes of this Regulation, the global adjustment smoothing amount for a month is the amount determined by the IESO in accordance with a directive from the Minister under section ■ of the Electricity Act in respect of the month. **[NTD: See above note re use of Minister directives]**

- **Section 1.2(2) (New):** Consider adding a section providing that the IESO shall publish the global adjustment smoothing amount for a month by no later than the 10th business day of the following month [to align with general publication requirements for global adjustment under s. 1.1(2)].

- **Section 10(1):** Amend formula for calculating Class B GA rate by subtracting the global adjustment smoothing amount for a month from "M", which is the total amount of the global adjustment for the month. The global adjustment smoothing amount could be designated as "X", such that the formula would be (M-X-N)/(P-Q). Define "X" as the global adjustment smoothing amount for the month as determined by the IESO in accordance with the Minister's directive under section ■ of the Electricity Act for the month. **[NTD: See above note re use of Minister directives]**

- **Section 10.1 (New):** Add new section to deal with adjustments under subsection 25.33(3) of the Act, i.e. in respect of RPP consumers. This section should require the IESO to establish, within the variance account(s) it maintains pursuant to subsection 25.33(3) of the Act, one or more subaccounts in which it shall record the global adjustment smoothing amounts applicable to the classes of consumers described in subsection 25.33(3) of the Act. This section must also specify that the IESO shall apply the amounts recorded in the subaccounts against the balances in the variance accounts for purposes of section 79.16(3) of the OEB Act.

- **Note:** This is a key aspect because, when the OEB determines RPP rates, it must take into account the balances in the variance accounts established by the IESO under s. 25.33 of the Electricity Act and make adjustments with a view to eliminating the balances within 12 months. This proposed new section 10.1 causes the IESO to reduce (in the near term) the variance account balances by the global adjustment smoothing amounts, as provided by Financing Trust, thereby enabling the OEB to determine RPP rates that, despite being lower for RPP consumers in the near term, still eliminate the relevant variance account balances within 12 months.

- **Paragraph 11(2)2.ii:** Amend the formula for calculating the allocation of global adjustment for a month to a licensed distributor that is a market participant by subtracting the global adjustment smoothing amount for a month from "M", which has the same meaning as under section 10(1). The global adjustment smoothing amount could be designated as "X", such that the formula would be [(M-X-N) x (R+S-T)]/(P-Q). Define "X" as suggested under section 10(1).

- **Paragraph 11(2)3:** Amend the formula for calculating the allocation of global adjustment for a month to each Class B market participant by subtracting the global adjustment smoothing amount for a month from "M", which has the same meaning as under section 10(1). The global adjustment smoothing amount could be designated as "X", such that the formula would be [(M-X-N) x U]/(P-Q). Define "X" as suggested under section 10(1).

- **Paragraph 16(7)4:** Consider amending the description of "Global Adjustment" that is required to be included on certain invoices so as to inform consumers that their portion of the global adjustment for the month (i) may have been reduced by the application of a global adjustment smoothing amount from the Financing Trust, or (ii) may include amounts payable to the Financing Trust in respect of global adjustment smoothing amounts previously applied.

- **Section 20(1):** This section establishes an obligation for the Ontario Electricity Financial Corporation and every licensed distributor that is a market participant to give the IESO such information as the IESO may require for the purposes of the Regulation in the form specified by the IESO and before the expiry of the period specified by the IESO. Consider amending to extend this obligation to the Financing Trust.

- **Section 20(6):** This section provides that on request by the OEB, the IESO, a licensed distributor, an embedded generator, a retailer or the OEFC shall give the OEB such information relating to this Regulation as the OEB may require, in the form and within the period specified by the OEB. Consider amending to extend this obligation to the Financing Trust.

D. Amendments Under OEB Act to Implement Cost Recovery for Financing Trust

Amendments to the *Ontario Energy Board Act*, including amendments to O. Reg. 95/05 (Classes of Consumers and Determination of Rates) and the introduction of a new regulation, would be needed to implement a cost recovery process for the Financing Trust in relation to the global adjustment smoothing mechanism, potentially with limited OEB oversight, as follows:

(i) Ontario Energy Board Act:

- **Section 78(3.3):** This provision establishes an obligation for the OEB, when determining rates for the retailing of electricity, to take into account balances in variance accounts established under section 25.33 of the Electricity Act and to make adjustments "with a view to eliminating those balances within 12 months or such shorter time periods as the Minister may direct." Consider whether any amendments are needed, and confirm this works with the framework being proposed.

- **Section 78.7 (New):** We understand that the Province may want the OEB to have an oversight role. One possible approach would be to establish a new statutory section establishing that the IESO shall make payments to the Financing Trust with respect to the internal administrative costs incurred by the Financing Trust in connection with the purchase and management of the Regulatory Asset and the Financing Trust. Such payments by the IESO would need to be made in accordance with the order of the OEB then in effect, which orders shall be made by the OEB in accordance with rules prescribed under a new regulation.

    - The new regulation would need to be clear that the OEB does not have jurisdiction to consider the principal amount or any interest, financing costs, third party fees or expenses. Rather, OEB's role would be limited to considering the internal administrative costs of the Financing Trust and ensuring the Financing Trust receives an appropriate fee for its services, all of which would be recovered by the Financing Trust from the IESO, which would collect those amounts in the global adjustment. Note that, if this approach is accepted, the IESO and distributors and retailers would need the authority to collect such amounts as part of the GA and IESO would need the authority to pay such amounts to the Financing Trust. As such, additional amendments would be needed under O. Reg. 429/04.

- **Note:** Section 79.16 of the OEB Act does not require changes, but the significance of this provision should be understood.

    - Section 79.16 gives the OEB responsibility for determining electricity commodity prices for eligible consumers. Eligibility is determined under Reg. 95/05 (Classes of Consumers and Determination of Rates), which is also known as the Regulated Price Plan (RPP) Regulation.
    - Section 4(2) of the RPP Regulation defines RPP-eligible consumers as low volume consumers (i.e. those who annually use less than 150,000 kWh

or such other amount as prescribed), consumers with demand of 50 kW or less, residential consumers that have accounts with distributors, consumers who annually use 150,000 to 250,000 kW of electricity, and consumers who have accounts with distributors if in the farming business.

- Paragraph 6(1)3 of the RPP Regulation provides that "In determining the rates (for RPP-eligible consumers), the Board shall forecast the cost of electricity to be consumed by the consumers to whom the rates apply, taking into consideration adjustments required under section 25.33 of the *Electricity Act, 1998* and shall ensure that the rates reflect those costs."
- The Ontario Energy Board has developed a Regulated Price Plan Manual (revised February 16, 2016) to describe the processes and methodologies it uses for determining electricity commodity prices that are charged to RPP consumers pursuant to Section 79.16 of the OEB Act and paragraph 6(1)3 of the RPP Regulation.

(ii) O. Reg. 95/05 (Classes of Consumers and Determination of Rates)

- **Paragraph 6(1)3:** Amend so as to require the Board, when forecasting the cost of electricity to be consumed by the consumers to whom the rates apply, to take into consideration not only the adjustments required under section 25.33 of the Electricity Act but also the application or prior application of global adjustment smoothing amounts determined by the IESO in accordance with Minister directives under section ■ of the Electricity Act, and to ensure that the RPP rates reflect those amounts. **[NTD: See above note re use of Minister directives]**

(iii) New Regulation (Payments to the Financing Trust)

- If the OEB is to be given the role of reviewing and approving the recovery of OPG's internal administrative costs for the Financing Trust under the potential section 78.7 (see above), then this regulation should describe the process and criteria pursuant through which the OEB would determine the amounts that the IESO would be required to collect through the global adjustment, in accordance with section 25.33 of the Electricity Act, and pay to the Financing Trust in respect of the provision of global adjustment smoothing amounts. This part of the regulation should establish:

    - any reporting requirements from the Financing Trust and/or the IESO to the OEB in connection with the global adjustment smoothing mechanism;
    - the frequency of the OEB making determinations under this part of the regulation;
    - the process through which the OEB shall make these determinations, which should be a streamlined administrative process rather than a public hearing process or, if a hearing is needed, then the scope of the proceeding should be clearly and narrowly constrained so as to deter intervenor involvement, lengthy proceedings and reduce/eliminate risk to recovery by Financing Trust;

- the basis for the OEB's determinations as to the payments that shall be made to the Financing Trust, which should specify that:
  - the Financing Trust shall recover its prudently incurred internal administrative costs on a forecast basis each year;
  - the Financing Trust shall receive an appropriate fee each year (with some guidance as to what would be appropriate); and
  - the approved payment amounts shall be collected by the IESO through the global adjustment and paid to the Financing Trust in accordance with the order of the OEB then in effect. Note that O. Reg. 429/04 would likely need amendments to permit IESO (and distributors and retailers) to collect these amounts through the global adjustment.

ONTARIO POWER GENERATION

February 27, 2017

Mr. Serge Imbrogno
Deputy Minister,
Ministry of Energy
4th Floor, Hearst Block
900 Bay Street
Toronto, Ontario
M7A 2E1

Dear Deputy:

Below is a summary of OPG's preliminary views on the implementation of the Province's proposed Global Adjustment Smoothing Account and financing structure. These views are contingent on the proposed terms and conditions that were sent to the Ministry of Energy on February 21, 2017.

Understanding that the finalization of the legal terms, the Trust indentures, financing structure and other detailed terms will take several months and will involve collaboration between legal counsel, input from capital markets, parties involved and other stakeholders, this letter is intended to provide the guideline and framework which could form the foundation of the plan.

Please do not hesitate to contact me if you have any questions regarding this summary.

Sincerely,

Mr. Ken Hartwick
Chief Financial Officer and Senior Vice President, Finance
Ontario Power Generation
W: 416-592-6985
C: 647-544-6985
ken.hartwick@ opg.com

cc. Jeff Lyash, President and CEO, OPG

Background:

The Province has indicated that it will take steps to reduce electricity bills in the near term. It has identified reductions in the Global Adjustment Charge (GAC) charged to electricity customers as a means to achieve its policy goals. The Province is proposing to temporarily reduce the amount of the GAC charged to electricity customers (primarily RPP-eligible customers). The exact quantum and duration of the program is still not known but based on discussions with the Province GAC charges of approximately $2-5B per year for the next 5-10 years would be deferred and collected over future periods commencing after the deferral period. A combination of senior debt and subordinated debt (mainly sourced by additional equity from the shareholder) would be issued to fund the amount deferred. The financing cost of the debt and other costs of running the program would form part of the amounts recovered from customers over the term of the program.

The Province has requested that OPG administer the GAC deferral, because of OPG's participation in the market, regulatory knowledge and the potential ability to consolidate the activity and accounting with OPG. Given the significant amount of financing required for the GAC deferral, OPG has developed a financing structure (depicted below) to:

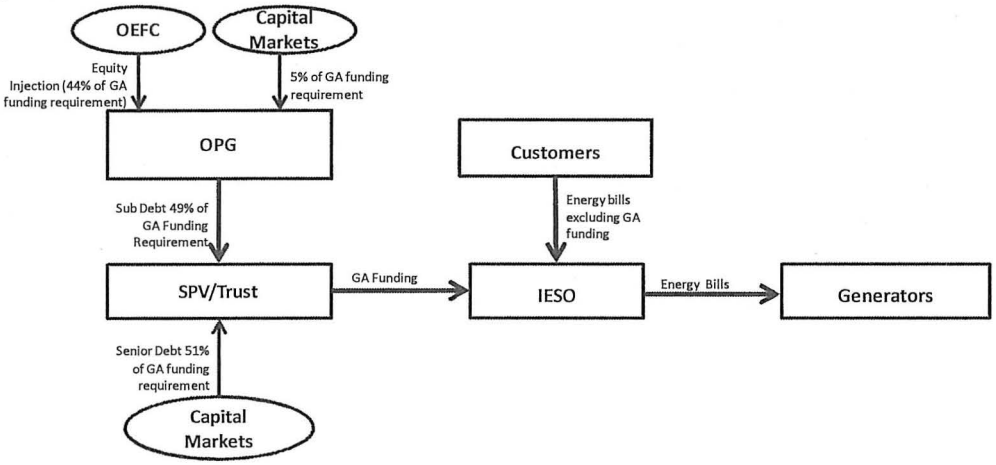
- restrict the risk to OPG;

- maximize the cost-effectiveness of the Trust or the Special Purpose Vehicle ("SPV") financing vehicle; and
- allow for consolidation into OPG financial statements.

The success of this structure is dependent on achieving a number of objectives which are reviewed in the following sections:

A. Ability to Recognize an Asset and Record Revenue
B. Ability to Consolidate the SPV into OPG
C. Ability to Finance
D. External Assessment
E. Risk Summary

All of the percentages shown in the graphic below are indicative and will be highly dependent on the legislation that the Province will enact:



Process:

The IESO will effectively sell the 'right to collect' deferred future revenue from ratepayers (GA Recovery Right asset) to the SPV in return for cash proceeds. In order for the SPV to purchase this asset the SPV will obtain the financing from two key sources: 51% directly from capital markets and 49% as subordinated debt from OPG. OPG will obtain 44% of this financing as an equity injection from the Province and 5% from capital markets.

A. Ability to Recognize an Asset and Record Revenue

Accounting Requirements under International Financial Reporting Standards (IFRS)

1) It is our understanding that the IESO and KPMG have concluded that the sale of this 'right to collect' future revenue (or regulatory asset) is not a financing transaction and will not be recorded as a financial liability. Based on that conclusion, the right to collect will be accounted for as an intangible asset in the SPV.

2) In order to the SPV to record this right as an intangible asset, the right must meet the following conditions:
   - The intangible asset must be separable and arise from a contractual or legal right (i.e. mandated by the Legislation and SPV Indenture Agreement).
   - The SPV must have the control and power to obtain future economic benefits from the intangible asset.
   - The SPV must be able to demonstrate that the intangible asset is purchased at fair value.

3) In order for the SPV to recognize appropriate revenue to offset any ongoing costs, the Legislation must require interest, carrying and administrative costs to be paid to the SPV on a monthly basis. This may result in additional amounts to be deferred to achieve the desired customer impact. Payment of revenue to the SPV is also important to service the interest expenses of the debt.

B. Ability to Consolidate the SPV into OPG under IFRS

OPG 'Control' of the SPV - Accounting Requirements

1) 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 SPV, or whether it has the ability to affect the returns of the SPV through its power over the SPV. Rather, all facts and circumstances are considered when assessing whether an entity has control over another entity. Based on the relevant accounting guidance under IFRS, OPG has proposed terms necessary to demonstrate that OPG has control over the SPV. OPG's external auditors, Ernst & Young, has provided their concurrence that based on the information provided to them to date that the following conditions should permit consolidation of the SPV by OPG.

Directive:

1. The SPV must be undertaken by OPG as a business initiative on its merits. A Shareholder Directive is to be limited to direct OPG to investigate the option of establishing a SPV vehicle to administer, finance and operate the Global Adjustment plan. The control, risk and rewards of that SPV will determine its consolidation into OPG as a business enterprise.

SPV:

2. The SPV should not operate in a predetermined way such that OPG does not have decision-making authority over the SPV's ongoing activities after its formation (i.e. should not operate on 'autopilot').
3. 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 SPV.
4. The Province cannot have the right to veto OPG's decisions about the relevant activities of the SPV. OPG must have the power over the relevant activities of the SPV and be compensated. The relevant activities of the SPV 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 SPV.
5. OPG must have the power to determine or change operating and financing policies of the SPV, which will affect the variability of risks and returns.
6. The Province or its agencies must not directly or indirectly fund (through debt or equity) more than 50% of the following:
    - The SPV
    - Any of OPG's investments in the most subordinated debt of the Trust
7. OPG must own greater than 50% of the most subordinated debt and targeted to be no less than 5%[1] of the total debt of the SPV. Such ownership must be financed entirely by OPG through operating cash flows or external debt, without assistance from Provincial sources. A quantitative analysis should be performed at a later date to corroborate the appropriateness of the 5% threshold to support that the 5% subordinated debt investment is sufficient to absorb most of the expected variability in the SPV.
8. OPG must have the ability to earn variable returns by exercising its authority, which shall be accomplished as follows:

[1] While the rest of the letter refers to a 10% investment in the most junior subordinated debt with OPG owning 5%, it should be noted that OPG should own more than 50% of the most subordinate debt. For simplicity, the degree to which OPG's ownership beyond 50% is not shown in this letter.

a. The cash flow from the restructured asset shall include interest determined based on a relevant benchmark that is appropriate relative to the restructured asset, plus an appropriate margin consistent with the relevant market and other risks
b. OPG shall have the authority to determine the financing strategy, which will vary the financing costs with the objective of enabling the SPV to achieve a more favourable return compared to the return from the restructured asset
c. The SPV shall establish classes of liabilities (senior, subordinated and the most subordinated). The classes would allow the SPV 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.
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.
e. OPG should participate in the detailed design of the above and the SPV 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.

Nothwithstanding the above, under certain 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), the OEFC may provide bridge financing beyond the designated percentage for a defined period. The relevant terms should ensure that this temporary measure does not detract from the rights of OPG to direct all of the relevant activities of the SPV. Additionally, OPG should not be protected from risk of loss by the OEFC with respect to its subordinated investment, nor should it lose its right to derive the residual returns should such bridge financing be required.

Legislation

9. The Legislation must require interest, carrying and administrative costs to be paid to the SPV on a monthly basis, so that the SPV is able to recognize appropriate revenue to offset any ongoing costs.
10. The Legislation must dictate the manner in which the restructured 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 Trustees.
11. The Legislation must be written to avoid legal or constitutional challenges and be irrevocable to reduce the cost of borrowing and with a specific formula which determines the deferral amount. As irrevocability would be difficult under Canadian law one mitigation would be to provide a Provincial guarantee which only applies with cancellation or amendment of the legislation.
12. The spirit of the above terms should be reflected in the SPV Indenture Agreement as well as Legislation, wherever possible.

2) The Trust is expected to be financed as follows:
   - 51% senior secured debt from external markets
   - 39% senior subordinated debt from OPG (via Province equity injection into OPG)

- 10% junior subordinated debt from OPG (5% from external markets and 5% from Province equity injection into OPG).

When assessing control, an investor shall consider the nature of its relationship with other parties and whether those parties are acting on the investor's behalf (i.e. they are 'de facto agents'). If OPG is assessed to be a 'de facto agent' of the Province, it will compromise the ability for OPG to consolidate the Trust. The split above is to meet the following conditions to ensure that OPG is not considered a 'de facto agent' of the Province:

- The Province or its agencies must not directly or indirectly fund (through debt or equity) more than 50% of the following:
  - The Trust
  - Any of OPG's investments in the most subordinated debt of the Trust
- OPG must own greater than 50% of the most subordinated debt and targeted to own no less than 5% of the total debt of the Trust. Such ownership must be financed entirely by OPG through operating cash flows or external debt, without assistance from Provincial sources.

3) The Province will need to conclude on whether OPG still meets the definition of a Government Business Enterprise as defined under Public Sector Accounting Board standards in order to obtain the preferred consolidation treatment after the transaction. We also recommend that the Province to undertake the analysis deemed necessary to confirm the accounting treatment in its consolidated Public Accounts, including if the recognition of the intangible asset would result in an offsetting liability in the Public Accounts.

C. Ability to Finance

Property Right or Right to Collect
Legislative Requirements for Financing
The GA Recovery Right must be structured to encompass the following elements:

- Right to recover from and bill Ontario electricity customers for (1) the principal amount of GA that is being deferred, (2) all interest and other financing costs incurred in respect of the deferral of the GA, (3) all fees, expenses and other administrative costs associated with such financing;
- Repayment/amortization schedule as agreed by the IESO and any purchaser of such GA Recovery Right (or pursuant to a pre-defined schedule/formula that covers all of the purchaser's principal, interest and ongoing financing costs on a monthly basis);
- Repayment/amortization schedule must include a true up mechanism to ensure all costs associated with the deferral can be recovered from customers;
- IESO may dispose of the GA Recovery Right, provided that any such disposition shall be a true sale and absolute transfer to the purchaser of the IESO's right, title and interest in and to the GA Recovery Right;
- Purchaser will have the right to require the IESO (or any successor) to collect the principal amount of GA Recovery Right, together with interest, financing and administration costs, on the agreed repayment/amortization schedule;
- Right must be irrevocable and, if amended by future governments, debt holders have the right of action against the government to recover the amount outstanding including interest, fees, expenses and any damages resulting from the amendment;
- GA Recovery Right will not be subject to any set-off, counterclaim or other defence by the IESO or any successor or affiliated entity; and
- Make certain amendments to the Electricity Act to allow OPG to implement the SPV financing structure (e.g. allowing OPG to create subsidiaries and holding companies, and to have a beneficial interest in the SPV, etc). This would provide flexibility to accommodate possible variations to the financing structure that may be desirable over time.

Detailed legislative requirements are specified in the attachments as follows:

Attachment 1 Legislative requirements to allow deferral of global adjustment amounts to be financeable

Attachment 2 Statutory amendments

The proposed financing structure for the SPV is:

	Risk Profile	Source	% of Total Funding Requirements
Tranche A Senior Debt	The least risky	Capital Markets	51%
Tranche B Sub Debt	In between A&C	OPG via OEFC	39%
Tranche C Sub Debt)	The most risky	OPG via OEFC	5%
		OPG via Capital Markets	5%

SPV structure is used to accomplish the following:

- SPV holds right to charge customers for the benefit of debt holders;
- Allows the financing vehicle to be ring-fenced from OPG as an SPV structure is set up as generally single purpose entities with no other operations that could add risk to the SPV, dilute debt holder rights, allow parties from other operations to claim rights to the future recovery from customers or allow these other parties to initiate bankruptcy proceedings;
- Enables SPV to potentially get a higher credit rating than OPG;
- Supports consolidation with OPG provided accounting requirements are satisfied;

This approach supports a number of objectives of the GA Recovery Right:

- 51% external senior debt supports separation of the SPV from the Province
- 5% junior subordinated debt establishes OPG's "at risk" equity which supports separation of the SPV from the Province
- Subordinated debt provides flexibility to the financing structure and additional credit support to external debt holders
- Subordinated debt sourced from OPG (mainly funded by equity injection from the Province) minimizes impact on OPG credit metrics reducing risk of an OPG rating downgrade that could result in the SPV being consolidated directly with the Province as the SPV would be considered an arm of the Province.

Recent transactions used as precedents are:

Duke Energy Florida Project Finance LLC
June 2016
5 series of bonds totalling USD$1.3B
Weighted average life from 2 to 19 years with interest rates from 1.2% to 3.1%
Credit rating AAA

Utility Debt Securitization Authority
Sponsored by Long Island Power Authority
March 2016
Amount issued USD$0.6B
Weighted average life of 12 years and weighted average yield of 2.7%

August 2016
Amount issued USD$0.5B
Weighted average life of 7 years and weighted average yield of 2.0%

Credit rating AAA

Cumulative outstanding (including previous issuances): USD$4.2B

D. External Assessment

Shakerhill Partners, an external advisor, identified the following items in an assessment of the structure and financeability of the structure:

- The structure is financeable however there are a number of significant risks to the structure:
  - Canadian and Ontario law does not provide the same protection to property right as exists in the US federal and state constitutions to limit the ability of governments to adversely impair contracts to the detriment of the holder;
  - Legislation could mitigate some of the risks – deferred recovery asset to be "uncapped", regular semi-annual true up to ensure recovery, Province provides sufficient committed liquidity to the IESO so that temporary shortfall in recovery does not affect payments to SPV, term of the deferral recovery substantially exceeds the longest maturity of debt of the SPV and that true-up mechanism take account of potential for currency, interest rate and duration mis-match between the debt of the SPV and the recovery mechanism;
  - Size of the program may be too large for Canadian securitization market requiring access to the US securitization market;
- Final maturity of debt should not exceed 30 years from inception of the program
- True up mechanism should be designed such that the forecast of recovery is less than 10% of the customer bill under downside scenarios to limit growth of the deferral balance as a higher portion of the customer bill increases the political risk to debt holders which could result in a lower credit rating and potential impact on financeability
- Securitized debt products are specialized and price at a premium to other fixed rate instruments however a successful program supported by a strong credit rating this premium could shrink over time to a minor spread over Provincial debt
- OPG's credit rating should be maintained provided sufficient equity is injected to maintain credit metrics
- While the structure is not expected to impact the Province there are risks that the program could negatively impact the rating agencies view of the Province's financial management.

E. Risk Summary

i. Consolidation

- Elements of the proposed structure were established to support consolidation of the SPV into OPG. These items may not be sufficient to establish OPG as risk owner of the SPV and the SPV may need to be consolidated directly with the Province.

ii. Financeability

- The legislation establishing the structure and the property right for recovering the financing and associated costs may not be adequate for financing purposes resulting in more expensive financing or an inability to obtain the required external financing.

iii. Cost of Financing

- Future governments may enact legislation that changes the right of the SPV to recover amounts from customers.
- The right to recover amounts from future customers must be irrevocable and subject to full recovery from the government in the event that future governments reduce or eliminate the recovery. A legal structure that is weaker than the precedent US transactions increases the risk to debt holders and the cost of financing.
- Interest rates on bonds in the securitization market are higher than equivalent rated bonds. Rate for a AAA securitization credit is about 50 bps higher than GOC (rated AAA) for a 5 year term. This difference is attributable to the specialized structure of the bond, smaller investor pool for this bond, smaller size of the market and higher perceived risks of the bond.
- Any regulator involvement must not be seen to modify any terms of debt issued or the property right securing the debt as this would increase risk to debt holders.

- It may not be possible to issue debt to match the terms of the deferred asset so shorter term debt would be used which raises risk to re-finance the maturing debt as the market may no longer be interested in this product. As well, underlying reference interest rates may be higher and the market may require a higher spread to invest in this product.
- With the GA Recovery Right program continuing for 10 years, debt issued over this period is subject to changes in both the underlying reference interest rates and appetite of the market for this product.

iv. OPG Credit Rating

- Minimizing the impact of significant additional debt on OPG's credit rating is dependent on higher EBITDA arising from earned income on the GA Recovery Right in excess of external debt. Ability of the SPV to record revenue reflecting the growth in asset value.
- Potential OPG credit rating downgrade if legislative structure is not adequate to support long term recoverability, inability to record revenue from growth in asset value or agencies view equity injection as debt.
- OPG credit rating downgrade could result in loss of GBE status or result in SPV being consolidated directly with the Province.

Attachment 1

LEGISLATIVE REQUIREMENTS TO ALLOW DEFERRAL OF GLOBAL ADJUSTMENT AMOUNTS TO BE FINANCEABLE

The IESO currently has a right to collect GA monthly from ratepayers through provisions in the *Electricity Act, 1998*. It is proposed that collection of a certain portion of the monthly GA be deferred for collection in the future, and that the right to recover the deferred GA from ratepayers be used as a basis for structured financing/securitization.

The current proposal is for a trust to be created as a financing vehicle (the "**Trust**") in connection the deferred GA. The Trust will finance the deferral of the GA by purchasing the right to recover such deferred GA from the IESO for the principal amount of the GA being deferred. For example, if the amount of GA that is being deferred is $200 million in a given month, the Trust will purchase from the IESO the right to future recovery of the deferred GA and the associated financing costs (including interest and transaction costs) for $200 million in cash.

The Trust is expected to finance these purchases from the IESO through a combination of senior secured financing raised in the capital markets and subordinated financing from OPG (the funding for which will mostly be from equity injections from the OEFC/Province).

For accounting purposes, OPG will need to have the ability to direct the activities of the Trust, through a services agreement and/or through the Trust's constating document.

Based on securitized financing raised by utilities in the US (backed by utility cost recovery orders) and the current regulatory framework in Ontario, the legislation in Ontario would need to be amended to provide the following, at a minimum:

1. The IESO will be empowered to create an asset (the "**Regulatory Asset**") consisting of all right, title and interest in and to:

   (a) right to recover from and bill Ontario electricity ratepayers for:

   (i) the principal amount of GA that is being deferred for collection;
   (ii) all interest and other financing costs incurred in respect of the deferral of the GA (whether through senior debt raised in the public markets or subordinated debt raised from OPG or others); and
   (iii) (subject to the comments in paragraph 5 below in respect of OPG's internal administrative costs only) all fees, expenses and other administrative costs associated with such financing, including up-front and ongoing financing costs and any indemnity payments;

all on such repayment/amortization schedule as agreed by the IESO and any purchaser of such right (or pursuant to a pre-defined schedule/formula in the legislation that covers all of the purchaser's principal, interest and ongoing financing costs on a monthly basis); and

(b) all revenues, collections, claims, rights to payments, money or proceeds arising from the rights and interests set out in paragraph (a) above, regardless of whether such revenues, collections, claims, rights to payments, money or proceeds are imposed, billed, received, collected or maintained together with or commingled with other revenues, collections, rights to payments, payments, money or proceeds.

2. The IESO may dispose of the Regulatory Assets created from time to time on such terms as the IESO determines in accordance with the terms of directives to be issued to the IESO from time to time by the Minister, provided that any such disposition shall be a true sale and absolute transfer of the IESO's right, title and interest in and to a Regulatory Asset to the purchaser of the Regulatory Asset.

3. The Regulatory Assets will not be subject to any set-off, counterclaim or other defence by the IESO or any successor or affiliated entity thereof.

4. The legislation will need to recognize the Regulatory Assets as amounts that may be recovered by the IESO (e.g. it could be designated as a "GA Deferral" and would be included in the amounts collectible by the IESO through the GA collection mechanism, and would include interest and financing costs).

5. The purchaser of the Regulatory Asset will have the right to require the IESO (or any successor) to collect the principal amount of GA deferred, together with interest, financing and administration costs, on the agreed repayment/amortization schedule. **[NTD: In the LIPA securitization rate order, if the entity that is authorized to collect rates to service the bonds ends up defaulting, there is the ability to request a court to order "sequestration" and payments of amounts owing to the owner of the Regulatory Asset. Consider whether to include a similar right here. Alternatively, consider whether a security interest over the moneys collected by the IESO could be provided to the purchaser.]**

OEB would be provided with oversight over the internal administrative costs collected by the Financing Trust. This could be accomplished by (a) providing the purchaser of the Regulatory Asset with the right to require

the IESO or a successor to collect only the principal amount of GA together with interest and financing costs and third party fees and expenses, and (b) requiring the IESO to collect amounts through the global adjustment and make payments to the purchaser of the Regulatory Asset with respect to the internal administrative costs incurred by the purchaser in connection with the purchase and management of the Regulatory Asset and the Financing Trust, in accordance with the order of the OEB then in effect. Under this mechanism, the OEB would be required to review the purchaser's internal administrative costs through a streamlined process and issue such orders in accordance with rules to be prescribed under a new regulation under the OEB Act, which would clearly limit the OEB's scope of review and could establish the basis for the purchaser to receive an appropriate fee for its services.

6. In the event that any action is taken or permitted by the Province or any regulatory authority that limits, alters, or impairs the value of a Regulatory Asset or reduces the ability of the IESO or the purchaser of the Regulatory Asset to collect or recover the costs associated therewith, the owner of the Regulatory Asset and the holders of any bonds or other securities issued to finance the purchase of the Regulatory Asset, will have a right of action against the Province for any damages suffered as a result of such amendment.

Attachment 2

STATUTORY AMENDMENTS

The following is preliminary and is based on our current understanding of the proposed structure and objectives. For example, we have assumed that the structure will not entail the insertion of a new Holdco between OPG and the Province. As these aspects are refined, some of the suggested amendments described below may not be needed and other aspects that we are not aware of may need to be considered. Accordingly, these suggested amendments are provided for discussion purposes and are subject to change. We would welcome the opportunity to work with OPG and the Ministry on refining the scope and substance of required legislative and regulatory amendments.

A. Amendments to Implement Structure

Certain *Electricity Act, 1998* amendments would be needed to implement the anticipated structure (which we understand, as noted above, would not include a Holdco), as follows:

- **Section 53.1(1):** Amend to permit owning and operating generation facilities through subsidiaries (not only directly through OPG). In addition, amend to permit OPG to administer, manage, loan moneys to and have a beneficial interest in, if applicable, Financing Trust.

- **Section 53.2:** Amend to permit the Minister to acquire, hold, dispose of or otherwise deal with securities or debt obligations of, or any other interest in, OPG or any subsidiaries. This is to accommodate possible variations to the financing structure that may be desirable over time.

- **Section 53.■ (new):** New statutory section to permit the Minister to enter into arrangements relating to an exercise of powers under 53.2.

- **Section 53.■ (new)**: New statutory section providing that creditors of Financing Trust have no recourse to the assets of OPG or any of its subsidiaries (other than Financing Trust, if applicable). In addition, consideration should be given as to whether the Act should be amended so that the Financing Trust cannot be wound up or liquidated.

B. Miscellaneous Corporate Items to Address

- **OPG Articles:** Amend the OPG's articles to remove the private company restrictions.

- **MOA with Province:** Consider whether any amendments to OPG's MOA with the Province are required to contemplate the Financing Trust.

C. Amendments Under Electricity Act to Implement GA Smoothing

Based on our understanding that the global adjustment smoothing mechanism is intended to benefit residential and small business customers only and that the Minister will be responsible for determining how much global adjustment smoothing is to be applied in a given month, if any, amendments to the *Electricity Act, 1998* and Ontario Regulation 429/04 (Adjustments Under Section 25.33 of the Act) would be needed to implement the mechanism, as follows:

(i) Electricity Act:

- **Section ■ (New):** Establish a new power for the Minister to make directives to the IESO in relation to the global adjustment smoothing mechanism and, particularly, for purposes of establishing global adjustment smoothing amounts from time to time (expected to be monthly). To the extent possible, the directive power should be drafted so as to limit the ability for a future Minister to require the IESO to do anything that would materially and adversely affect the Financing Trust or its lenders. **[NTD: While our understanding is that the Minister would direct this, we note from other materials we have seen that OPG may instead be recommending a formula approach. It is not clear what the formula would look like, where it would be set out or how it would be applied and by whom]**

- **Paragraph 25.33(1):** This section says that IESO shall make adjustments in accordance with the regulations to ensure that, over time, payments by prescribed classes of market participants reflect amounts paid to OPG, OEFC and distributors, as well as amounts paid to entities with whom IESO has a procurement contract. Add new subsection (c) so as to require IESO to ensure that, over time, payments by prescribed classes of market participants also reflect amounts paid to Financing Trust. **[NTD: Not certain this is needed if only to benefit residential and small business consumers, who are not market participants. May be needed in reference to payments from distributors and retailers]**

- **Paragraph 25.33(2):** This section says that distributors and retailers shall make adjustments in accordance with the regulations to ensure that, over time, payments by prescribed classes of consumers reflect amounts paid to OPG, OEFC and distributors, as well as amounts paid to entities with whom IESO has a procurement contract. Add new subsection (c) so as to require distributors and retailers to ensure that, over time, payments by prescribed classes of consumers also reflect amounts paid to Financing Trust.

- **Note**: As described below, the regulation will need to include new requirements for the IESO to record the global adjustment smoothing amounts in one or more variance accounts and to use those amounts to offset amounts otherwise recorded in the variance accounts under Section 25.33(3) of the Act. For context, we note:

    - Section 25.33(3) says that adjustments under (1) or (2) relating to electricity consumed by consumers whose rates are determined by

the OEB under s. 79.16 of the OEB Act (i.e. RPP Customers) shall instead be made in accordance with the regulations to one or more variance accounts established and maintained by the IESO.

- Section 25.33(4) says IESO, distributors and retailers shall make and receive such payments, set-offs and credits as may be required or permitted by the regulations with respect to consumers described in (3), i.e. RPP Customers.

- Section 25.33(5) says that IESO shall establish and maintain such variance accounts as may be needed to record all amounts payable or receivable by it under 25.33.

(ii) O. Reg. 429/04 (Adjustments Under Section 25.33 of the Act):

- **Section 1(1):** Consider adding definitions for "Financing Trust" and "global adjustment smoothing amount" or such other terms as may be preferred.

- **Section 1.2(1) (New):** Add section providing that, for the purposes of this Regulation, the global adjustment smoothing amount for a month is the amount determined by the IESO in accordance with a directive from the Minister under section ■ of the Electricity Act in respect of the month. **[NTD: See above note re use of Minister directives]**

- **Section 1.2(2) (New):** Consider adding a section providing that the IESO shall publish the global adjustment smoothing amount for a month by no later than the 10th business day of the following month [to align with general publication requirements for global adjustment under s. 1.1(2)].

- **Section 10(1):** Amend formula for calculating Class B GA rate by subtracting the global adjustment smoothing amount for a month from "M", which is the total amount of the global adjustment for the month. The global adjustment smoothing amount could be designated as "X", such that the formula would be (M-X-N)/(P-Q). Define "X" as the global adjustment smoothing amount for the month as determined by the IESO in accordance with the Minister's directive under section ■ of the Electricity Act for the month. **[NTD: See above note re use of Minister directives]**

- **Section 10.1 (New):** Add new section to deal with adjustments under subsection 25.33(3) of the Act, i.e. in respect of RPP consumers. This section should require the IESO to establish, within the variance account(s) it maintains pursuant to subsection 25.33(3) of the Act, one or more subaccounts in which it shall record the global adjustment smoothing amounts applicable to the classes of consumers described in subsection 25.33(3) of the Act. This section must also specify that the IESO shall apply the amounts recorded in the subaccounts against the balances in the variance accounts for purposes of section 79.16(3) of the OEB Act.

- **Note:** This is a key aspect because, when the OEB determines RPP rates, it must take into account the balances in the variance accounts established by the IESO under s. 25.33 of the Electricity Act and make adjustments with a view to eliminating the balances within 12 months. This proposed new section 10.1 causes the IESO to reduce (in the near term) the variance account balances by the global adjustment smoothing amounts, as provided by Financing Trust, thereby enabling the OEB to determine RPP rates that, despite being lower for RPP consumers in the near term, still eliminate the relevant variance account balances within 12 months.

- **Paragraph 11(2)2.ii:** Amend the formula for calculating the allocation of global adjustment for a month to a licensed distributor that is a market participant by subtracting the global adjustment smoothing amount for a month from "M", which has the same meaning as under section 10(1). The global adjustment smoothing amount could be designated as "X", such that the formula would be [(M-X-N) x (R+S-T)]/(P-Q). Define "X" as suggested under section 10(1).

- **Paragraph 11(2)3:** Amend the formula for calculating the allocation of global adjustment for a month to each Class B market participant by subtracting the global adjustment smoothing amount for a month from "M", which has the same meaning as under section 10(1). The global adjustment smoothing amount could be designated as "X", such that the formula would be [(M-X-N) x U]/(P-Q). Define "X" as suggested under section 10(1).

- **Paragraph 16(7)4:** Consider amending the description of "Global Adjustment" that is required to be included on certain invoices so as to inform consumers that their portion of the global adjustment for the month (i) may have been reduced by the application of a global adjustment smoothing amount from the Financing Trust, or (ii) may include amounts payable to the Financing Trust in respect of global adjustment smoothing amounts previously applied.

- **Section 20(1):** This section establishes an obligation for the Ontario Electricity Financial Corporation and every licensed distributor that is a market participant to give the IESO such information as the IESO may require for the purposes of the Regulation in the form specified by the IESO and before the expiry of the period specified by the IESO. Consider amending to extend this obligation to the Financing Trust.

- **Section 20(6):** This section provides that on request by the OEB, the IESO, a licensed distributor, an embedded generator, a retailer or the OEFC shall give the OEB such information relating to this Regulation as the OEB may require, in the form and within the period specified by the OEB. Consider amending to extend this obligation to the Financing Trust.

D. Amendments Under OEB Act to Implement Cost Recovery for Financing Trust

Amendments to the *Ontario Energy Board Act*, including amendments to O. Reg. 95/05 (Classes of Consumers and Determination of Rates) and the introduction of a new regulation, would be needed to implement a cost recovery process for the Financing Trust in relation to the global adjustment smoothing mechanism, potentially with limited OEB oversight, as follows:

(i) Ontario Energy Board Act:

- **Section 78(3.3):** This provision establishes an obligation for the OEB, when determining rates for the retailing of electricity, to take into account balances in variance accounts established under section 25.33 of the Electricity Act and to make adjustments "with a view to eliminating those balances within 12 months or such shorter time periods as the Minister may direct." Consider whether any amendments are needed, and confirm this works with the framework being proposed.

- **Section 78.7 (New):** We understand that the Province may want the OEB to have an oversight role. One possible approach would be to establish a new statutory section establishing that the IESO shall make payments to the Financing Trust with respect to the internal administrative costs incurred by the Financing Trust in connection with the purchase and management of the Regulatory Asset and the Financing Trust. Such payments by the IESO would need to be made in accordance with the order of the OEB then in effect, which orders shall be made by the OEB in accordance with rules prescribed under a new regulation.

    - The new regulation would need to be clear that the OEB does not have jurisdiction to consider the principal amount or any interest, financing costs, third party fees or expenses. Rather, OEB's role would be limited to considering the internal administrative costs of the Financing Trust and ensuring the Financing Trust receives an appropriate fee for its services, all of which would be recovered by the Financing Trust from the IESO, which would collect those amounts in the global adjustment. Note that, if this approach is accepted, the IESO and distributors and retailers would need the authority to collect such amounts as part of the GA and IESO would need the authority to pay such amounts to the Financing Trust. As such, additional amendments would be needed under O. Reg. 429/04.

- **Note:** Section 79.16 of the OEB Act does not require changes, but the significance of this provision should be understood.

    - Section 79.16 gives the OEB responsibility for determining electricity commodity prices for eligible consumers. Eligibility is determined under Reg. 95/05 (Classes of Consumers and Determination of Rates), which is also known as the Regulated Price Plan (RPP) Regulation.
    - Section 4(2) of the RPP Regulation defines RPP-eligible consumers as low volume consumers (i.e. those who annually use less than 150,000 kWh

or such other amount as prescribed), consumers with demand of 50 kW or less, residential consumers that have accounts with distributors, consumers who annually use 150,000 to 250,000 kW of electricity, and consumers who have accounts with distributors if in the farming business.

- Paragraph 6(1)3 of the RPP Regulation provides that "In determining the rates (for RPP-eligible consumers), the Board shall forecast the cost of electricity to be consumed by the consumers to whom the rates apply, taking into consideration adjustments required under section 25.33 of the *Electricity Act, 1998* and shall ensure that the rates reflect those costs."
- The Ontario Energy Board has developed a Regulated Price Plan Manual (revised February 16, 2016) to describe the processes and methodologies it uses for determining electricity commodity prices that are charged to RPP consumers pursuant to Section 79.16 of the OEB Act and paragraph 6(1)3 of the RPP Regulation.

(ii) O. Reg. 95/05 (Classes of Consumers and Determination of Rates)

- **Paragraph 6(1)3:** Amend so as to require the Board, when forecasting the cost of electricity to be consumed by the consumers to whom the rates apply, to take into consideration not only the adjustments required under section 25.33 of the Electricity Act but also the application or prior application of global adjustment smoothing amounts determined by the IESO in accordance with Minister directives under section ■ of the Electricity Act, and to ensure that the RPP rates reflect those amounts. **[NTD: See above note re use of Minister directives]**

(iii) New Regulation (Payments to the Financing Trust)

- If the OEB is to be given the role of reviewing and approving the recovery of OPG's internal administrative costs for the Financing Trust under the potential section 78.7 (see above), then this regulation should describe the process and criteria pursuant through which the OEB would determine the amounts that the IESO would be required to collect through the global adjustment, in accordance with section 25.33 of the Electricity Act, and pay to the Financing Trust in respect of the provision of global adjustment smoothing amounts. This part of the regulation should establish:

    - any reporting requirements from the Financing Trust and/or the IESO to the OEB in connection with the global adjustment smoothing mechanism;
    - the frequency of the OEB making determinations under this part of the regulation;
    - the process through which the OEB shall make these determinations, which should be a streamlined administrative process rather than a public hearing process or, if a hearing is needed, then the scope of the proceeding should be clearly and narrowly constrained so as to deter intervenor involvement, lengthy proceedings and reduce/eliminate risk to recovery by Financing Trust;

- the basis for the OEB's determinations as to the payments that shall be made to the Financing Trust, which should specify that:
  - the Financing Trust shall recover its prudently incurred internal administrative costs on a forecast basis each year;
  - the Financing Trust shall receive an appropriate fee each year (with some guidance as to what would be appropriate); and
  - the approved payment amounts shall be collected by the IESO through the global adjustment and paid to the Financing Trust in accordance with the order of the OEB then in effect. Note that O. Reg. 429/04 would likely need amendments to permit IESO (and distributors and retailers) to collect these amounts through the global adjustment.

Kacaba, Jennifer (ENERGY)

From: Rehob, James (ENERGY)
Sent: April 24, 2017 9:33 AM
To: Calwell, Carolyn (ENERGY/MEDEI/MRI); Shear, Dan (ENERGY); Kacaba, Jennifer (ENERGY); Huang, Jackson (MEDG/MRIS)
Cc: Johnson, Paul (ENERGY/MEDEI/MRI)
Subject: Re: instructions

OK, understood.

Sent from my BlackBerry 10 smartphone on the Rogers network.

From: Calwell, Carolyn (ENERGY/MEDEI/MRI)
Sent: Monday, April 24, 2017 9:20 AM
To: Rehob, James (ENERGY); Shear, Dan (ENERGY); Kacaba, Jennifer (ENERGY); Huang, Jackson (MEDG/MRIS)
Cc: Johnson, Paul (ENERGY/MEDEI/MRI)
Subject: RE: instructions

Hi – I was able to go through OPG's and the dealers comments on drafting points.

Notes

- I didn't deal with s. 5 at all. James, I will leave you to take this up with CLOC, MOF and probably TBS (Paul will fill you in on their interests after he speaks with Len Hatzis). Please consider OPG's and the dealers comments on those sections as well
- Dan, I didn't deal with any of the Part II comments. I would note that the CoS would like the proxy customer detail moved to the regs (he is worried about explaining why we are focused on a Toronto Hydro consumer). This work has been important to getting to this point, so please don't think moving this detail undermines your work.
- Dan, I have also left all of the OEB comments to you and will leave you to follow up with Martine, as you propose.
- I will discuss OPG's role as FSM and with respect to the fair allocation at a meeting this morning and I am hoping we will resolve outstanding questions on that front this morning.

We do need to get Tara working on the next turn, so please focus on getting this out the door. If it makes more sense to send her what we have now and then approach the other pieces in riders, I am open to it. I am very focused on – and nervous about - our expiring timeline.

Carolyn

From: Calwell, Carolyn (ENERGY/MEDEI/MRI)
Sent: April-23-17 6:16 PM
To: Rehob, James (ENERGY); Shear, Dan (ENERGY); Kacaba, Jennifer (ENERGY); Huang, Jackson (MEDG/MRIS)
Cc: Johnson, Paul (ENERGY/MEDEI/MRI)
Subject: instructions

Hi – here is a starting point for drafting instructions. I tried to respond to comments received from Blakes and I accepted most of IESO's suggestions and put them in here as well. I haven't yet looked at the OPG comments, so I will leave it to Dan and James to figure out which changes from them need to be incorporated.

<< File: Instructions 23 April 2017.docx >>

A few notes on the IESO comments:

- I did not adopt their reference to procurement contracts (definition of clean energy costs). James, would you please consider whether this should also go in.
- Dan, please look at the IESO's comments in Part II - about the "average baseline rate", rate determination and the fair adjustment (s 6(1), (2) and 7). I did not address those comments.
- I put in the comments about the determination of the clean energy adjustment (s. 10). Dan and James, please consider whether this works.
- I did not adopt IESO's comments on s. 23 or 24. I would like Blakes to take a look at those provisions.
- I would also like Blakes' views on s. 31(3) and 33.
- I didn't address IESO's comments on the consequential amendments.

Blakes made the point that the definition of refinancing doesn't deal with redemptions. I would like to clarify with them whether we should be referring to redemptions and refinancing or whether a redemption is a type of refinancing. I will send Blakes an email on these points shortly.

Dan, a small point, but please consider if the reference in s. 6xx(5) to "adapt its invoices" should be to "adapt its billing processes".

I also haven't dealt with the question of OPG's cash flow needs in the first period (16xx(4)). James, I think you are reaching out to Bryson on the language you circulated on Friday night.

James, I believe you are also looking at OPG's comments on the consequential amendments.

Given the extent of the changes required, we need to get instructions to Tara no later than noon tomorrow and earlier if at all possible.

If you would like to talk through any of these matters, please call me at 647-883-7091. I may not be instantly available, but I will try to keep my bb handy and I will get back to you as soon as I can.

Thank you all.

Carolyn

From: Rehob, James (ENERGY)
Sent: April-23-17 5:20 PM
To: Calwell, Carolyn (ENERGY/MEDEI/MRI); Kacaba, Jennifer (ENERGY); Shear, Dan (ENERGY)
Cc: Huang, Jackson (MEDG/MRIS)
Subject: LSB Energy Responses to OPG cmnts - Fair Hydro Plan Act (OPG_Torys_ Comments - April 23 2017) Consultation.docx

Confidential/Solicitor & Client Privileged

Hi, Team. Here are my proposed responses (with some suggested drafting language in where I could). Regarding OPG Governance, it didn't appear that Tory's / OPG took much in the way of issue with the provisions related to EA s.53.1 so there was nothing really to react to in t his document on that front.

Pleased to have your feedback. I gather the plan is to settle on instructions by mid-morning tomorrow so that we can ship them over to Tara.

Best, and have a good night.

James

<< File: LSB Energy Responses to OPG cmnts - Fair Hydro Plan Act (OPG_Torys_ Comments - April 23 2017) Consultation.docx >>

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Powering Tomorrow.

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February 28, 2017

Deputy Minister Serge Imbrogno
Ontario Ministry of Energy
900 Bay Street
Hearst Block, 4th Floor
Toronto, ON M7A 2E1

Dear Deputy Imbrogno:

Attached are two documents prepared in conjunction with our KPMG advisors. The first outlines the proposed adoption by the IESO of the guidance in *ASC980 Regulated Operations* and the recognition of regulatory assets, as a more appropriate and transparent presentation in our financial statements.

The second is associated with the potential recognition and de-recognition of the regulatory assets associated with the IESO's role under the Global Adjustment Smoothing Account.

The conclusions of the second analysis are based on the structure of the account as the IESO currently understands it, and may vary depending on the final legislative materials.

We are available to address any questions you may have on these matters.

Sincerely,

Bruce B. Campbell

Attach.

Bruce B. Campbell
President and CEO
bruce.campbell@ieso.ca
t 416 506 2829

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White Paper - Adoption of the guidance in ASC 980 Regulated Operations

Independent Electricity System Operator ("IESO" or the "Company") is considering making changes in its accounting policies to reflect the balances of market participants within the IESO-administered markets (see separate technical analysis) and the economic impacts of rate regulation, as the changes would result in a more appropriate presentation of events or transactions in its financial statements.

Issue being considered in this document is: Can the IESO adopt the guidance in ASC 980 *Regulated Operations (US GAAP in FASB)*?

Background and Assumptions

The facts, circumstances, and assumptions relevant to the specific transactions are as follows:

1. The IESO's legal status is a not-for-profit, non-taxable, corporation established pursuant to Part II of the *Electricity Act, 1998*. IESO is classified as an Other Governmental Organization and prepares its financial statements in accordance with Canadian public sector accounting standards (PSAB).
2. IESO is rate regulated by the OEB in accordance with the Electricity Act, 1998 and the Ontario Energy Board ("OEB") Act, 1998 but currently does not recognize the economic impacts of rate regulation in its general purpose financial statements.
3. The IESO is required to obtain approval from the OEB under s. 25(1) of the Electricity Act, 1998 for the approval of its own expenditures, revenue requirement and fees. The last rate approval was obtained on December 29, 2016[1].
4. The OEB issued a Decision and Order on March 28, 2013 that permits IESO to recover the MDMR costs (the Smart Metering Charge) (see Appendix A). *(i.e. Costs incurred in the past will be fully recovered through future rates)*
5. Furthermore, in accordance with the *Electricity Act, 1998* and the *OEB Act, 1998*, the IESO has approved variance accounts to record all amounts payable or receivable by it in connection with the amounts paid to generators, the Financial Corporation, distributors and to entities with whom the IESO has a procurement contract. (i.e. costs incurred in the past will be fully recovered through future rates)
6. The IESO would change its accounting policies to permit the recognition of the economic impacts of rate regulation as from the 2016 financial year. IESO would adopt the guidance of ASC 980 *Regulated Operations* to better reflect the economic substance of its operations and enhance the transparency and accountability of its financial reporting.

Appropriate Accounting Principle

PS2120.02, "*a change in an accounting policy may be made... if it is considered that the change would result in a more appropriate presentation of events or transactions in the financial statements of the government.*"

PS1150.05 "*When the primary sources of GAAP do not deal with the accounting and reporting in financial statements of transactions or events encountered by the public sector reporting entity, or additional guidance is needed to apply a primary source to specific circumstances, the selection of an appropriate accounting policy requires the exercise of professional judgment. In these circumstances, a public sector reporting entity should adopt accounting policies and disclosures that are consistent with:*

[1] http://www.rds.ontarioenergyboard.ca/webdrawer/webdrawer.dll/webdrawer/rec/556699/view/Dec_Order_IESO_20161229.PDF

(a) *the primary sources of GAAP; and*

(b) *the application of the concepts described in FINANCIAL STATEMENT CONCEPTS, Section PS 1000.*"

PS1150.19 "*Pronouncements issued by other bodies authorized to issue accounting standards may be useful sources to consult. For example, accounting pronouncements published with the authority of the Canadian Accounting Standards Board (AcSB), International Accounting Standards Board (IASB), US Federal Accounting Standards Advisory Board (FASB), US Governmental Accounting Standards Board (GASB), or International Public Sector Accounting Standards Board (IPSASB) are often important sources to consult on matters not covered by primary sources of GAAP or for assistance in applying a primary source of GAAP to specific circumstances.*"

PS1150.08 "A public sector reporting entity consults sources other than primary sources of GAAP to assist in selecting accounting policies and disclosures only when these sources comply with paragraph PS1150.05. The public sector reporting entity evaluates sources in selecting the appropriate accounting policies and disclosures based on all of the following criteria:

(a) *The specificity of the source — A source that deals with the specific circumstances is likely to be more relevant than one from which the public sector reporting entity must analogize.*

(b) *The authority of the issuer or author — A source issued by an accounting standard setter in its own jurisdiction is likely to be more relevant than a source issued by others in the same jurisdiction.*

(c) *The continued relevance of the source — The passage of time may diminish the relevance of certain sources.*

(d) *The development process for the source — A source developed after extensive consultation and debate is likely to be more relevant than a source developed without such discipline."*

PS1150.10 "PSAB considers a source to be consistent with the concepts in paragraph PS 1150.05(b) when the guidance in that source is compatible with the (i) qualitative characteristics of financial information, (ii) the elements of financial statements, and (iii) the recognition and measurement criteria in paragraph PS 1150.05(b)."

PS1000.58 "In the absence of appropriate public sector recognition and measurement criteria for intangibles, all intangibles, including those that have been purchased, developed, constructed or inherited in right of the Crown, are not recognized as assets in government financial statements. The intangible often called "human capital" that embodies the talent or intellectual capital of government employees is not recognized as an asset under existing accounting principles."

PS3210.03 "Assets are economic resources controlled by a public sector entity as a result of past transactions or events and from which future economic benefits are expected to be obtained."

PS3210.04 "Assets have three essential characteristics:

(a) *They embody future economic benefits that involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows, or to reduce cash outflows.*

(b) *The public sector entity can control the economic resource and access to the future economic benefits.*

(c) *The transaction or event giving rise to the public sector entity's control has already occurred."*

Issue: Can the IESO adopt the guidance in ASC 980 *Regulated Operations*?

In accordance with PS2120.02, the IESO can reflect the economic impacts of rate regulation only if it is considered that the change of accounting policy would result in a more appropriate presentation of events or transactions in the financial statements of the government. As mentioned in the Agenda ref. 9A of the IASB meeting of February 2017[2], rate regulated entities have long argued that, without recognizing regulatory assets and regulatory liabilities, the entity's performance is distorted by the rate regulator's intervention in the imposition of performance obligations on the entity and the timing of cash flows from the ratepayers.

[2] http://www.ifrs.org/Meetings/MeetingDocs/IASB/2017/February/AP09-Rate-regulated-Activities.pdf

The recognition of regulatory assets and liabilities would better reflect the economic substance of IESO's operations and enhance the transparency and accountability of its financial reporting. For example, during the period from 2007 to April 2013 the IESO incurred costs relating to the Smart Meter Program amounting to $90.9 million, and these costs were expensed and are included in the accumulated deficit. In the absence of applicable regulatory accounting under PSAS, the IESO was unable to recognize a regulatory asset for this charge, despite receiving a rate order to recover it over the period from May 1, 2013 to October 31, 2018. Should the IESO choose to adopt ASC 980, a regulatory asset for the Smart Metering Charge would be recognized at December 31, 2016 for an amount of approximately $21.6 million, which would represent the remaining unamortized amount that would have been reported if the asset was recognized originally in 2013.

PSAS does not address accounting concepts in a rate regulated environment. Since there is no guidance in PSAS regarding the recognition and measurement of regulatory assets and liabilities, IESO may consider other sources based upon PSAS 1150.05 in the GAAP hierarchy to determine appropriate accounting policies in a rate regulated environment.

Within AcSB, Accounting Standards for Private Enterprises (ASPE) defines a rate regulated entity but provides no guidance on regulatory assets and liabilities however requires disclosure of such balances if they are recognized. IASB has not completed their project on rate regulated activities and current standards only include a holding standard based upon what was done under previous GAAP. It will be important for the IESO to monitor the IASB's ongoing project on rate regulated activities as this may affect the recognition, measurement, presentation and disclosures of the regulatory assets and liabilities. Both FASB and GASB have guidance on accounting in a regulatory environment. IPSASB does not provide any guidance on accounting by rate regulated entities.

It is important to note that rate regulated entities in Canada that prepare their general purpose financial statements in accordance with US GAAP (e.g. Hydro One and Ontario Power Generation), ASPE (e.g. the three Fortis subsidiaries in Ontario), as well as those rate regulated entities that are eligible to elect to apply the requirements of IFRS 14 and elected to do so when they adopted IFRS (e.g. over 60 LDCs in Ontario), generally all recognize regulatory deferral and variance accounts in accordance with US GAAP accounting principles set out ASC 980 *Regulated Operations*.

Statement 62 issued by GASB in December 2010 is effective for financial statements for periods beginning after December 15, 2011. The objective of the Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the Financial Accounting Standards Board (FASB) Statements and Interpretations issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements. Paragraphs 476–500 may be applied to activities reported in business-type activities that have regulated operations that meet all of the three criteria in paragraph 476 as follows:

(a) The regulated business-type activity's rates for regulated services provided to its customers are established by or are subject to approval by an independent, third-party regulator or by its own governing board empowered by statute or contract to establish rates that bind customers.

(b) The regulated rates are designed to recover the specific regulated business-type activity's costs of providing the regulated services.

(c) In view of the demand for the regulated services or products and the level of competition, direct and indirect, it is reasonable to assume that rates set at levels that will recover the regulated business-type activity's costs can be charged to and collected from customers. This criterion requires consideration of anticipated changes in levels of demand or competition during the recovery period for any capitalized costs.

The criteria above and the guidance in paragraphs 476-500 are based on ASC 980 *Regulated Operations*.

It is also important to note that in its statement of financial position, the Ontario Electricity Financial Corporation ("OEFC"), which reports under Canadian public sector accounting standards, recognizes a net unamortized liability balance for power purchase contracts, as detailed in the summary of significant accounting policies:

"The liability for power purchase contracts was originally calculated by discounting estimated losses over the life of the contracts. Under the *Electricity Restructuring Act, 2004*, OEFC began receiving actual contract prices for power from electricity consumers, effective January 1, 2005, and no longer incurs losses on these power purchase contracts. At that time, the Ministry of Finance estimated that the bulk of the liability would be eliminated over 12 years as existing electricity contracts expire. As a result, the bulk of the liability is being amortized to revenue over that period."

Although this liability is not defined as a regulatory liability in the OEFC's financial statements, the argument can be made that it substantively meets the definition under ASC 980 of a regulatory liability, as the OEFC had no further obligation and should have reversed the liability into income. After consultation with the AG at that time, it was decided to amortize the gain over the remaining term of the contracts.

In summary

Rate regulated entities in North America reporting under US GAAP, ASPE, IFRS (entities which have elected to use IFRS 14) and GASB generally all recognize regulatory deferral and variance accounts in accordance with US GAAP accounting principles based on ASC 980 *Regulated Operations* (see Appendix B for the accounting framework used by the Canadian rate regulated entities).

Evaluation of Other Sources of GAAP

When looking to other sources of GAAP, PSAS requires the other sources of GAAP to be evaluated

1. *as to whether they are consistent with accounting policies and disclosure within PSAS,*
2. *as to whether they are consistent with the application of concepts in PS 1000 and*
3. *as to all of the following criteria:*
   - *(a) Source deals with the specific circumstance*
   - *(b) Source is issued by an accounting standard setter*
   - *(c) Source continues to be relevant*
   - *(d) Source uses a consultative process and deliberation when developing policies*

As required by PS 1150.05(b), we need to analyze whether the concepts in the other source (i.e. ASC 980) are compatible with the (i) qualitative characteristics of financial information, (ii) the elements of financial statements, and (iii) the recognition and measurement criteria in PS 1000.

(i) Qualitative Characteristics of Financial Information

FASB	**PSAS 1000**	**Evaluation**
Concepts and objectives are for both business and non-business organizations as well as governmental units (Concept #4.3 to 4.5)	Public, legislators, councilors, investors, analysts, other governments (par. 14)	FASB considers governmental units
Financial reporting should: – Be useful in making resource allocation decisions – Be useful in assessing services and ability to provide services – Be useful in assessing management stewardship and performance – Provide information about economic resources, obligations, net resources and changes in them (Concept # 4.33-.54)	Financial statements should be relevant to the needs of the users and reliable. Relevance is achieved through timeliness, predictability and accountability value. Reliable information has the following characteristics: representational faithfulness, completeness, neutrality, conservatism and verifiability. (par. 28-29)	Similar

(ii) Elements of Financial Statements

FASB	PSAS	Evaluation
Assets		
Probable future economic benefits obtained or controlled by the entity as a result of past transactions or events. (Concept #6.25-.34)	Economic resources controlled by a government as a result of past transactions or event and from which future economic benefits are expected to be obtained. (par. 35)	Essential characteristics similar
Liabilities		
Probable future sacrifices of economic benefits arising from present obligations of the entity to transfer assets or provide services in the future as a result of past transactions or events. (Concept #6.35-.43)	Present obligations to others arising from past transactions or events, the settlement of which is expected to result in the future sacrifice of economic benefits with little or no discretion to avoid settlement. (par. 44)	Essential characteristics similar
Revenues		
Inflows from delivering or producing goods, rendering services or other activities that constitute the entity's central operations. (Concept #6.78-.79)	Increases in economic resources resulting from operations, transactions and events of the accounting period. (par. 46)	Similar
Expenses		
Outflows from delivering or producing goods, rendering services or carrying out other activities that constitute the entity's central operations. (Concept # 6.80-.81)	Decreases in economic resources resulting from operations, transactions and events of the accounting period. (par. 49)	Similar

(iii) Recognition Criteria

FASB	PSAS	Evaluation
To be recognized, an item must meet the definition of an element of the financial statements, must be measurable with sufficient reliability, be relevant and be reliable. (Concept # 5.64)	Item must have an appropriate basis of measurement, a reasonable estimate can be made of the amount and if the item involves obtaining or giving up future economic benefits, it is expected those benefits will be obtained or given up. (par. 55)	Similar

(iii) Measurement Criteria

FASB	PSAS	Evaluation
Measurement basis dependent upon nature of item. Historical cost basis, replacement cost, market value. (Concept # 5.65-.70)	Primarily using historical cost basis. Replacement cost and realizable value are also used, but in limited circumstances. (par. 60)	Similar

Criteria of PS 1150.08

Criteria	Evaluation
Source deals with the specific circumstance	Yes, ASC 980 Regulated Operations
Source is issued by an accounting standard setter	Yes, FASB
Source continues to be relevant	Yes, still used by rate regulated entities
Source uses a consultative process and deliberation when developing policies	Yes, comprehensive consultative process and deliberation

Evaluation whether regulatory assets meet the definition of Assets as per Section PS3210

PS3210 defines assets as *"economic resources controlled by a public sector entity as a result of past transactions or events and from which future economic benefits are expected to be obtained."* (par. 03)

The analysis of the three essential characteristics as defined by PS3210.4 are analyzed in the next table.

Characteristics	Additional guidance	Comments
They embody future economic benefits that involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows, or to reduce cash outflows. (par. 4(a))	The essence of assets are their future economic benefits. Assets embody future economic benefits that allow public sector entities to achieve their objectives. The future economic benefits embodied in assets involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows or to reduce cash outflows. (par. 11) The future economic benefits embodied in an asset may also be in the form of generating future cash inflows. Cash inflows benefit the public sector entity because cash can be used to purchase or to provide goods and services, redistribute wealth or settle liabilities. (par. 13)	The economic benefit embodied in the variance accounts (i.e regulatory asset) is the right to collect the incurred costs from ratepayers in order to settle the liability for the energy already consumed by the ratepayers. The electricity Act, 1998 ("EA") section 25.33(1) states: *"The IESO shall, through its billing and settlement systems, make adjustments in accordance with the regulations that ensure that, over time, payments by classes of market participants in Ontario that are prescribed by regulation reflect,* *a) amounts paid to generators, the Financial Corporation and distributors, whether the amounts are determined under the market rules or under section 78.1, 78.2 or 78.5 of the Ontario Energy Board Act, 1998; and* *b) amounts paid to entities with whom the IESO has a procurement contract, as determined under the procurement contract."*
The public sector entity can control the economic resource and access to the future economic benefits. (par. 4(b))	Economic resources can arise from, but are not limited to, the following: government's own legislation (for example, taxes, fines and penalties); (par. 08(c)) A public sector entity controls the economic resource and access to the	The economic resources is the right created by the legislation that the energy costs IESO incurs will result in future cash flows. In the regulatory environments, incurring costs creates an enforceable right to set rates at a level that permits

	future economic benefits when it: a. can benefit from the economic resource through its capacity to provide goods and services, to provide future cash inflows or to reduce cash outflows; b. can deny or regulate access to those benefits by others; and c. is exposed to the risks associated with the economic resource. (par.16)	IESO to recover those costs. The adjustment of future rates is the mechanism the OEB uses to implement the right. Currently, the EA section 25.33(5) states: *"The IESO shall establish and maintain such variance accounts as may be necessary to record all amounts payable or receivable by it under this section."* The legislation would be amended to permit IESO to collect specifically the deferral of the energy costs and the related interest and administrative costs.
The transaction or event giving rise to the public sector entity's control has already occurred. (par.4(c))	It is the occurrence of a past transaction or event on or before the financial statement date that distinguishes a present economic resource controlled by a public sector entity from an economic resource that may be controlled by a public sector entity in the future. (par. 25) The past transaction or event that gives rise to control of an economic resource resulting from exchange agreements or contracts usually occurs at the point of exchange. This arises when substantially all the benefits and risks of ownership have been transferred to the public sector entity and normally coincides with the disbursement of funds, exchange of other assets or assumption of liabilities. (par. 26)	The past event giving rise to IESO's control occurs as the energy cost is incurred, as IESO has a right to collect it from the ratepayers.
Conclusion: The right to collect the deferral of the energy costs and the related interest and administrative costs meets the definition of assets.		

When concepts are in conflict with PSAS then PSAS prevails (PS 1150.12). For example, PSAS does not recognize intangible assets (PS 3150.03, .14 and PS1000.58). So if regulatory assets are considered to be intangible assets, they would not be allowed to be recognized through another source of GAAP.

It is worth noting that the economic impacts of rate regulation are not recognized under US GAAP as intangible assets as the FASB has specific guidance to deal with this type of asset. It is also worth noting that the IASB has an ongoing project on rate regulated activities and are currently developing an accounting model based on the principles of IFRS 15 *Revenue from contracts with customers* to provide a principle-based framework for recognizing regulatory assets (see Agenda Ref. 9 for the IASB meeting on February 23, 2017). Furthermore, the Summary Comment Letter Analysis related to the ED/2009/8 on Rate Regulated Activities published by the IASB in July 2009 states on page 2 of 50:

"The International Financial Reporting Interpretations Committee ("IFRIC") observed that it had previously discussed whether a regulatory asset should be recognized in the context of service concession arrangements, either as deferred costs or as an intangible asset to reflect an expectation that the entity will

recover these costs as part of the price charged in future periods. It had concluded that entities applying IFRSs should recognize only assets that qualified for recognition in accordance with the IASB's *Framework for the Preparation and Presentation of Financial Statements* and relevant accounting standards, such as IAS 11 *Construction Contracts*, IAS 18 *Revenue*, IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*."

Entities that are not eligible to elect to apply the requirements of IFRS 14 do not recognize regulatory assets because in 2009 the IFRIC determined they did not meet the criteria for recognition of an intangible asset under IAS 38.

Therefore, we can conclude that ASC 980 is NOT in conflict with PS 3150.03, .14 and PS1000.58 with respect to intangible assets.

Conclusion:
FASB is appropriate to use as "*other source of GAAP*". FASB standard ASC 980 has extensive guidance for rate regulated entities including the recognition of regulatory assets and use of rate regulated accounting by IESO would be consistent with current reporting practices of H1, OPG and OEFC.

Appendix A:

Extract from the "DECISION and ORDER issued by the OEB on March 28, 2013" available on the IFRS website

Proceeding on the Ontario Energy Board's own motion to review the options for and ultimately determine the appropriate allocation and recovery of the Smart Metering Charge pursuant to section 19 of the Ontario Energy Board Act, 1998.

THE BOARD ORDERS THAT:

Effective May 1, 2013, the Smart Metering Entity charge to be levied and collected by the Smart Metering Entity from all Distributors identified in the Board's annual Yearbook of Electricity Distributors shall be $0.788 per month for each Residential and General Service <50kW customers for each distributor. The Smart Metering Entity charge shall be in effect from May 1, 2013 to October 31, 2018. The number of Residential and General Service <50kW customers to which the Smart Metering Entity charge will be applied to shall be in accordance with the methodology set forth in the Settlement Agreement attached as Appendix A.

http://www.ontarioenergyboard.ca/oeb/_Documents/EB-2012-0100/dec_order_IESO-SME_20130328.pdf

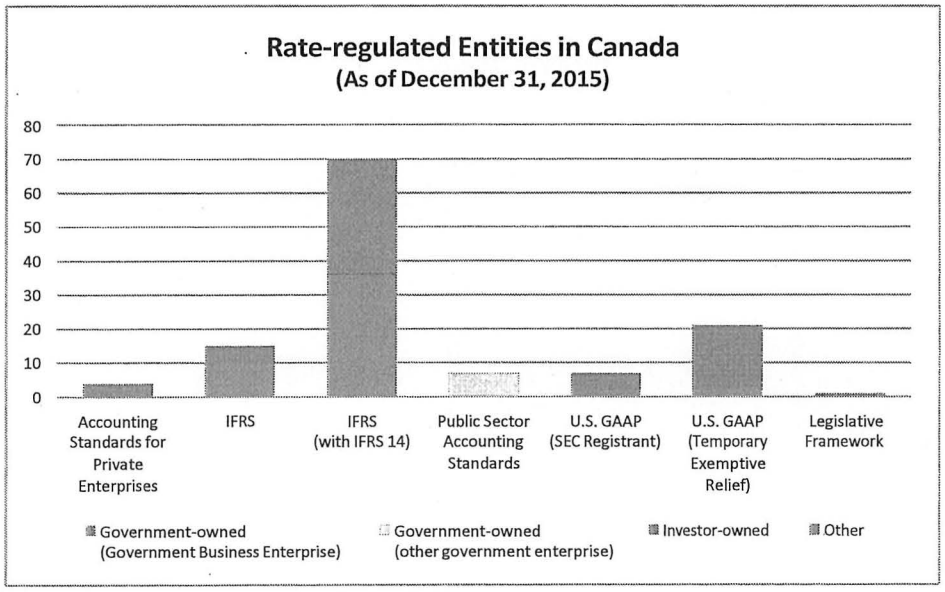
Appendix B:

Extract from the "Accounting Standards Advisory Forum Agenda Ref: 3A dated September 29, 2016" available on the IFRS website

Canadian Rate-regulated Entities

18. The accounting framework landscape for Canadian rate-regulated entities is currently diverse. For annual periods beginning on or after January 1, 2015, rate-regulated entities that are Canadian publicly accountable enterprises are required to apply IFRS. Rate-regulated entities that adopted IFRS for the first time after IFRS 14 *Regulatory Deferral Accounts* was issued continue to recognize these balances. Government Business Enterprises (which operate to generate a profit or on a break-even basis) that are also rate-regulated entities are also directed to apply standards applicable to for-profit entities, and thus apply IFRS. Canadian securities legislation permits dual-listed entities (i.e., Canadian entities also registered with the U.S. Securities and Exchange Commission) to apply U.S. GAAP in the normal course. Temporary exemptive relief is also available from the Canadian Securities Administrators that permits rate-regulated entities that are not dual-listed to apply U.S. GAAP in place of IFRS. If a rate-regulated entity is not a publicly accountable enterprise or a Government Business Enterprise, additional accounting framework options may also include Accounting Standards for Private Enterprises or Public Sector Accounting Standards. A non-GAAP reporting framework is used when legislated by the provincial owner of a government-owned rate-regulated entity.

19. As of December 31, 2015, there were approximately 125 rate-regulated entities in Canada. These entities mainly range in size from small entities owned by municipal governments to large investor-owned entities or entities owned by provincial governments.



Source: Information compiled based on audited financial statements for fiscal year 2015, or information from rate filings that confirmed the accounting framework used by these entities. Due to data collection constraints, the population could be slightly larger.

20. The chart above highlights two key points:

(a) The majority of investor-owned entities have chosen U.S. GAAP over IFRS. A few entities that are not reporting issuers apply Accounting Standards for Private Enterprises. Both U.S. GAAP and Accounting Standards for Private Enterprises permit the recognition of balances arising from rate regulation. Several entities that apply U.S. GAAP have told us this choice was influenced by the need to provide their users with financial statements that accurately reflect the economics of their business. Further, some entities presently using the temporary exemptive relief described in paragraph18 have said they are considering incurring the cost and effort necessary to become a registrant of the U.S. Securities and Exchange Commission in order to have the permanent ability to apply U.S. GAAP. While such a decision could be primarily for business reasons such as the entity expanding its operations into the U.S., it could also be attributed to the continuing uncertainty about the ultimate outcome of the IASB's Rate-regulated Activities project and the approaching expiry date of the securities regulators' exemptive relief.

(b) Public sector entities that are Government Business Enterprises tend to apply IFRS. The majority of these entities is made up of several large provincially-owned utilities, and many small municipally-owned local distribution utilities that do not issue debt or list in the U.S. stock market, and are not subject to Canadian securities legislation. As a result, they cannot apply U.S. GAAP. As shown in the chart, many of these entities adopted IFRS for the first time after the IASB issued IFRS 14, which allowed them to continue their previous accounting practices for rate-regulated activities.

21. Within the pool of government-owned rate-regulated entities, there are entities that do not meet the characteristics of Government Business Enterprises and are required to apply Public Sector Accounting Standards.

22. The data on the different accounting frameworks in Canada is unique. It demonstrates that when given a choice, rate-regulated entities select an accounting framework that captures the effects of rate regulation on their financial position and financial performance in order to communicate more decision-useful information to users.

http://www.ifrs.org/Meetings/MeetingDocs/ASAF/2016/September/1609-ASAF-03A-Rate-regulated-Activities-Canada.pdf

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White Paper on the Province's proposed Global Adjustment Smoothing Account

Below is a summary of IESO's preliminary views on the implementation of the Province's proposed Global Adjustment Smoothing Account.

Understanding that the finalization of the legal terms, the financing structure and other detailed terms will take several months and will involve collaboration between legal counsel, parties involved and other stakeholders, this letter is intended to provide the guideline and framework which could form the foundation of the plan.

Issues being considered in this document are:

Issue #1: Can the IESO recognize deferral or variance accounts related to the annual Global Adjustment Smoothing Account as a regulatory asset on its statement of financial position?

Issue #2: Can the IESO derecognize the deferral or variance accounts related to the Global Adjustment Smoothing Account upon sale to the OPG Trust?

1. Recognition of regulatory assets (deferral and variance accounts)

Background and Assumptions for issue #1

The facts, circumstances, and assumptions relevant to the specific transactions are as follows:

1. The IESO's legal status is a not-for-profit, non-taxable, corporation established pursuant to Part II of the *Electricity Act, 1998*. IESO is classified as an Other Governmental Organization and prepares its financial statements in accordance with Canadian public sector accounting standards (PSAB).
2. IESO is rate regulated by the OEB in accordance with the Electricity Act, 1998 and the Ontario Energy Board ("OEB") Act, 1998 but currently does not recognize the economic impacts of rate regulation in its general purpose financial statements.
3. The IESO is required to obtain approval from the OEB under s. 25(1) of the Electricity Act, 1998 for the approval of its own expenditures, revenue requirement and fees. The last rate approval was obtained on December 29, 2016[1].
4. The OEB issued a Decision and Order on March 28, 2013 that permits IESO to recover the MDMR costs (the Smart Metering Charge) (see Appendix A). *(i.e. Costs incurred in the past will be fully recovered through future rates)*
5. Furthermore, in accordance with the *Electricity Act, 1998* and the *OEB Act, 1998*, the IESO has approved variance accounts to record all amounts payable or receivable by it in connection with the amounts paid to generators, the Financial Corporation, distributors and to entities with whom the IESO has a procurement contract. (i.e. costs incurred in the past will be fully recovered through future rates)
6. The province is contemplating deferring the recovery of a portion of the annual Global Adjustment Smoothing Account (comprised primarily of the electricity costs paid to the generators) over a period of 25-30 years, so that costs incurred would be fully recovered through future rates.
7. The *Electricity Act, 1998* and the *OEB Act, 1998* would be amended through legislation to require the deferral of the recovery of the Global Adjustment Smoothing Account and the future recovery in rates charged to customers.

[1] http://www.rds.ontarioenergyboard.ca/webdrawer/webdrawer.dll/webdrawer/rec/556699/view/Dec_Order_IESO 20161229.PDF

8. The OEB would grant generic deferral or variance accounts to capture the difference between the amounts paid to generators and others, and the amounts collected in rates. Furthermore, the interest and ancillary costs related to the contemplated transaction would also be included in future rates charged to customers. In summary, the legislation would create a right to collect the incurred cost.

9. The IESO would change its accounting policies to permit the recognition of the economic impacts of rate regulation as from the 2016 financial year. IESO would adopt the guidance of ASC 980 *Regulated Operations* to better reflect the economic substance of its operations and enhance the transparency and accountability of its financial reporting.

Appropriate Accounting Principle for issue #1

ASC 980 Regulated Operations

- 980-10-15-2 *"The guidance in the Regulated Operations Topic applies to general-purpose external financial statements of an entity that has regulated operations that meet all of the following criteria:*

  (a) The entity's rates for regulated services or products provided to its customers are established by or are subject to approval by an independent, third-party regulator or by its own governing board empowered by statute or contract to establish rates that bind customers.

  (b) The regulated rates are designed to recover the specific entity's costs of providing the regulated services or products. This criterion is intended to be applied to the substance of the regulation, rather than its form. If an entity's regulated rates are based on the costs of a group of entities and the entity is so large in relation to the group of entities that its costs are, in essence, the group's costs, the regulation would meet this criterion for that entity.

  (c) In view of the demand for the regulated services or products and the level of competition, direct and indirect, it is reasonable to assume that rates set at levels that will recover the entity's costs can be charged to and collected from customers. This criterion requires consideration of anticipated changes in levels of demand or competition during the recovery period for any capitalized costs."

- 980-10-20 Glossary, Definition of incurred costs *"A cost arising from cash paid out or obligation to pay for an acquired asset or service, a loss from any cause that has been sustained and has been or must be paid for."*

- 980-10-05-8 *"Unless an accounting order indicates the way a cost will be handled for rate-making purposes, it causes no economic effects that would justify deviation from the GAAP applicable to business entities in general. The mere issuance of an accounting order not tied to rate treatment does not change an entity's economic resources or obligations. In other words, the economic effect of regulatory decisions—not the mere existence of regulation—is the pervasive factor that determines the application of GAAP. 980-340 – Other Assets and Deferred Costs."*

- 980-340-25-1 *"Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An entity shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:*

  (a) It is probable (as defined in Topic 450) that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.

  (b) Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.

  A cost that does not meet these asset recognition criteria at the date the cost is incurred shall be recognized as a regulatory asset when it does meet those criteria at a later date."

- 980-340-40-1: *"If at any time an entity's incurred cost no longer meets the criteria for the capitalization of an incurred cost (see paragraph 980-340-25-1), that cost shall be charged to earnings."*

- 980-350-50-1: "*In some cases, a regulator may permit an entity to include a cost that would be charged to expense by an unregulated entity as an allowable cost over a period of time by amortizing that cost for rate-making purposes, but the regulator does not include the unrecovered amount in the rate base. That procedure does not provide a return on investment during the recovery period. If recovery of such major costs is provided without a return on investment during the recovery period, the entity shall disclose the remaining amounts of such assets and the remaining recovery period applicable to them.*"
- 980-340-55-2: "*In some cases, a regulator may approve rates that are intended to recover an incurred cost over an extended period without a return on the unrecovered cost during the recovery period.*"
- 980-340-55-3: "*The regulator's action provides reasonable assurance of the existence of an asset (see paragraph 980-340-25-1). Accordingly, the regulated entity would capitalize the cost and amortize it over the period during which it will be allowed for rate-making purposes. That cost would not be recorded at discounted present value. An exception to this general rule is provided for costs of abandoned plants.*"

Issue #1: Can the IESO recognize deferral or variance accounts related to the annual Global Adjustment Smoothing Account as a regulatory asset on its statement of financial position?

US GAAP includes special accounting provisions that are applicable to entities with activities that are subject to rate regulation (see White Paper - Adoption of the Guidance in ASC 980 Regulated Operations). The result is that rate regulated entities are required to recognize regulatory assets and liabilities provided the following three criteria are met:

Criteria	Comment	Evaluation
The entity's rates for regulated services or products provided to its customers are established by or are subject to approval by an independent, third-party regulator or by its own governing board empowered by statute or contract to establish rates that bind customers.	IESO has unrecognized variance accounts related to the MDMR (smart meters), that have been approved by the OEB in accordance with the Electricity Act and the OEB Act (see Appendix A). It is important to note that Hydro One and OPG are both consolidated into the province's books, are both regulated by the OEB and their respective regulatory assets and liabilities are reported in the province's books.	Met
The regulated rates are designed to recover the specific entity's costs of providing the regulated services or products.	Currently, the rates approved by the OEB are designed to recover the IESO's costs of providing the regulated services and the pass-through related to the energy purchased from the generators. The contemplated transaction is based on the fact that the OEB would grant generic deferral or variance accounts to capture the difference between the amounts paid to generators and others, and the amounts collected in rates. Furthermore, the interest and ancillary costs related to the contemplated transaction would also be included in future rates charged to customers. In summary, the legislation would create a right to collect the incurred costs.	Met

In view of the demand for the regulated services or products and the level of competition, direct and indirect, it is reasonable to assume that rates set at levels that will recover the entity's costs can be charged to and collected from customers. This criterion requires consideration of anticipated changes in levels of demand or competition during the recovery period for any capitalized costs."	Since the deferral or variance accounts would be sold to the OPG Trust at least on a monthly basis and cash would be received on the same day, this criteria would be met. This criteria would need to be monitored on a yearly basis to ensure that IESO and the OPG Trust would be able to recover the future deferred amount taking into account the levels of demand or competition during the recovery period.	Met
Conclusion: The three criteria would be met.		

Conclusion: Based on the assumptions mentioned above, IESO should be able to recognize a regulatory asset for the deferral of the annual Global Adjustment Smoothing Account. As mentioned in the ASC 980 guidance above, it is important that an accounting order be issued by the OEB which indicates the way the incurred costs would be handled for rate-making purposes as the OEB's action provides reasonable assurance of the existence of a regulatory asset.

2. Derecognition of regulatory assets (deferral and variance accounts)

Background and Assumptions for issue #2

The facts, circumstances, and assumptions relevant to the specific transactions are as follows:

1. The annual Global Adjustment Smoothing Account that would be deferred in the deferral or variance accounts (the "Asset") would be significant.
2. The IESO does not currently have the financial capability to finance the Asset and is contemplating selling the Asset to a Trust to be set-up by OPG (the "OPG Trust").
3. The OPG Trust would be consolidated by OPG.
4. Proposed terms of the sale agreement between the IESO and the OPG Trust:
   - The sale contract would be structured as an absolute sale, which would assign future economic benefits or cash flows related to the Asset exclusively to the OPG Trust.
   - The arrangement would be structured whereby there is no recourse or obligations remaining of IESO related to the Asset.
   - The arrangement is not considered to be a financing transaction as IESO would have no obligations to the OPG Trust after the Asset is sold to the OPG Trust.
   - IESO would not retain any rights or benefits from the Asset.
   - IESO would not have any rights to interest or penalties on the Asset once it has been transferred to the OPG Trust.
   - The contract would be clear that IESO cannot pledge the Asset as collateral to obtain future cash flows or financing.
   - IESO would continue to collect related cash flows on the OPG Trust's behalf and remit those cash flows to the OPG Trust without material delay. In addition, IESO would not be entitled to reinvest such cash flows, except for investments in cash or cash equivalents during the short settlement period from the collection date to the date of required remittance to the OPG Trust, and interest earned on such cash and cash equivalents is passed to the OPG Trust. The contract would define IESO's role strictly as that of agent, under a pass-through arrangement.
   - Servicing, origination, and arrangement fees, would be collected by IESO in rates charged to ratepayers as part of its market dealings.
   - The Asset would be sold to the OPG Trust at least, on a monthly basis and cash would be received on the same day.

Appropriate Accounting Principles for issue #2

Public Sector Accounting Standard ("PSAS") 3210, *Assets*, defines an asset as "*...economic resources controlled by a government as a result of past transactions or events and from which future economic benefits are expected to be obtained.*" [par. 3]

.04 *"Assets have three essential characteristics:*

(a) they embody future economic benefits that involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows, or to reduce cash outflows;

(b) the public sector entity can control the economic resource and access to the future economic benefits; and

(c) the transaction or event giving rise to the public sector entity's control has already occurred."

.22 *"Control of an economic resource and of access to the future economic benefits are essential characteristics of an asset, whereas possession or ownership is not."*

.24 *"A public sector entity may act as trustee when it administers trusts on behalf of the beneficiaries specified in the agreement or statute. As trustee, the public sector entity merely administers the assets, following the terms*

and conditions set out in the agreement. It does not control the asset because it does not have access to the future economic benefits. Those benefits flow to the beneficiaries."

As noted in PS1000 Financial statement concepts:

.37 *"An item is not an asset of a government if it lacks one or more of the essential characteristics listed in the preceding paragraph. Thus, for example, an item does not qualify as an asset of a government if the item involves:*

(a) no future economic benefit;

(b) future economic benefit, but the government cannot obtain it; or

(c) future economic benefit that the government may obtain, but the events or circumstances that give the government control of the benefit have not yet occurred."

As noted in PS3450, derecognition of a financial liability:

.042 *"A government should remove a financial liability (or part of a financial liability) from its statement of financial position when, and only when, it is extinguished (i.e., when the obligation specified in the contract is discharged or cancelled, or expires)."*

.043 *"A financial liability (or part of a financial liability) is extinguished when the debtor either:*

(a) discharges the liability (or part of it) by paying the creditor, normally with cash, other financial assets, goods or services; or

(b) is legally released from primary responsibility for the liability (or part of it) either by process of law or by the creditor. (When the debtor has given a guarantee, this condition may still be met.)"

.046 *"Payment to a third party, including a trust (sometimes called "in-substance defeasance"), does not, by itself, relieve the debtor of its primary obligation to the creditor in the absence of legal release."*

.047 *"If a debtor pays a third party to assume an obligation and notifies its creditor that the third party has assumed its debt obligation, the debtor does not derecognize the debt obligation, unless the condition in paragraph PS 3450.043(b) is met. If the debtor pays a third party to assume an obligation and obtains a legal release from its creditor, the debtor has extinguished the debt. However, if the debtor agrees to make payments on the debt to the third party or direct to the original creditor, the debtor recognizes a new debt obligation to the third party."*

Issue #2: Can the IESO derecognize the deferral or variance accounts related to the annual Global Adjustment Smoothing Account upon sale to the OPG Trust?

PS3210 does not specifically address the derecognition of a regulatory asset as the concept of a regulatory asset does not exist under PSAS.

As mentioned above, regulatory assets do not meet the definition of intangible asset or financial asset. Specifically, regulatory assets do not meet the definition of financial asset because they are imposed on customers through the tariff (i.e., imposed by the OEB) and do not represent a right to receive payments from another party as a result of a contract.

More generally, PSAS.3210.37 suggests that an asset would no longer be recognized when it fails to meet the definition of an asset.

Based on PS1000.37(b), an item does not qualify as an asset of a government if the item involves future economic benefit, but the government cannot obtain it.

Based on the assumptions mentioned above, the legal title of the Asset would be transferred to the OPG Trust, as well as, ALL risks and rewards, including the following:

- the contract would define IESO's role strictly as that of agent, under a pass-through arrangement;
- all cash flows related to the Asset would be transferred without material delay to the OPG Trust;
- rights to interest or penalties on the Asset would be for the benefits of the OPG Trust;
- IESO cannot pledge the Asset; and
- no recourse or obligations remaining of IESO related to the Asset.

IESO should also evaluate whether the sale of the Asset should in fact be considered as a borrowing arrangement. In the absence of detailed guidance on this subject, we can analogize to the guidance in PS3450 *Financial Instruments* for the derecognition of a financial liability. Par. 43 states that *"A financial liability (or part of a financial liability) is extinguished when the debtor is legally released from primary responsibility for the liability (or part of it) either by process of law or by the creditor. (When the debtor has given a guarantee, this condition may still be met.)"* Based on the assumptions mentioned above, since the legal title of the Asset would be transferred to the OPG Trust, as well as, ALL risks and rewards, it can be concluded that the sale of the Asset is not a borrowing arrangement.

Conclusion: Based on the proposed terms of the sale agreement between the IESO and OPG Trust mentioned above, the deferral or variance accounts would be derecognized at the point where the IESO would derive no future economic benefit from it. This would occur where the IESO ultimately transfers the rights, risk and rewards related to those deferral or variance accounts to the OPG Trust. This would occur on the receipt of cash from the OPG Trust.

Appendix A:

Extract from the "DECISION and ORDER issued by the OEB on March 28, 2013" available on the IFRS website

Proceeding on the Ontario Energy Board's own motion to review the options for and ultimately determine the appropriate allocation and recovery of the Smart Metering Charge pursuant to section 19 of the Ontario Energy Board Act, 1998.

THE BOARD ORDERS THAT:

Effective May 1, 2013, the Smart Metering Entity charge to be levied and collected by the Smart Metering Entity from all Distributors identified in the Board's annual Yearbook of Electricity Distributors shall be $0.788 per month for each Residential and General Service <50kW customers for each distributor. The Smart Metering Entity charge shall be in effect from May 1, 2013 to October 31, 2018. The number of Residential and General Service <50kW customers to which the Smart Metering Entity charge will be applied to shall be in accordance with the methodology set forth in the Settlement Agreement attached as Appendix A.

http://www.ontarioenergyboard.ca/oeb/_Documents/EB-2012-0100/dec_order_IESO-SME_20130328.pdf

ONTARIO POWER GENERATION

February 27, 2017

Mr. Serge Imbrogno
Deputy Minister,
Ministry of Energy
4th Floor, Hearst Block
900 Bay Street
Toronto, Ontario
M7A 2E1

Dear Deputy:

Below is a summary of OPG's preliminary views on the implementation of the Province's proposed Global Adjustment Smoothing Account and financing structure. These views are contingent on the proposed terms and conditions that were sent to the Ministry of Energy on February 21, 2017.

Understanding that the finalization of the legal terms, the Trust indentures, financing structure and other detailed terms will take several months and will involve collaboration between legal counsel, input from capital markets, parties involved and other stakeholders, this letter is intended to provide the guideline and framework which could form the foundation of the plan.

Please do not hesitate to contact me if you have any questions regarding this summary.

Sincerely,

Mr. Ken Hartwick
Chief Financial Officer and Senior Vice President, Finance
Ontario Power Generation
W: 416-592-6985
C: 647-544-6985
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cc. Jeff Lyash, President and CEO, OPG

Background:

The Province has indicated that it will take steps to reduce electricity bills in the near term. It has identified reductions in the Global Adjustment Charge (GAC) charged to electricity customers as a means to achieve its policy goals. The Province is proposing to temporarily reduce the amount of the GAC charged to electricity customers (primarily RPP-eligible customers). The exact quantum and duration of the program is still not known but based on discussions with the Province GAC charges of approximately $2-5B per year for the next 5-10 years would be deferred and collected over future periods commencing after the deferral period. A combination of senior debt and subordinated debt (mainly sourced by additional equity from the shareholder) would be issued to fund the amount deferred. The financing cost of the debt and other costs of running the program would form part of the amounts recovered from customers over the term of the program.

The Province has requested that OPG administer the GAC deferral, because of OPG's participation in the market, regulatory knowledge and the potential ability to consolidate the activity and accounting with OPG. Given the significant amount of financing required for the GAC deferral, OPG has developed a financing structure (depicted below) to:

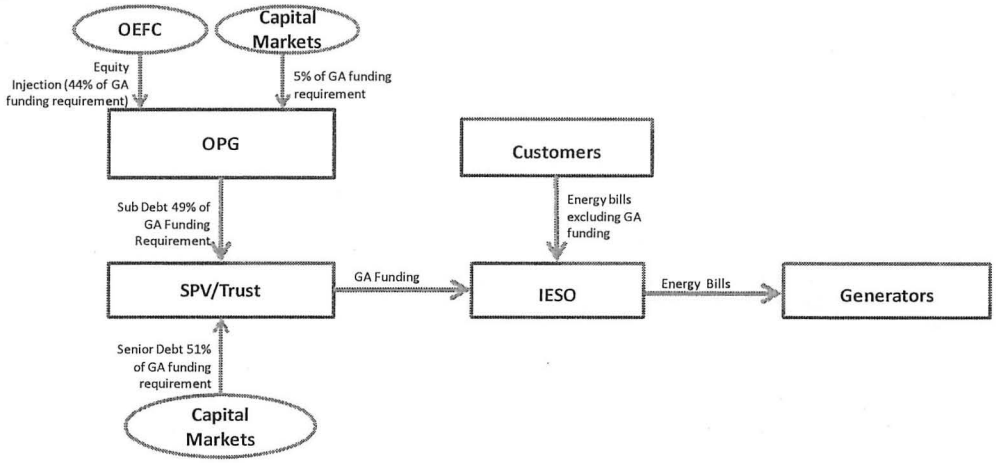
- restrict the risk to OPG;

- maximize the cost-effectiveness of the Trust or the Special Purpose Vehicle ("SPV") financing vehicle; and
- allow for consolidation into OPG financial statements.

The success of this structure is dependent on achieving a number of objectives which are reviewed in the following sections:

A. Ability to Recognize an Asset and Record Revenue
B. Ability to Consolidate the SPV into OPG
C. Ability to Finance
D. External Assessment
E. Risk Summary

All of the percentages shown in the graphic below are indicative and will be highly dependent on the legislation that the Province will enact:



Process:

The IESO will effectively sell the 'right to collect' deferred future revenue from ratepayers (GA Recovery Right asset) to the SPV in return for cash proceeds. In order for the SPV to purchase this asset the SPV will obtain the financing from two key sources: 51% directly from capital markets and 49% as subordinated debt from OPG. OPG will obtain 44% of this financing as an equity injection from the Province and 5% from capital markets.

A. Ability to Recognize an Asset and Record Revenue

Accounting Requirements under International Financial Reporting Standards (IFRS)

1) It is our understanding that the IESO and KPMG have concluded that the sale of this 'right to collect' future revenue (or regulatory asset) is not a financing transaction and will not be recorded as a financial liability. Based on that conclusion, the right to collect will be accounted for as an intangible asset in the SPV.

2) In order to the SPV to record this right as an intangible asset, the right must meet the following conditions:
   - The intangible asset must be separable and arise from a contractual or legal right (i.e. mandated by the Legislation and SPV Indenture Agreement).
   - The SPV must have the control and power to obtain future economic benefits from the intangible asset.
   - The SPV must be able to demonstrate that the intangible asset is purchased at fair value.

3) In order for the SPV to recognize appropriate revenue to offset any ongoing costs, the Legislation must require interest, carrying and administrative costs to be paid to the SPV on a monthly basis. This may result in additional amounts to be deferred to achieve the desired customer impact. Payment of revenue to the SPV is also important to service the interest expenses of the debt.

B. Ability to Consolidate the SPV into OPG under IFRS

OPG 'Control' of the SPV - Accounting Requirements

1) 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 SPV, or whether it has the ability to affect the returns of the SPV through its power over the SPV. Rather, all facts and circumstances are considered when assessing whether an entity has control over another entity. Based on the relevant accounting guidance under IFRS, OPG has proposed terms necessary to demonstrate that OPG has control over the SPV. OPG's external auditors, Ernst & Young, has provided their concurrence that based on the information provided to them to date that the following conditions should permit consolidation of the SPV by OPG.

Directive:

1. The SPV must be undertaken by OPG as a business initiative on its merits. A Shareholder Directive is to be limited to direct OPG to investigate the option of establishing a SPV vehicle to administer, finance and operate the Global Adjustment plan. The control, risk and rewards of that SPV will determine its consolidation into OPG as a business enterprise.

SPV:

2. The SPV should not operate in a predetermined way such that OPG does not have decision-making authority over the SPV's ongoing activities after its formation (i.e. should not operate on 'autopilot').
3. 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 SPV.
4. The Province cannot have the right to veto OPG's decisions about the relevant activities of the SPV. OPG must have the power over the relevant activities of the SPV and be compensated. The relevant activities of the SPV 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 SPV.
5. OPG must have the power to determine or change operating and financing policies of the SPV, which will affect the variability of risks and returns.
6. The Province or its agencies must not directly or indirectly fund (through debt or equity) more than 50% of the following:
    - The SPV
    - Any of OPG's investments in the most subordinated debt of the Trust
7. OPG must own greater than 50% of the most subordinated debt and targeted to be no less than 5%[1] of the total debt of the SPV. Such ownership must be financed entirely by OPG through operating cash flows or external debt, without assistance from Provincial sources. A quantitative analysis should be performed at a later date to corroborate the appropriateness of the 5% threshold to support that the 5% subordinated debt investment is sufficient to absorb most of the expected variability in the SPV.
8. OPG must have the ability to earn variable returns by exercising its authority, which shall be accomplished as follows:

[1] While the rest of the letter refers to a 10% investment in the most junior subordinated debt with OPG owning 5%, it should be noted that OPG should own more than 50% of the most subordinate debt. For simplicity, the degree to which OPG's ownership beyond 50% is not shown in this letter.

a. The cash flow from the restructured asset shall include interest determined based on a relevant benchmark that is appropriate relative to the restructured asset, plus an appropriate margin consistent with the relevant market and other risks
b. OPG shall have the authority to determine the financing strategy, which will vary the financing costs with the objective of enabling the SPV to achieve a more favourable return compared to the return from the restructured asset
c. The SPV shall establish classes of liabilities (senior, subordinated and the most subordinated). The classes would allow the SPV 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.
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.
e. OPG should participate in the detailed design of the above and the SPV 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.

Nothwithstanding the above, under certain 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), the OEFC may provide bridge financing beyond the designated percentage for a defined period. The relevant terms should ensure that this temporary measure does not detract from the rights of OPG to direct all of the relevant activities of the SPV. Additionally, OPG should not be protected from risk of loss by the OEFC with respect to its subordinated investment, nor should it lose its right to derive the residual returns should such bridge financing be required.

Legislation

9. The Legislation must require interest, carrying and administrative costs to be paid to the SPV on a monthly basis, so that the SPV is able to recognize appropriate revenue to offset any ongoing costs.
10. The Legislation must dictate the manner in which the restructured 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 Trustees.
11. The Legislation must be written to avoid legal or constitutional challenges and be irrevocable to reduce the cost of borrowing and with a specific formula which determines the deferral amount. As irrevocability would be difficult under Canadian law one mitigation would be to provide a Provincial guarantee which only applies with cancellation or amendment of the legislation.
12. The spirit of the above terms should be reflected in the SPV Indenture Agreement as well as Legislation, wherever possible.

2) The Trust is expected to be financed as follows:
   - 51% senior secured debt from external markets
   - 39% senior subordinated debt from OPG (via Province equity injection into OPG)

- 10% junior subordinated debt from OPG (5% from external markets and 5% from Province equity injection into OPG).

When assessing control, an investor shall consider the nature of its relationship with other parties and whether those parties are acting on the investor's behalf (i.e. they are 'de facto agents'). If OPG is assessed to be a 'de facto agent' of the Province, it will compromise the ability for OPG to consolidate the Trust. The split above is to meet the following conditions to ensure that OPG is not considered a 'de facto agent' of the Province:

- The Province or its agencies must not directly or indirectly fund (through debt or equity) more than 50% of the following:
  - The Trust
  - Any of OPG's investments in the most subordinated debt of the Trust
- OPG must own greater than 50% of the most subordinated debt and targeted to own no less than 5% of the total debt of the Trust. Such ownership must be financed entirely by OPG through operating cash flows or external debt, without assistance from Provincial sources.

3) The Province will need to conclude on whether OPG still meets the definition of a Government Business Enterprise as defined under Public Sector Accounting Board standards in order to obtain the preferred consolidation treatment after the transaction. We also recommend that the Province to undertake the analysis deemed necessary to confirm the accounting treatment in its consolidated Public Accounts, including if the recognition of the intangible asset would result in an offsetting liability in the Public Accounts.

C. Ability to Finance

Property Right or Right to Collect
Legislative Requirements for Financing

The GA Recovery Right must be structured to encompass the following elements:

- Right to recover from and bill Ontario electricity customers for (1) the principal amount of GA that is being deferred, (2) all interest and other financing costs incurred in respect of the deferral of the GA, (3) all fees, expenses and other administrative costs associated with such financing;
- Repayment/amortization schedule as agreed by the IESO and any purchaser of such GA Recovery Right (or pursuant to a pre-defined schedule/formula that covers all of the purchaser's principal, interest and ongoing financing costs on a monthly basis);
- Repayment/amortization schedule must include a true up mechanism to ensure all costs associated with the deferral can be recovered from customers;
- IESO may dispose of the GA Recovery Right, provided that any such disposition shall be a true sale and absolute transfer to the purchaser of the IESO's right, title and interest in and to the GA Recovery Right;
- Purchaser will have the right to require the IESO (or any successor) to collect the principal amount of GA Recovery Right, together with interest, financing and administration costs, on the agreed repayment/amortization schedule;
- Right must be irrevocable and, if amended by future governments, debt holders have the right of action against the government to recover the amount outstanding including interest, fees, expenses and any damages resulting from the amendment;
- GA Recovery Right will not be subject to any set-off, counterclaim or other defence by the IESO or any successor or affiliated entity; and
- Make certain amendments to the Electricity Act to allow OPG to implement the SPV financing structure (e.g. allowing OPG to create subsidiaries and holding companies, and to have a beneficial interest in the SPV, etc). This would provide flexibility to accommodate possible variations to the financing structure that may be desirable over time.

Detailed legislative requirements are specified in the attachments as follows:

Attachment 1 Legislative requirements to allow deferral of global adjustment amounts to be financeable

Attachment 2 Statutory amendments

The proposed financing structure for the SPV is:

	Risk Profile	Source	% of Total Funding Requirements
Tranche A Senior Debt	The least risky	Capital Markets	51%
Tranche B Sub Debt	In between A&C	OPG via OEFC	39%
Tranche C Sub Debt)	The most risky	OPG via OEFC	5%
		OPG via Capital Markets	5%

SPV structure is used to accomplish the following:

- SPV holds right to charge customers for the benefit of debt holders;
- Allows the financing vehicle to be ring-fenced from OPG as an SPV structure is set up as generally single purpose entities with no other operations that could add risk to the SPV, dilute debt holder rights, allow parties from other operations to claim rights to the future recovery from customers or allow these other parties to initiate bankruptcy proceedings;
- Enables SPV to potentially get a higher credit rating than OPG;
- Supports consolidation with OPG provided accounting requirements are satisfied;

This approach supports a number of objectives of the GA Recovery Right:

- 51% external senior debt supports separation of the SPV from the Province
- 5% junior subordinated debt establishes OPG's "at risk" equity which supports separation of the SPV from the Province
- Subordinated debt provides flexibility to the financing structure and additional credit support to external debt holders
- Subordinated debt sourced from OPG (mainly funded by equity injection from the Province) minimizes impact on OPG credit metrics reducing risk of an OPG rating downgrade that could result in the SPV being consolidated directly with the Province as the SPV would be considered an arm of the Province.

Recent transactions used as precedents are:

Duke Energy Florida Project Finance LLC
June 2016
5 series of bonds totalling USD$1.3B
Weighted average life from 2 to 19 years with interest rates from 1.2% to 3.1%
Credit rating AAA

Utility Debt Securitization Authority
Sponsored by Long Island Power Authority
March 2016
Amount issued USD$0.6B
Weighted average life of 12 years and weighted average yield of 2.7%

August 2016
Amount issued USD$0.5B
Weighted average life of 7 years and weighted average yield of 2.0%

Credit rating AAA

Cumulative outstanding (including previous issuances): USD$4.2B

D. External Assessment

Shakerhill Partners, an external advisor, identified the following items in an assessment of the structure and financeability of the structure:

- The structure is financeable however there are a number of significant risks to the structure:
  - Canadian and Ontario law does not provide the same protection to property right as exists in the US federal and state constitutions to limit the ability of governments to adversely impair contracts to the detriment of the holder;
  - Legislation could mitigate some of the risks – deferred recovery asset to be "uncapped", regular semi-annual true up to ensure recovery, Province provides sufficient committed liquidity to the IESO so that temporary shortfall in recovery does not affect payments to SPV, term of the deferral recovery substantially exceeds the longest maturity of debt of the SPV and that true-up mechanism take account of potential for currency, interest rate and duration mis-match between the debt of the SPV and the recovery mechanism;
  - Size of the program may be too large for Canadian securitization market requiring access to the US securitization market;
- Final maturity of debt should not exceed 30 years from inception of the program
- True up mechanism should be designed such that the forecast of recovery is less than 10% of the customer bill under downside scenarios to limit growth of the deferral balance as a higher portion of the customer bill increases the political risk to debt holders which could result in a lower credit rating and potential impact on financeability
- Securitized debt products are specialized and price at a premium to other fixed rate instruments however a successful program supported by a strong credit rating this premium could shrink over time to a minor spread over Provincial debt
- OPG's credit rating should be maintained provided sufficient equity is injected to maintain credit metrics
- While the structure is not expected to impact the Province there are risks that the program could negatively impact the rating agencies view of the Province's financial management.

E. Risk Summary

i. Consolidation

- Elements of the proposed structure were established to support consolidation of the SPV into OPG. These items may not be sufficient to establish OPG as risk owner of the SPV and the SPV may need to be consolidated directly with the Province.

ii. Financeability

- The legislation establishing the structure and the property right for recovering the financing and associated costs may not be adequate for financing purposes resulting in more expensive financing or an inability to obtain the required external financing.

iii. Cost of Financing

- Future governments may enact legislation that changes the right of the SPV to recover amounts from customers.
- The right to recover amounts from future customers must be irrevocable and subject to full recovery from the government in the event that future governments reduce or eliminate the recovery. A legal structure that is weaker than the precedent US transactions increases the risk to debt holders and the cost of financing.
- Interest rates on bonds in the securitization market are higher than equivalent rated bonds. Rate for a AAA securitization credit is about 50 bps higher than GOC (rated AAA) for a 5 year term. This difference is attributable to the specialized structure of the bond, smaller investor pool for this bond, smaller size of the market and higher perceived risks of the bond.
- Any regulator involvement must not be seen to modify any terms of debt issued or the property right securing the debt as this would increase risk to debt holders.

- It may not be possible to issue debt to match the terms of the deferred asset so shorter term debt would be used which raises risk to re-finance the maturing debt as the market may no longer be interested in this product. As well, underlying reference interest rates may be higher and the market may require a higher spread to invest in this product.
- With the GA Recovery Right program continuing for 10 years, debt issued over this period is subject to changes in both the underlying reference interest rates and appetite of the market for this product.

iv. OPG Credit Rating

- Minimizing the impact of significant additional debt on OPG's credit rating is dependent on higher EBITDA arising from earned income on the GA Recovery Right in excess of external debt. Ability of the SPV to record revenue reflecting the growth in asset value.
- Potential OPG credit rating downgrade if legislative structure is not adequate to support long term recoverability, inability to record revenue from growth in asset value or agencies view equity injection as debt.
- OPG credit rating downgrade could result in loss of GBE status or result in SPV being consolidated directly with the Province.

Attachment 1

LEGISLATIVE REQUIREMENTS TO ALLOW DEFERRAL OF GLOBAL ADJUSTMENT AMOUNTS TO BE FINANCEABLE

The IESO currently has a right to collect GA monthly from ratepayers through provisions in the *Electricity Act, 1998*. It is proposed that collection of a certain portion of the monthly GA be deferred for collection in the future, and that the right to recover the deferred GA from ratepayers be used as a basis for structured financing/securitization.

The current proposal is for a trust to be created as a financing vehicle (the "**Trust**") in connection the deferred GA. The Trust will finance the deferral of the GA by purchasing the right to recover such deferred GA from the IESO for the principal amount of the GA being deferred. For example, if the amount of GA that is being deferred is $200 million in a given month, the Trust will purchase from the IESO the right to future recovery of the deferred GA and the associated financing costs (including interest and transaction costs) for $200 million in cash.

The Trust is expected to finance these purchases from the IESO through a combination of senior secured financing raised in the capital markets and subordinated financing from OPG (the funding for which will mostly be from equity injections from the OEFC/Province).

For accounting purposes, OPG will need to have the ability to direct the activities of the Trust, through a services agreement and/or through the Trust's constating document.

Based on securitized financing raised by utilities in the US (backed by utility cost recovery orders) and the current regulatory framework in Ontario, the legislation in Ontario would need to be amended to provide the following, at a minimum:

1. The IESO will be empowered to create an asset (the "**Regulatory Asset**") consisting of all right, title and interest in and to:

   (a) right to recover from and bill Ontario electricity ratepayers for:

   (i) the principal amount of GA that is being deferred for collection;
   (ii) all interest and other financing costs incurred in respect of the deferral of the GA (whether through senior debt raised in the public markets or subordinated debt raised from OPG or others); and
   (iii) (subject to the comments in paragraph 5 below in respect of OPG's internal administrative costs only) all fees, expenses and other administrative costs associated with such financing, including up-front and ongoing financing costs and any indemnity payments;

all on such repayment/amortization schedule as agreed by the IESO and any purchaser of such right (or pursuant to a pre-defined schedule/formula in the legislation that covers all of the purchaser's principal, interest and ongoing financing costs on a monthly basis); and

(b) all revenues, collections, claims, rights to payments, money or proceeds arising from the rights and interests set out in paragraph (a) above, regardless of whether such revenues, collections, claims, rights to payments, money or proceeds are imposed, billed, received, collected or maintained together with or commingled with other revenues, collections, rights to payments, payments, money or proceeds.

2. The IESO may dispose of the Regulatory Assets created from time to time on such terms as the IESO determines in accordance with the terms of directives to be issued to the IESO from time to time by the Minister, provided that any such disposition shall be a true sale and absolute transfer of the IESO's right, title and interest in and to a Regulatory Asset to the purchaser of the Regulatory Asset.

3. The Regulatory Assets will not be subject to any set-off, counterclaim or other defence by the IESO or any successor or affiliated entity thereof.

4. The legislation will need to recognize the Regulatory Assets as amounts that may be recovered by the IESO (e.g. it could be designated as a "GA Deferral" and would be included in the amounts collectible by the IESO through the GA collection mechanism, and would include interest and financing costs).

5. The purchaser of the Regulatory Asset will have the right to require the IESO (or any successor) to collect the principal amount of GA deferred, together with interest, financing and administration costs, on the agreed repayment/amortization schedule. **[NTD: In the LIPA securitization rate order, if the entity that is authorized to collect rates to service the bonds ends up defaulting, there is the ability to request a court to order "sequestration" and payments of amounts owing to the owner of the Regulatory Asset. Consider whether to include a similar right here. Alternatively, consider whether a security interest over the moneys collected by the IESO could be provided to the purchaser.]**

OEB would be provided with oversight over the internal administrative costs collected by the Financing Trust. This could be accomplished by (a) providing the purchaser of the Regulatory Asset with the right to require

the IESO or a successor to collect only the principal amount of GA together with interest and financing costs and third party fees and expenses, and (b) requiring the IESO to collect amounts through the global adjustment and make payments to the purchaser of the Regulatory Asset with respect to the internal administrative costs incurred by the purchaser in connection with the purchase and management of the Regulatory Asset and the Financing Trust, in accordance with the order of the OEB then in effect. Under this mechanism, the OEB would be required to review the purchaser's internal administrative costs through a streamlined process and issue such orders in accordance with rules to be prescribed under a new regulation under the OEB Act, which would clearly limit the OEB's scope of review and could establish the basis for the purchaser to receive an appropriate fee for its services.

6. In the event that any action is taken or permitted by the Province or any regulatory authority that limits, alters, or impairs the value of a Regulatory Asset or reduces the ability of the IESO or the purchaser of the Regulatory Asset to collect or recover the costs associated therewith, the owner of the Regulatory Asset and the holders of any bonds or other securities issued to finance the purchase of the Regulatory Asset, will have a right of action against the Province for any damages suffered as a result of such amendment.

STATUTORY AMENDMENTS

The following is preliminary and is based on our current understanding of the proposed structure and objectives. For example, we have assumed that the structure will not entail the insertion of a new Holdco between OPG and the Province. As these aspects are refined, some of the suggested amendments described below may not be needed and other aspects that we are not aware of may need to be considered. Accordingly, these suggested amendments are provided for discussion purposes and are subject to change. We would welcome the opportunity to work with OPG and the Ministry on refining the scope and substance of required legislative and regulatory amendments.

A. Amendments to Implement Structure

Certain *Electricity Act, 1998* amendments would be needed to implement the anticipated structure (which we understand, as noted above, would not include a Holdco), as follows:

- **Section 53.1(1):** Amend to permit owning and operating generation facilities through subsidiaries (not only directly through OPG). In addition, amend to permit OPG to administer, manage, loan moneys to and have a beneficial interest in, if applicable, Financing Trust.

- **Section 53.2:** Amend to permit the Minister to acquire, hold, dispose of or otherwise deal with securities or debt obligations of, or any other interest in, OPG or any subsidiaries. This is to accommodate possible variations to the financing structure that may be desirable over time.

- **Section 53.■ (new):** New statutory section to permit the Minister to enter into arrangements relating to an exercise of powers under 53.2.

- **Section 53.■ (new)**: New statutory section providing that creditors of Financing Trust have no recourse to the assets of OPG or any of its subsidiaries (other than Financing Trust, if applicable). In addition, consideration should be given as to whether the Act should be amended so that the Financing Trust cannot be wound up or liquidated.

B. Miscellaneous Corporate Items to Address

- **OPG Articles:** Amend the OPG's articles to remove the private company restrictions.

- **MOA with Province:** Consider whether any amendments to OPG's MOA with the Province are required to contemplate the Financing Trust.

C. Amendments Under Electricity Act to Implement GA Smoothing

Based on our understanding that the global adjustment smoothing mechanism is intended to benefit residential and small business customers only and that the Minister will be responsible for determining how much global adjustment smoothing is to be applied in a given month, if any, amendments to the *Electricity Act, 1998* and Ontario Regulation 429/04 (Adjustments Under Section 25.33 of the Act) would be needed to implement the mechanism, as follows:

(i) Electricity Act:

- **Section ■ (New):** Establish a new power for the Minister to make directives to the IESO in relation to the global adjustment smoothing mechanism and, particularly, for purposes of establishing global adjustment smoothing amounts from time to time (expected to be monthly). To the extent possible, the directive power should be drafted so as to limit the ability for a future Minister to require the IESO to do anything that would materially and adversely affect the Financing Trust or its lenders. **[NTD: While our understanding is that the Minister would direct this, we note from other materials we have seen that OPG may instead be recommending a formula approach. It is not clear what the formula would look like, where it would be set out or how it would be applied and by whom]**

- **Paragraph 25.33(1):** This section says that IESO shall make adjustments in accordance with the regulations to ensure that, over time, payments by prescribed classes of market participants reflect amounts paid to OPG, OEFC and distributors, as well as amounts paid to entities with whom IESO has a procurement contract. Add new subsection (c) so as to require IESO to ensure that, over time, payments by prescribed classes of market participants also reflect amounts paid to Financing Trust. **[NTD: Not certain this is needed if only to benefit residential and small business consumers, who are not market participants. May be needed in reference to payments from distributors and retailers]**

- **Paragraph 25.33(2):** This section says that distributors and retailers shall make adjustments in accordance with the regulations to ensure that, over time, payments by prescribed classes of consumers reflect amounts paid to OPG, OEFC and distributors, as well as amounts paid to entities with whom IESO has a procurement contract. Add new subsection (c) so as to require distributors and retailers to ensure that, over time, payments by prescribed classes of consumers also reflect amounts paid to Financing Trust.

- Note: As described below, the regulation will need to include new requirements for the IESO to record the global adjustment smoothing amounts in one or more variance accounts and to use those amounts to offset amounts otherwise recorded in the variance accounts under Section 25.33(3) of the Act. For context, we note:

    - Section 25.33(3) says that adjustments under (1) or (2) relating to electricity consumed by consumers whose rates are determined by

the OEB under s. 79.16 of the OEB Act (i.e. RPP Customers) shall instead be made in accordance with the regulations to one or more variance accounts established and maintained by the IESO.

- Section 25.33(4) says IESO, distributors and retailers shall make and receive such payments, set-offs and credits as may be required or permitted by the regulations with respect to consumers described in (3), i.e. RPP Customers.

- Section 25.33(5) says that IESO shall establish and maintain such variance accounts as may be needed to record all amounts payable or receivable by it under 25.33.

(ii) O. Reg. 429/04 (Adjustments Under Section 25.33 of the Act):

- **Section 1(1):** Consider adding definitions for "Financing Trust" and "global adjustment smoothing amount" or such other terms as may be preferred.

- **Section 1.2(1) (New):** Add section providing that, for the purposes of this Regulation, the global adjustment smoothing amount for a month is the amount determined by the IESO in accordance with a directive from the Minister under section ■ of the Electricity Act in respect of the month. **[NTD: See above note re use of Minister directives]**

- **Section 1.2(2) (New):** Consider adding a section providing that the IESO shall publish the global adjustment smoothing amount for a month by no later than the 10th business day of the following month [to align with general publication requirements for global adjustment under s. 1.1(2)].

- **Section 10(1):** Amend formula for calculating Class B GA rate by subtracting the global adjustment smoothing amount for a month from "M", which is the total amount of the global adjustment for the month. The global adjustment smoothing amount could be designated as "X", such that the formula would be (M-X-N)/(P-Q). Define "X" as the global adjustment smoothing amount for the month as determined by the IESO in accordance with the Minister's directive under section ■ of the Electricity Act for the month. **[NTD: See above note re use of Minister directives]**

- **Section 10.1 (New):** Add new section to deal with adjustments under subsection 25.33(3) of the Act, i.e. in respect of RPP consumers. This section should require the IESO to establish, within the variance account(s) it maintains pursuant to subsection 25.33(3) of the Act, one or more subaccounts in which it shall record the global adjustment smoothing amounts applicable to the classes of consumers described in subsection 25.33(3) of the Act. This section must also specify that the IESO shall apply the amounts recorded in the subaccounts against the balances in the variance accounts for purposes of section 79.16(3) of the OEB Act.

- **Note:** This is a key aspect because, when the OEB determines RPP rates, it must take into account the balances in the variance accounts established by the IESO under s. 25.33 of the Electricity Act and make adjustments with a view to eliminating the balances within 12 months. This proposed new section 10.1 causes the IESO to reduce (in the near term) the variance account balances by the global adjustment smoothing amounts, as provided by Financing Trust, thereby enabling the OEB to determine RPP rates that, despite being lower for RPP consumers in the near term, still eliminate the relevant variance account balances within 12 months.

- **Paragraph 11(2)2.ii:** Amend the formula for calculating the allocation of global adjustment for a month to a licensed distributor that is a market participant by subtracting the global adjustment smoothing amount for a month from "M", which has the same meaning as under section 10(1). The global adjustment smoothing amount could be designated as "X", such that the formula would be [(M-X-N) x (R+S-T)]/(P-Q). Define "X" as suggested under section 10(1).

- **Paragraph 11(2)3:** Amend the formula for calculating the allocation of global adjustment for a month to each Class B market participant by subtracting the global adjustment smoothing amount for a month from "M", which has the same meaning as under section 10(1). The global adjustment smoothing amount could be designated as "X", such that the formula would be [(M-X-N) x U]/(P-Q). Define "X" as suggested under section 10(1).

- **Paragraph 16(7)4:** Consider amending the description of "Global Adjustment" that is required to be included on certain invoices so as to inform consumers that their portion of the global adjustment for the month (i) may have been reduced by the application of a global adjustment smoothing amount from the Financing Trust, or (ii) may include amounts payable to the Financing Trust in respect of global adjustment smoothing amounts previously applied.

- **Section 20(1):** This section establishes an obligation for the Ontario Electricity Financial Corporation and every licensed distributor that is a market participant to give the IESO such information as the IESO may require for the purposes of the Regulation in the form specified by the IESO and before the expiry of the period specified by the IESO. Consider amending to extend this obligation to the Financing Trust.

- **Section 20(6):** This section provides that on request by the OEB, the IESO, a licensed distributor, an embedded generator, a retailer or the OEFC shall give the OEB such information relating to this Regulation as the OEB may require, in the form and within the period specified by the OEB. Consider amending to extend this obligation to the Financing Trust.

D. Amendments Under OEB Act to Implement Cost Recovery for Financing Trust

Amendments to the *Ontario Energy Board Act*, including amendments to O. Reg. 95/05 (Classes of Consumers and Determination of Rates) and the introduction of a new regulation, would be needed to implement a cost recovery process for the Financing Trust in relation to the global adjustment smoothing mechanism, potentially with limited OEB oversight, as follows:

(i) Ontario Energy Board Act:

- **Section 78(3.3):** This provision establishes an obligation for the OEB, when determining rates for the retailing of electricity, to take into account balances in variance accounts established under section 25.33 of the Electricity Act and to make adjustments "with a view to eliminating those balances within 12 months or such shorter time periods as the Minister may direct." Consider whether any amendments are needed, and confirm this works with the framework being proposed.

- **Section 78.7 (New):** We understand that the Province may want the OEB to have an oversight role. One possible approach would be to establish a new statutory section establishing that the IESO shall make payments to the Financing Trust with respect to the internal administrative costs incurred by the Financing Trust in connection with the purchase and management of the Regulatory Asset and the Financing Trust. Such payments by the IESO would need to be made in accordance with the order of the OEB then in effect, which orders shall be made by the OEB in accordance with rules prescribed under a new regulation.

    - The new regulation would need to be clear that the OEB does not have jurisdiction to consider the principal amount or any interest, financing costs, third party fees or expenses. Rather, OEB's role would be limited to considering the internal administrative costs of the Financing Trust and ensuring the Financing Trust receives an appropriate fee for its services, all of which would be recovered by the Financing Trust from the IESO, which would collect those amounts in the global adjustment. Note that, if this approach is accepted, the IESO and distributors and retailers would need the authority to collect such amounts as part of the GA and IESO would need the authority to pay such amounts to the Financing Trust. As such, additional amendments would be needed under O. Reg. 429/04.

- **Note:** Section 79.16 of the OEB Act does not require changes, but the significance of this provision should be understood.

    - Section 79.16 gives the OEB responsibility for determining electricity commodity prices for eligible consumers. Eligibility is determined under Reg. 95/05 (Classes of Consumers and Determination of Rates), which is also known as the Regulated Price Plan (RPP) Regulation.
    - Section 4(2) of the RPP Regulation defines RPP-eligible consumers as low volume consumers (i.e. those who annually use less than 150,000 kWh

or such other amount as prescribed), consumers with demand of 50 kW or less, residential consumers that have accounts with distributors, consumers who annually use 150,000 to 250,000 kW of electricity, and consumers who have accounts with distributors if in the farming business.

- Paragraph 6(1)3 of the RPP Regulation provides that "In determining the rates (for RPP-eligible consumers), the Board shall forecast the cost of electricity to be consumed by the consumers to whom the rates apply, taking into consideration adjustments required under section 25.33 of the *Electricity Act, 1998* and shall ensure that the rates reflect those costs."
- The Ontario Energy Board has developed a Regulated Price Plan Manual (revised February 16, 2016) to describe the processes and methodologies it uses for determining electricity commodity prices that are charged to RPP consumers pursuant to Section 79.16 of the OEB Act and paragraph 6(1)3 of the RPP Regulation.

(ii) O. Reg. 95/05 (Classes of Consumers and Determination of Rates)

- **Paragraph 6(1)3:** Amend so as to require the Board, when forecasting the cost of electricity to be consumed by the consumers to whom the rates apply, to take into consideration not only the adjustments required under section 25.33 of the Electricity Act but also the application or prior application of global adjustment smoothing amounts determined by the IESO in accordance with Minister directives under section ■ of the Electricity Act, and to ensure that the RPP rates reflect those amounts. **[NTD: See above note re use of Minister directives]**

(iii) New Regulation (Payments to the Financing Trust)

- If the OEB is to be given the role of reviewing and approving the recovery of OPG's internal administrative costs for the Financing Trust under the potential section 78.7 (see above), then this regulation should describe the process and criteria pursuant through which the OEB would determine the amounts that the IESO would be required to collect through the global adjustment, in accordance with section 25.33 of the Electricity Act, and pay to the Financing Trust in respect of the provision of global adjustment smoothing amounts. This part of the regulation should establish:

  - any reporting requirements from the Financing Trust and/or the IESO to the OEB in connection with the global adjustment smoothing mechanism;
  - the frequency of the OEB making determinations under this part of the regulation;
  - the process through which the OEB shall make these determinations, which should be a streamlined administrative process rather than a public hearing process or, if a hearing is needed, then the scope of the proceeding should be clearly and narrowly constrained so as to deter intervenor involvement, lengthy proceedings and reduce/eliminate risk to recovery by Financing Trust;

- the basis for the OEB's determinations as to the payments that shall be made to the Financing Trust, which should specify that:
  - the Financing Trust shall recover its prudently incurred internal administrative costs on a forecast basis each year;
  - the Financing Trust shall receive an appropriate fee each year (with some guidance as to what would be appropriate); and
  - the approved payment amounts shall be collected by the IESO through the global adjustment and paid to the Financing Trust in accordance with the order of the OEB then in effect. Note that O. Reg. 429/04 would likely need amendments to permit IESO (and distributors and retailers) to collect these amounts through the global adjustment.

GA Smoothing – OPG Accounting Considerations

- An SPV/Trust is a stand-alone entity able to conduct business separately under a Trust agreement

The conditions required for OPG to consolidate the SPV/Trust are outlined in the following table

Issue	Response
1. Decision Making	• OPG must have decision making authority on the operation of the SPV/Trust (without a veto right by the Province), including naming of trustees, establishing operating plans and budgets, setting or changing financing policies. • The SPV/Trust while operating within the legislation, must be controlled by OPG to operate freely and to alter terms and conditions not specified in the legislation to ensure recovery of the deferred amounts
2. Business Risk	• The SPV/Trust must have variability of returns as a normal business enterprise would, including such things as interest charged on deferred amounts, decisions on how to finance these deferred amounts, the ability to make / lose and keep any spread from financing
3. Funding	• The Province cannot directly or indirectly fund more than 50% of SPV/Trust or any investment in the SPV/Trust • OPG must own at least 50% of the most exposed equity /sub-debt in the SPV/Trust
4. Directive	• Directive that is issued should not be prescriptive or direct OPG to set up this business. The directive should only be "guiding" i.e. to allow OPG to evaluate options and put forward to the OPG Board a recommended plan for Shareholder approval

GA Smoothing – OPG Accounting Considerations - continued

Issue	Response
5. Other required Attributes:	The legislation that supports the formation of the SPV/Trust must have the following attributes: • Must require interest, carrying and administrative costs be paid to the Trust to allow for Revenue recognition • The amount to be deferred must either be specified or be calculated based on a specific formula that is not subject to ongoing decision making by the Province. **The Province cannot have the ability to override this formula** • Legislation should be written to avoid the possibility of being revoked with wording to ensure the SPV/Trust and its debt holders would have their capital guaranteed and paid for directly by the Province if such a situation were to happen • The spirit of the legislation should be reflected in the Trust Indenture Agreement

GA Financing Structure Requirements

KEY ELEMENTS REQUIRED TO ENSURE THE DEFERRAL OF GA CHARGES CAN BE FINANCED:

Creation of Strong Property Rights

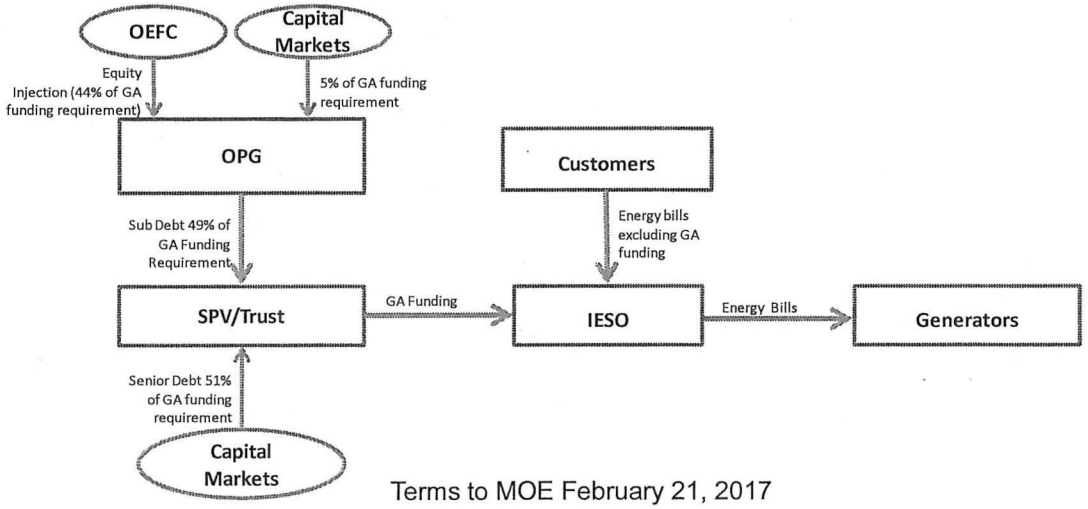
- Legislation enshrines the ability of the IESO to create a Right to charge customers in the future for the Global Adjustment (GA) deferred today including principal amount deferred, interest and other financing costs on the amount deferred and fees, expenses and other administrative costs.
- The Right can be sold to an appropriate Trust or Special Purpose Vehicle (SPV) to obtain funds to pay amounts due to generators under contracts or regulation. These SPVs are generally single purpose entities with no other operations that could add risk to the entity, dilute debt holder rights, allow parties from other operations to claim rights to the future recovery from customers or allow these other parties to initiate bankruptcy proceedings.
- Right must be irrevocable and if the Right is amended by future governments the debt holders have the right of action against the government to recover the amount outstanding including interest, fees, expenses and any damages resulting from the amendment.
- Right must specify the recovery period or the mechanism for setting the recovery rate including true up of the rate to ensure all amounts are recovered

Economic Factors

- Limits on the recovery amount (principal, interest, fees and expenses) charged to customers in future periods must have compensating elements such as longer recovery period to ensure the full amount deferred plus interest, financing and other administration costs is recovered from customers.
- Need to balance customer relief with debt holder risk. Longer recovery periods and larger deferred balances increase risk to the debt holder of future government intervention.
- The amount required by the SPV to purchase and service the Right will be funded 51% from debt holders, 5% from OPG through capital markets and 44% from OPG via equity injection to OPG from the Province. The funding from OPG will be loaned to the SPV as subordinated debt.

GA Financing Structure Requirements - continued

- SPV will be used to raise the GA financing and ring fence OPG from its legal obligations
- SPV will be structured to allow for GBE accounting consolidation into OPG
- Given that SPV will be consolidated into OPG for accounting purposes, the significant amount of debt required to fund the GA deferral will have a severe impact on OPG's credit rating. If 100% of the requirement is funded by debt OPG would be downgraded.
- To manage this exposure and minimize the cost of funding. The required funding would be split into 2 buckets:
    1. 56% from capital markets, and
    2. The remainder provided by the Province via equity injection, which would be loaned to SPV as subordinated debt.
- The use of equity to fund a portion of the GA deferral also allows for an improvement in both Net Income and EBITDA as incremental revenue is captured by the increase in the value of the deferral which would offset the fiscal impact of the borrowing at Province level.
- Credit rating metrics are generally maintained within established limits.



Terms to MOE February 21, 2017

INDICATORs OF CONTROL
Government has the power to unilaterally appoint or remove a majority of the members of the governing body of the organization
Government has ongoing access to the assets of the organization, has the ability to direct the ongoing use of those assets, or has ongoing responsibility for losses
Government holds the majority of the voting shares or a "golden share" that confers the power to govern the financial and operating policies of the organization
Government has the unilateral power to dissolve the organization and thereby access its assets and become responsible for its obligations

Other indicators that may provide evidence of control exist when the government has the power to:

Provide significant input into the appointment of members of the governing body of the organization by appointing a majority of those members from a list of nominees provided by others or being otherwise involved in the appointment or removal of a significant number of members
Appoint or remove the CEO or other key personnel
Establish or amend the mission or mandate of the organization
Approve the business plans or budgets for the organization and require amendments, either on a net or line-by-line basis
Establish borrowing or investment limits or restrict the organization's investments
Restrict the revenue-generating capacity of the organization, notably the sources of revenue
Establish or amend the policies that the organization uses to manage, such as those relating to accounting, personnel, compensation, collective bargaining or deployment of resources

GLOBAL ADJUSTMENT DEFERRAL

POTENTIAL FRAMEWORK FOR THE "REGULATED ASSETS"

EXECUTIVE SUMMARY

- Each month where the IESO does not collect the full GA amount, the IESO shall establish a deferral account pursuant to the legislation and record in the account the amount that it has deferred and which will be collected in future (each such deferral account would be a "**Regulatory Asset**").
- The IESO would then sell the Regulatory Asset to the Financing Trust (the "**Trust**") in exchange for a payment equal to the GA amount not collected in respect of that month. Note that this right to sell the Regulatory Asset would need to be explicitly permitted by the legislation as this type of sale has not, to our knowledge, been authorized by the OEB previously.
- The Trust would then be required to apply to the OEB for approval to clear and recover amounts from time to time from the Regulatory Asset (i.e., the deferral account).
- A specific regulation would be promulgated setting out the basis upon which OEB would make its decision to approve the clearance and recovery of amounts from the Regulatory Asset (i.e., the deferral account). Specifically, the OEB's discretion would be limited to ensuring the accuracy of amounts recorded in the Regulatory Asset (i.e., the deferral account).
- OEB would be granted broader discretion to consider prudence when approving costs of the Trust arising from OPG's internal costs.

DETAILED ANALYSIS OF REQUIRED CHANGES TO LEGISLATION AND REGULATION

- If necessary, establish authority for the OEB to license the Trust and a requirement for the Trust to obtain such a license from the OEB in order to make the Trust an OEB-regulated entity (s. 57 of the OEB Act)
    - Direct or otherwise require the OEB to issue a license to the Trust on an expedited basis, subject to limited conditions
- Establish authority for the OEB to determine payment amounts for the Trust (strictly in accordance with the following bullet), together with a requirement for the IESO to make payments to the Trust in accordance with the order of the OEB then in effect (similar to the framework that applies in respect of OPG's payment amounts for prescribed generation under s. 78.1 of the OEB Act)
- Require the OEB to make orders determining payment amounts for the Trust in accordance with rules to be prescribed by regulations and create a new regulation that sets out limitations on the OEB's discretion in establishing those payments (similar to O. Reg. 53/05 in respect of OPG's payment amounts). Under the regulation:

- Require the IESO to establish the deferral accounts (i.e., the Regulatory Assets) to record the amount of uncollected GA

- Require the Trust to record in the Regulatory Assets (i.e., the deferral accounts purchased from the IESO): (a) interest costs on amounts borrowed to acquire the Regulatory Assets, and (b) financing and third party transaction costs.

- Require the Trust to establish another deferral account and record therein administrative costs of the Trust payable to OPG

- Require the OEB, in making an order determining payment amounts for the Trust, to ensure that the Trust recovers the balances recorded in each of the deferral accounts as long as the OEB is satisfied that the amounts have been accurately recorded in the accounts (similar to rules under s. 6 of O. Reg. 53/05 in respect of OPG's payment amounts).

    - Consider allowing the OEB to consider prudence only in respect of reviewing internal administrative costs of the Trust payable to OPG.

    - Consider specifying the timing for recovery of the balances in each of the deferral accounts, i.e. once a balance is approved for recovery, over how long a period will the Trust recover that balance?

    - Consider further prescribing the form, methodology, assumptions and/or calculations that the OEB shall be required to use in making orders determining payment amounts for the Trust, such as requiring the OEB to make these determinations by delegated authority and/or without a hearing, specifying the frequency with which such orders must be issued and specifying the information needed from the Trust to enable the OEB to make its determinations from time to time.

- As noted above, the IESO would be required to make payments to the Trust in accordance with the order of the OEB then in effect. To do so, the IESO would need to be authorized to collect, through the Global Adjustment, the amounts it needs to make payments to the Trust in accordance with such orders of the OEB. This would require amendments to s. 25.33 of the Electricity Act and to O. Reg. 429/04 to enable the IESO to collect the relevant amounts from distributors, retailers and directly from market participants that are connected directly to the IESO-controlled grid.

- **[NTD: Need to establish mechanism through which determinations are made (such as Minister directives or otherwise) as to whether and how much smoothing should be obtained by IESO from the Trust and applied to reduce the global adjustment in a particular period, as well as the timing for commencing recovery by the Trust of principal amounts.]**

- **[NTD: Through a separate process associated with the existing Rate Protection Plan, the OEB would be expected to incorporate the impacts of the smoothing mechanism into rates for customers that are subject to RPP rates.]**

Maksymuik, Amanda (ENERGY)

From: Rehob, James (ENERGY)
Sent: March-03-17 3:34 PM
To: Maksymuik, Amanda (ENERGY)
Subject: FW: Documents to use for GA structure
Attachments: Overview of Legislative Changes for Financeability 23020589_3.docx; GA Smoothing - Potential Regulatory Framework (Confidential) - February 27 2017 (2).docx; Global Adjustment Deferral_White Paper_OPG r1a.pdf

Importance: High

From: Shear, Dan (ENERGY)
Sent: Friday, March 03, 2017 12:59 PM
To: Calwell, Carolyn (ENERGY/MEDEI/MRI)
Cc: Rehob, James (ENERGY)
Subject: Documents to use for GA structure
Importance: High

Hi Carolyn,

Forgive me if I am three steps behind everyone else, but I want to confirm which documents we should draw upon (at least at this preliminary stage) for the details/principles related to the GA deferral construct.

For e.g., I have three documents that are fairly recent that discuss the construct (copies attached):

- Legislative Requirements to Allow Deferral of GA Amounts to be Financeable (from OPG – attached to Feb27/17 letter from Ken Hartwick to Serge Imbrogno
- GA Smoothing – OPG Accounting Considerations (footer says "Terms to MOE Feb21/17")
- GA Deferral – Potential Framework for the "Regulated Assets"

It would be helpful (for me at least) to have a clear understanding of the starting point details (such as they are). Would you have a moment to discuss before the 1:30 call?

Dan

LEGISLATIVE REQUIREMENTS

TO ALLOW DEFERRAL OF

GLOBAL ADJUSTMENT AMOUNTS TO BE FINANCEABLE

The IESO currently has a right to collect GA monthly from ratepayers through provisions in the *Electricity Act, 1998*. It is proposed that collection of a certain portion of the monthly GA be deferred for collection in the future, and that the right to recover the deferred GA from ratepayers be used as a basis for structured financing/securitization.

The current proposal is for a trust to be created as a financing vehicle (the "**Trust**") in connection the deferred GA. The Trust will finance the deferral of the GA by purchasing the right to recover such deferred GA from the IESO for the principal amount of the GA being deferred. For example, if the amount of GA that is being deferred is $200 million in a given month, the Trust will purchase from the IESO the right to future recovery of the deferred GA and the associated financing costs (including interest and transaction costs) for $200 million in cash.

The Trust is expected to finance these purchases from the IESO through a combination of senior secured financing raised in the capital markets and subordinated financing from OPG (the funding for which will mostly be from equity injections from the OEFC/Province).

For accounting purposes, OPG will need to have the ability to direct the activities of the Trust, through a services agreement and/or through the Trust's constating document.

Based on securitized financing raised by utilities in the US (backed by utility cost recovery orders) and the current regulatory framework in Ontario, the legislation in Ontario would need to be amended to provide the following, at a minimum:

1. The IESO will be empowered to create an asset (the "**Regulatory Asset**") consisting of all right, title and interest in and to:

   (a) right to recover from and bill Ontario electricity ratepayers for:

   (i) the principal amount of GA that is being deferred for collection;
   (ii) all interest and other financing costs incurred in respect of the deferral of the GA (whether through senior debt raised in the public markets or subordinated debt raised from OPG or others); and

(iii) (subject to the comments in paragraph 5 below in respect of OPG's internal administrative costs only) all fees, expenses and other administrative costs associated with such financing, including up-front and ongoing financing costs and any indemnity payments;

all on such repayment/amortization schedule as agreed by the IESO and any purchaser of such right (or pursuant to a pre-defined schedule/formula in the legislation that covers all of the purchaser's principal, interest and ongoing financing costs on a monthly basis); and

(b) all revenues, collections, claims, rights to payments, money or proceeds arising from the rights and interests set out in paragraph (a) above, regardless of whether such revenues, collections, claims, rights to payments, money or proceeds are imposed, billed, received, collected or maintained together with or commingled with other revenues, collections, rights to payments, payments, money or proceeds.

2. The IESO may dispose of the Regulatory Assets created from time to time on such terms as the IESO determines in accordance with the terms of directives to be issued to the IESO from time to time by the Minister **[Torys NTD: While our understanding is that the Minister would direct this, we note from other materials we have seen that OPG may instead be recommending a formula approach. It is not clear what the formula would look like, where it would be set out or how it would be applied and by whom]**, provided that any such disposition shall be a true sale and absolute transfer of the IESO's right, title and interest in and to a Regulatory Asset to the purchaser of the Regulatory Asset. **[Torys NTD: part of being able to convey a property interest in a chose in action (which the regulatory asset would represent since the aspect that makes it a "regulatory asset" is the ability to recover the amount recorded in the account) is the ability to convey all legal and equitable interests – this would include the right to collect. But if the right to record and recover is created by legislation, can the IESO fully assign a legislative right? This issue may be resolved by having the IESO collect the Regulatory Assets on behalf of the purchaser thereof (perhaps as an agent for the purchaser)]**

3. The Regulatory Assets will not be subject to any set-off, counterclaim or other defence by the IESO or any successor or affiliated entity thereof.

4. The legislation will need to recognize the Regulatory Assets as amounts that may be recovered by the IESO (e.g. it could be designated as a "GA Deferral" and would be included in the amounts collectible by the IESO through the GA collection mechanism, and would include interest and financing costs).

5. The purchaser of the Regulatory Asset will have the right to require the IESO (or any successor) to collect the principal amount of GA deferred, together with interest, financing and administration costs, on the agreed repayment/amortization schedule. **[NTD: In the LIPA securitization rate order, if the entity that is authorized to collect rates to service the bonds ends up defaulting, there is the ability to request a court to order "sequestration" and payments of amounts owing to the owner of the Regulatory Asset. Consider whether to include a similar right here. Alternatively, consider whether a security interest over the moneys collected by the IESO could be provided to the purchaser.]**

   OEB would be provided with oversight over the internal administrative costs collected by the Financing Trust. This could be accomplished by (a) providing the purchaser of the Regulatory Asset with the right to require the IESO or a successor to collect only the principal amount of GA together with interest and financing costs and third party fees and expenses, and (b) requiring the IESO to collect amounts through the global adjustment and make payments to the purchaser of the Regulatory Asset with respect to the internal administrative costs incurred by the purchaser in connection with the purchase and management of the Regulatory Asset and the Financing Trust, in accordance with the order of the OEB then in effect. Under this mechanism, the OEB would be required to review the purchaser's internal administrative costs through a streamlined process and issue such orders in accordance with rules to be prescribed under a new regulation under the OEB Act, which would clearly limit the OEB's scope of review and could establish the basis for the purchaser to receive an appropriate fee for its services.

6. In the event that any action is taken or permitted by the Province or any regulatory authority that limits, alters, or impairs **[Torys NTD: the legislation would have to limit the authority of independent quasi-judicial tribunals like the OEB for this to be effective, also deal with any statutory provisions relating to liability against the Crown]** the value of a Regulatory Asset or reduces the ability of the IESO or the purchaser of the Regulatory Asset to collect or recover the costs associated therewith, the owner of the Regulatory Asset and the holders of any bonds or other

securities issued to finance the purchase of the Regulatory Asset, will have a right of action against the Province for any damages suffered as a result of such amendment.

[NTD: Additional details, if necessary, could be built into regulations under the statute.]

[NTD: Any external review, e.g. by the OEB, should be limited to the amount of GA deferred and the time period for recovery. The financing program itself should not be subject to OEB or other regulatory review, as this would add significant risk to bondholders, challenging the financeability of the structure.] [Torys NTD: Our understanding is that these aspects were to be for the Minister to determine, and that OEB review would best be limited to considering the internal administrative costs of the Trust in managing Regulatory Assets]

ONTARIO POWER GENERATION

February 27, 2017

Mr. Serge Imbrogno
Deputy Minister,
Ministry of Energy
4th Floor, Hearst Block
900 Bay Street
Toronto, Ontario
M7A 2E1

Dear Deputy:

Below is a summary of OPG's preliminary views on the implementation of the Province's proposed Global Adjustment Smoothing Account and financing structure. These views are contingent on the proposed terms and conditions that were sent to the Ministry of Energy on February 21, 2017.

Understanding that the finalization of the legal terms, the Trust indentures, financing structure and other detailed terms will take several months and will involve collaboration between legal counsel, input from capital markets, parties involved and other stakeholders, this letter is intended to provide the guideline and framework which could form the foundation of the plan.

Please do not hesitate to contact me if you have any questions regarding this summary.

Sincerely,

Mr. Ken Hartwick
Chief Financial Officer and Senior Vice President, Finance
Ontario Power Generation
W: 416-592-6985
C: 647-544-6985
ken.hartwick@ opg.com

cc. Jeff Lyash, President and CEO, OPG

Background:

The Province has indicated that it will take steps to reduce electricity bills in the near term. It has identified reductions in the Global Adjustment Charge (GAC) charged to electricity customers as a means to achieve its policy goals. The Province is proposing to temporarily reduce the amount of the GAC charged to electricity customers (primarily RPP-eligible customers). The exact quantum and duration of the program is still not known but based on discussions with the Province GAC charges of approximately $2-5B per year for the next 5-10 years would be deferred and collected over future periods commencing after the deferral period. A combination of senior debt and subordinated debt (mainly sourced by additional equity from the shareholder) would be issued to fund the amount deferred. The financing cost of the debt and other costs of running the program would form part of the amounts recovered from customers over the term of the program.

The Province has requested that OPG administer the GAC deferral, because of OPG's participation in the market, regulatory knowledge and the potential ability to consolidate the activity and accounting with OPG. Given the significant amount of financing required for the GAC deferral, OPG has developed a financing structure (depicted below) to:

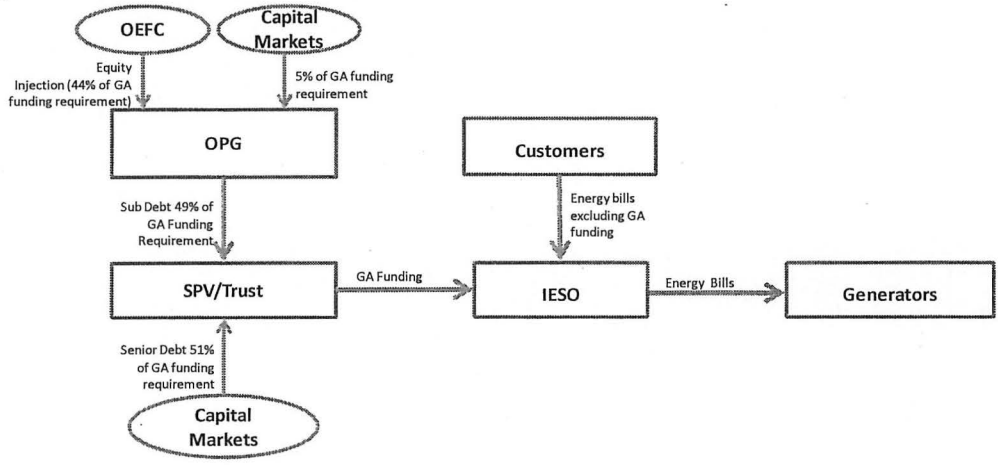
- restrict the risk to OPG;

- maximize the cost-effectiveness of the Trust or the Special Purpose Vehicle ("SPV") financing vehicle; and
- allow for consolidation into OPG financial statements.

The success of this structure is dependent on achieving a number of objectives which are reviewed in the following sections:

A. Ability to Recognize an Asset and Record Revenue
B. Ability to Consolidate the SPV into OPG
C. Ability to Finance
D. External Assessment
E. Risk Summary

All of the percentages shown in the graphic below are indicative and will be highly dependent on the legislation that the Province will enact:



Process:

The IESO will effectively sell the 'right to collect' deferred future revenue from ratepayers (GA Recovery Right asset) to the SPV in return for cash proceeds. In order for the SPV to purchase this asset the SPV will obtain the financing from two key sources: 51% directly from capital markets and 49% as subordinated debt from OPG. OPG will obtain 44% of this financing as an equity injection from the Province and 5% from capital markets.

A. Ability to Recognize an Asset and Record Revenue

Accounting Requirements under International Financial Reporting Standards (IFRS)

1) It is our understanding that the IESO and KPMG have concluded that the sale of this 'right to collect' future revenue (or regulatory asset) is not a financing transaction and will not be recorded as a financial liability. Based on that conclusion, the right to collect will be accounted for as an intangible asset in the SPV.

2) In order to the SPV to record this right as an intangible asset, the right must meet the following conditions:
   - The intangible asset must be separable and arise from a contractual or legal right (i.e. mandated by the Legislation and SPV Indenture Agreement).
   - The SPV must have the control and power to obtain future economic benefits from the intangible asset.
   - The SPV must be able to demonstrate that the intangible asset is purchased at fair value.

3) In order for the SPV to recognize appropriate revenue to offset any ongoing costs, the Legislation must require interest, carrying and administrative costs to be paid to the SPV on a monthly basis. This may result in additional amounts to be deferred to achieve the desired customer impact. Payment of revenue to the SPV is also important to service the interest expenses of the debt.

B. Ability to Consolidate the SPV into OPG under IFRS

OPG 'Control' of the SPV - Accounting Requirements

1) 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 SPV, or whether it has the ability to affect the returns of the SPV through its power over the SPV. Rather, all facts and circumstances are considered when assessing whether an entity has control over another entity. Based on the relevant accounting guidance under IFRS, OPG has proposed terms necessary to demonstrate that OPG has control over the SPV. OPG's external auditors, Ernst & Young, has provided their concurrence that based on the information provided to them to date that the following conditions should permit consolidation of the SPV by OPG.

Directive:

1. The SPV must be undertaken by OPG as a business initiative on its merits. A Shareholder Directive is to be limited to direct OPG to investigate the option of establishing a SPV vehicle to administer, finance and operate the Global Adjustment plan. The control, risk and rewards of that SPV will determine its consolidation into OPG as a business enterprise.

SPV:

2. The SPV should not operate in a predetermined way such that OPG does not have decision-making authority over the SPV's ongoing activities after its formation (i.e. should not operate on 'autopilot').
3. 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 SPV.
4. The Province cannot have the right to veto OPG's decisions about the relevant activities of the SPV. OPG must have the power over the relevant activities of the SPV and be compensated. The relevant activities of the SPV 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 SPV.
5. OPG must have the power to determine or change operating and financing policies of the SPV, which will affect the variability of risks and returns.
6. The Province or its agencies must not directly or indirectly fund (through debt or equity) more than 50% of the following:
    - The SPV
    - Any of OPG's investments in the most subordinated debt of the Trust
7. OPG must own greater than 50% of the most subordinated debt and targeted to be no less than 5%[1] of the total debt of the SPV. Such ownership must be financed entirely by OPG through operating cash flows or external debt, without assistance from Provincial sources. A quantitative analysis should be performed at a later date to corroborate the appropriateness of the 5% threshold to support that the 5% subordinated debt investment is sufficient to absorb most of the expected variability in the SPV.
8. OPG must have the ability to earn variable returns by exercising its authority, which shall be accomplished as follows:

[1] While the rest of the letter refers to a 10% investment in the most junior subordinated debt with OPG owning 5%, it should be noted that OPG should own more than 50% of the most subordinate debt. For simplicity, the degree to which OPG's ownership beyond 50% is not shown in this letter.

a. The cash flow from the restructured asset shall include interest determined based on a relevant benchmark that is appropriate relative to the restructured asset, plus an appropriate margin consistent with the relevant market and other risks
b. OPG shall have the authority to determine the financing strategy, which will vary the financing costs with the objective of enabling the SPV to achieve a more favourable return compared to the return from the restructured asset
c. The SPV shall establish classes of liabilities (senior, subordinated and the most subordinated). The classes would allow the SPV 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.
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.
e. OPG should participate in the detailed design of the above and the SPV 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.

Nothwithstanding the above, under certain 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), the OEFC may provide bridge financing beyond the designated percentage for a defined period. The relevant terms should ensure that this temporary measure does not detract from the rights of OPG to direct all of the relevant activities of the SPV. Additionally, OPG should not be protected from risk of loss by the OEFC with respect to its subordinated investment, nor should it lose its right to derive the residual returns should such bridge financing be required.

Legislation

9. The Legislation must require interest, carrying and administrative costs to be paid to the SPV on a monthly basis, so that the SPV is able to recognize appropriate revenue to offset any ongoing costs.
10. The Legislation must dictate the manner in which the restructured 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 Trustees.
11. The Legislation must be written to avoid legal or constitutional challenges and be irrevocable to reduce the cost of borrowing and with a specific formula which determines the deferral amount. As irrevocability would be difficult under Canadian law one mitigation would be to provide a Provincial guarantee which only applies with cancellation or amendment of the legislation.
12. The spirit of the above terms should be reflected in the SPV Indenture Agreement as well as Legislation, wherever possible.

2) The Trust is expected to be financed as follows:
   - 51% senior secured debt from external markets
   - 39% senior subordinated debt from OPG (via Province equity injection into OPG)

- 10% junior subordinated debt from OPG (5% from external markets and 5% from Province equity injection into OPG).

When assessing control, an investor shall consider the nature of its relationship with other parties and whether those parties are acting on the investor's behalf (i.e. they are 'de facto agents'). If OPG is assessed to be a 'de facto agent' of the Province, it will compromise the ability for OPG to consolidate the Trust. The split above is to meet the following conditions to ensure that OPG is not considered a 'de facto agent' of the Province:

- The Province or its agencies must not directly or indirectly fund (through debt or equity) more than 50% of the following:
  - The Trust
  - Any of OPG's investments in the most subordinated debt of the Trust
- OPG must own greater than 50% of the most subordinated debt and targeted to own no less than 5% of the total debt of the Trust. Such ownership must be financed entirely by OPG through operating cash flows or external debt, without assistance from Provincial sources.

3) The Province will need to conclude on whether OPG still meets the definition of a Government Business Enterprise as defined under Public Sector Accounting Board standards in order to obtain the preferred consolidation treatment after the transaction. We also recommend that the Province to undertake the analysis deemed necessary to confirm the accounting treatment in its consolidated Public Accounts, including if the recognition of the intangible asset would result in an offsetting liability in the Public Accounts.

C. Ability to Finance

Property Right or Right to Collect
Legislative Requirements for Financing

The GA Recovery Right must be structured to encompass the following elements:

- Right to recover from and bill Ontario electricity customers for (1) the principal amount of GA that is being deferred, (2) all interest and other financing costs incurred in respect of the deferral of the GA, (3) all fees, expenses and other administrative costs associated with such financing;
- Repayment/amortization schedule as agreed by the IESO and any purchaser of such GA Recovery Right (or pursuant to a pre-defined schedule/formula that covers all of the purchaser's principal, interest and ongoing financing costs on a monthly basis);
- Repayment/amortization schedule must include a true up mechanism to ensure all costs associated with the deferral can be recovered from customers;
- IESO may dispose of the GA Recovery Right, provided that any such disposition shall be a true sale and absolute transfer to the purchaser of the IESO's right, title and interest in and to the GA Recovery Right;
- Purchaser will have the right to require the IESO (or any successor) to collect the principal amount of GA Recovery Right, together with interest, financing and administration costs, on the agreed repayment/amortization schedule;
- Right must be irrevocable and, if amended by future governments, debt holders have the right of action against the government to recover the amount outstanding including interest, fees, expenses and any damages resulting from the amendment;
- GA Recovery Right will not be subject to any set-off, counterclaim or other defence by the IESO or any successor or affiliated entity; and
- Make certain amendments to the Electricity Act to allow OPG to implement the SPV financing structure (e.g. allowing OPG to create subsidiaries and holding companies, and to have a beneficial interest in the SPV, etc). This would provide flexibility to accommodate possible variations to the financing structure that may be desirable over time.

Detailed legislative requirements are specified in the attachments as follows:

Attachment 1 Legislative requirements to allow deferral of global adjustment amounts to be financeable

Attachment 2 Statutory amendments

The proposed financing structure for the SPV is:

	Risk Profile	Source	% of Total Funding Requirements
Tranche A Senior Debt	The least risky	Capital Markets	51%
Tranche B Sub Debt	In between A&C	OPG via OEFC	39%
Tranche C Sub Debt)	The most risky	OPG via OEFC	5%
		OPG via Capital Markets	5%

SPV structure is used to accomplish the following:

- SPV holds right to charge customers for the benefit of debt holders;
- Allows the financing vehicle to be ring-fenced from OPG as an SPV structure is set up as generally single purpose entities with no other operations that could add risk to the SPV, dilute debt holder rights, allow parties from other operations to claim rights to the future recovery from customers or allow these other parties to initiate bankruptcy proceedings;
- Enables SPV to potentially get a higher credit rating than OPG;
- Supports consolidation with OPG provided accounting requirements are satisfied;

This approach supports a number of objectives of the GA Recovery Right:

- 51% external senior debt supports separation of the SPV from the Province
- 5% junior subordinated debt establishes OPG's "at risk" equity which supports separation of the SPV from the Province
- Subordinated debt provides flexibility to the financing structure and additional credit support to external debt holders
- Subordinated debt sourced from OPG (mainly funded by equity injection from the Province) minimizes impact on OPG credit metrics reducing risk of an OPG rating downgrade that could result in the SPV being consolidated directly with the Province as the SPV would be considered an arm of the Province.

Recent transactions used as precedents are:

Duke Energy Florida Project Finance LLC
June 2016
5 series of bonds totalling USD$1.3B
Weighted average life from 2 to 19 years with interest rates from 1.2% to 3.1%
Credit rating AAA

Utility Debt Securitization Authority
Sponsored by Long Island Power Authority
March 2016
Amount issued USD$0.6B
Weighted average life of 12 years and weighted average yield of 2.7%

August 2016
Amount issued USD$0.5B
Weighted average life of 7 years and weighted average yield of 2.0%

Credit rating AAA

Cumulative outstanding (including previous issuances): USD$4.2B

D. External Assessment

Shakerhill Partners, an external advisor, identified the following items in an assessment of the structure and financeability of the structure:

- The structure is financeable however there are a number of significant risks to the structure:
  - Canadian and Ontario law does not provide the same protection to property right as exists in the US federal and state constitutions to limit the ability of governments to adversely impair contracts to the detriment of the holder;
  - Legislation could mitigate some of the risks – deferred recovery asset to be "uncapped", regular semi-annual true up to ensure recovery, Province provides sufficient committed liquidity to the IESO so that temporary shortfall in recovery does not affect payments to SPV, term of the deferral recovery substantially exceeds the longest maturity of debt of the SPV and that true-up mechanism take account of potential for currency, interest rate and duration mis-match between the debt of the SPV and the recovery mechanism;
  - Size of the program may be too large for Canadian securitization market requiring access to the US securitization market;
- Final maturity of debt should not exceed 30 years from inception of the program
- True up mechanism should be designed such that the forecast of recovery is less than 10% of the customer bill under downside scenarios to limit growth of the deferral balance as a higher portion of the customer bill increases the political risk to debt holders which could result in a lower credit rating and potential impact on financeability
- Securitized debt products are specialized and price at a premium to other fixed rate instruments however a successful program supported by a strong credit rating this premium could shrink over time to a minor spread over Provincial debt
- OPG's credit rating should be maintained provided sufficient equity is injected to maintain credit metrics
- While the structure is not expected to impact the Province there are risks that the program could negatively impact the rating agencies view of the Province's financial management.

E. Risk Summary

i. Consolidation

- Elements of the proposed structure were established to support consolidation of the SPV into OPG. These items may not be sufficient to establish OPG as risk owner of the SPV and the SPV may need to be consolidated directly with the Province.

ii. Financeability

- The legislation establishing the structure and the property right for recovering the financing and associated costs may not be adequate for financing purposes resulting in more expensive financing or an inability to obtain the required external financing.

iii. Cost of Financing

- Future governments may enact legislation that changes the right of the SPV to recover amounts from customers.
- The right to recover amounts from future customers must be irrevocable and subject to full recovery from the government in the event that future governments reduce or eliminate the recovery. A legal structure that is weaker than the precedent US transactions increases the risk to debt holders and the cost of financing.
- Interest rates on bonds in the securitization market are higher than equivalent rated bonds. Rate for a AAA securitization credit is about 50 bps higher than GOC (rated AAA) for a 5 year term. This difference is attributable to the specialized structure of the bond, smaller investor pool for this bond, smaller size of the market and higher perceived risks of the bond.
- Any regulator involvement must not be seen to modify any terms of debt issued or the property right securing the debt as this would increase risk to debt holders.

- It may not be possible to issue debt to match the terms of the deferred asset so shorter term debt would be used which raises risk to re-finance the maturing debt as the market may no longer be interested in this product. As well, underlying reference interest rates may be higher and the market may require a higher spread to invest in this product.
- With the GA Recovery Right program continuing for 10 years, debt issued over this period is subject to changes in both the underlying reference interest rates and appetite of the market for this product.

iv. OPG Credit Rating

- Minimizing the impact of significant additional debt on OPG's credit rating is dependent on higher EBITDA arising from earned income on the GA Recovery Right in excess of external debt. Ability of the SPV to record revenue reflecting the growth in asset value.
- Potential OPG credit rating downgrade if legislative structure is not adequate to support long term recoverability, inability to record revenue from growth in asset value or agencies view equity injection as debt.
- OPG credit rating downgrade could result in loss of GBE status or result in SPV being consolidated directly with the Province.

Attachment 1

LEGISLATIVE REQUIREMENTS TO ALLOW DEFERRAL OF GLOBAL ADJUSTMENT AMOUNTS TO BE FINANCEABLE

The IESO currently has a right to collect GA monthly from ratepayers through provisions in the *Electricity Act, 1998*. It is proposed that collection of a certain portion of the monthly GA be deferred for collection in the future, and that the right to recover the deferred GA from ratepayers be used as a basis for structured financing/securitization.

The current proposal is for a trust to be created as a financing vehicle (the "**Trust**") in connection the deferred GA. The Trust will finance the deferral of the GA by purchasing the right to recover such deferred GA from the IESO for the principal amount of the GA being deferred. For example, if the amount of GA that is being deferred is $200 million in a given month, the Trust will purchase from the IESO the right to future recovery of the deferred GA and the associated financing costs (including interest and transaction costs) for $200 million in cash.

The Trust is expected to finance these purchases from the IESO through a combination of senior secured financing raised in the capital markets and subordinated financing from OPG (the funding for which will mostly be from equity injections from the OEFC/Province).

For accounting purposes, OPG will need to have the ability to direct the activities of the Trust, through a services agreement and/or through the Trust's constating document.

Based on securitized financing raised by utilities in the US (backed by utility cost recovery orders) and the current regulatory framework in Ontario, the legislation in Ontario would need to be amended to provide the following, at a minimum:

1. The IESO will be empowered to create an asset (the "**Regulatory Asset**") consisting of all right, title and interest in and to:

   (a) right to recover from and bill Ontario electricity ratepayers for:

   (i) the principal amount of GA that is being deferred for collection;
   (ii) all interest and other financing costs incurred in respect of the deferral of the GA (whether through senior debt raised in the public markets or subordinated debt raised from OPG or others); and
   (iii) (subject to the comments in paragraph 5 below in respect of OPG's internal administrative costs only) all fees, expenses and other administrative costs associated with such financing, including up-front and ongoing financing costs and any indemnity payments;

all on such repayment/amortization schedule as agreed by the IESO and any purchaser of such right (or pursuant to a pre-defined schedule/formula in the legislation that covers all of the purchaser's principal, interest and ongoing financing costs on a monthly basis); and

(b) all revenues, collections, claims, rights to payments, money or proceeds arising from the rights and interests set out in paragraph (a) above, regardless of whether such revenues, collections, claims, rights to payments, money or proceeds are imposed, billed, received, collected or maintained together with or commingled with other revenues, collections, rights to payments, payments, money or proceeds.

2. The IESO may dispose of the Regulatory Assets created from time to time on such terms as the IESO determines in accordance with the terms of directives to be issued to the IESO from time to time by the Minister, provided that any such disposition shall be a true sale and absolute transfer of the IESO's right, title and interest in and to a Regulatory Asset to the purchaser of the Regulatory Asset.

3. The Regulatory Assets will not be subject to any set-off, counterclaim or other defence by the IESO or any successor or affiliated entity thereof.

4. The legislation will need to recognize the Regulatory Assets as amounts that may be recovered by the IESO (e.g. it could be designated as a "GA Deferral" and would be included in the amounts collectible by the IESO through the GA collection mechanism, and would include interest and financing costs).

5. The purchaser of the Regulatory Asset will have the right to require the IESO (or any successor) to collect the principal amount of GA deferred, together with interest, financing and administration costs, on the agreed repayment/amortization schedule. **[NTD: In the LIPA securitization rate order, if the entity that is authorized to collect rates to service the bonds ends up defaulting, there is the ability to request a court to order "sequestration" and payments of amounts owing to the owner of the Regulatory Asset. Consider whether to include a similar right here. Alternatively, consider whether a security interest over the moneys collected by the IESO could be provided to the purchaser.]**

OEB would be provided with oversight over the internal administrative costs collected by the Financing Trust. This could be accomplished by (a) providing the purchaser of the Regulatory Asset with the right to require

the IESO or a successor to collect only the principal amount of GA together with interest and financing costs and third party fees and expenses, and (b) requiring the IESO to collect amounts through the global adjustment and make payments to the purchaser of the Regulatory Asset with respect to the internal administrative costs incurred by the purchaser in connection with the purchase and management of the Regulatory Asset and the Financing Trust, in accordance with the order of the OEB then in effect. Under this mechanism, the OEB would be required to review the purchaser's internal administrative costs through a streamlined process and issue such orders in accordance with rules to be prescribed under a new regulation under the OEB Act, which would clearly limit the OEB's scope of review and could establish the basis for the purchaser to receive an appropriate fee for its services.

6. In the event that any action is taken or permitted by the Province or any regulatory authority that limits, alters, or impairs the value of a Regulatory Asset or reduces the ability of the IESO or the purchaser of the Regulatory Asset to collect or recover the costs associated therewith, the owner of the Regulatory Asset and the holders of any bonds or other securities issued to finance the purchase of the Regulatory Asset, will have a right of action against the Province for any damages suffered as a result of such amendment.

Attachment 2

STATUTORY AMENDMENTS

The following is preliminary and is based on our current understanding of the proposed structure and objectives. For example, we have assumed that the structure will not entail the insertion of a new Holdco between OPG and the Province. As these aspects are refined, some of the suggested amendments described below may not be needed and other aspects that we are not aware of may need to be considered. Accordingly, these suggested amendments are provided for discussion purposes and are subject to change. We would welcome the opportunity to work with OPG and the Ministry on refining the scope and substance of required legislative and regulatory amendments.

A. Amendments to Implement Structure

Certain *Electricity Act, 1998* amendments would be needed to implement the anticipated structure (which we understand, as noted above, would not include a Holdco), as follows:

- **Section 53.1(1):** Amend to permit owning and operating generation facilities through subsidiaries (not only directly through OPG). In addition, amend to permit OPG to administer, manage, loan moneys to and have a beneficial interest in, if applicable, Financing Trust.

- **Section 53.2:** Amend to permit the Minister to acquire, hold, dispose of or otherwise deal with securities or debt obligations of, or any other interest in, OPG or any subsidiaries. This is to accommodate possible variations to the financing structure that may be desirable over time.

- **Section 53.■ (new):** New statutory section to permit the Minister to enter into arrangements relating to an exercise of powers under 53.2.

- **Section 53.■ (new)**: New statutory section providing that creditors of Financing Trust have no recourse to the assets of OPG or any of its subsidiaries (other than Financing Trust, if applicable). In addition, consideration should be given as to whether the Act should be amended so that the Financing Trust cannot be wound up or liquidated.

B. Miscellaneous Corporate Items to Address

- **OPG Articles:** Amend the OPG's articles to remove the private company restrictions.

- **MOA with Province:** Consider whether any amendments to OPG's MOA with the Province are required to contemplate the Financing Trust.

C. Amendments Under Electricity Act to Implement GA Smoothing

Based on our understanding that the global adjustment smoothing mechanism is intended to benefit residential and small business customers only and that the Minister will be responsible for determining how much global adjustment smoothing is to be applied in a given month, if any, amendments to the *Electricity Act, 1998* and Ontario Regulation 429/04 (Adjustments Under Section 25.33 of the Act) would be needed to implement the mechanism, as follows:

(i) Electricity Act:

- **Section ■ (New):** Establish a new power for the Minister to make directives to the IESO in relation to the global adjustment smoothing mechanism and, particularly, for purposes of establishing global adjustment smoothing amounts from time to time (expected to be monthly). To the extent possible, the directive power should be drafted so as to limit the ability for a future Minister to require the IESO to do anything that would materially and adversely affect the Financing Trust or its lenders. **[NTD: While our understanding is that the Minister would direct this, we note from other materials we have seen that OPG may instead be recommending a formula approach. It is not clear what the formula would look like, where it would be set out or how it would be applied and by whom]**

- **Paragraph 25.33(1):** This section says that IESO shall make adjustments in accordance with the regulations to ensure that, over time, payments by prescribed classes of market participants reflect amounts paid to OPG, OEFC and distributors, as well as amounts paid to entities with whom IESO has a procurement contract. Add new subsection (c) so as to require IESO to ensure that, over time, payments by prescribed classes of market participants also reflect amounts paid to Financing Trust. **[NTD: Not certain this is needed if only to benefit residential and small business consumers, who are not market participants. May be needed in reference to payments from distributors and retailers]**

- **Paragraph 25.33(2):** This section says that distributors and retailers shall make adjustments in accordance with the regulations to ensure that, over time, payments by prescribed classes of consumers reflect amounts paid to OPG, OEFC and distributors, as well as amounts paid to entities with whom IESO has a procurement contract. Add new subsection (c) so as to require distributors and retailers to ensure that, over time, payments by prescribed classes of consumers also reflect amounts paid to Financing Trust.

- **Note**: As described below, the regulation will need to include new requirements for the IESO to record the global adjustment smoothing amounts in one or more variance accounts and to use those amounts to offset amounts otherwise recorded in the variance accounts under Section 25.33(3) of the Act. For context, we note:

    - Section 25.33(3) says that adjustments under (1) or (2) relating to electricity consumed by consumers whose rates are determined by

the OEB under s. 79.16 of the OEB Act (i.e. RPP Customers) shall instead be made in accordance with the regulations to one or more variance accounts established and maintained by the IESO.

- Section 25.33(4) says IESO, distributors and retailers shall make and receive such payments, set-offs and credits as may be required or permitted by the regulations with respect to consumers described in (3), i.e. RPP Customers.

- Section 25.33(5) says that IESO shall establish and maintain such variance accounts as may be needed to record all amounts payable or receivable by it under 25.33.

(ii) O. Reg. 429/04 (Adjustments Under Section 25.33 of the Act):

- **Section 1(1):** Consider adding definitions for "Financing Trust" and "global adjustment smoothing amount" or such other terms as may be preferred.

- **Section 1.2(1) (New):** Add section providing that, for the purposes of this Regulation, the global adjustment smoothing amount for a month is the amount determined by the IESO in accordance with a directive from the Minister under section ■ of the Electricity Act in respect of the month. **[NTD: See above note re use of Minister directives]**

- **Section 1.2(2) (New):** Consider adding a section providing that the IESO shall publish the global adjustment smoothing amount for a month by no later than the 10th business day of the following month [to align with general publication requirements for global adjustment under s. 1.1(2)].

- **Section 10(1):** Amend formula for calculating Class B GA rate by subtracting the global adjustment smoothing amount for a month from "M", which is the total amount of the global adjustment for the month. The global adjustment smoothing amount could be designated as "X", such that the formula would be (M-X-N)/(P-Q). Define "X" as the global adjustment smoothing amount for the month as determined by the IESO in accordance with the Minister's directive under section ■ of the Electricity Act for the month. **[NTD: See above note re use of Minister directives]**

- **Section 10.1 (New):** Add new section to deal with adjustments under subsection 25.33(3) of the Act, i.e. in respect of RPP consumers. This section should require the IESO to establish, within the variance account(s) it maintains pursuant to subsection 25.33(3) of the Act, one or more subaccounts in which it shall record the global adjustment smoothing amounts applicable to the classes of consumers described in subsection 25.33(3) of the Act. This section must also specify that the IESO shall apply the amounts recorded in the subaccounts against the balances in the variance accounts for purposes of section 79.16(3) of the OEB Act.

- **Note:** This is a key aspect because, when the OEB determines RPP rates, it must take into account the balances in the variance accounts established by the IESO under s. 25.33 of the Electricity Act and make adjustments with a view to eliminating the balances within 12 months. This proposed new section 10.1 causes the IESO to reduce (in the near term) the variance account balances by the global adjustment smoothing amounts, as provided by Financing Trust, thereby enabling the OEB to determine RPP rates that, despite being lower for RPP consumers in the near term, still eliminate the relevant variance account balances within 12 months.

- **Paragraph 11(2)2.ii:** Amend the formula for calculating the allocation of global adjustment for a month to a licensed distributor that is a market participant by subtracting the global adjustment smoothing amount for a month from "M", which has the same meaning as under section 10(1). The global adjustment smoothing amount could be designated as "X", such that the formula would be [(M-X-N) x (R+S-T)]/(P-Q). Define "X" as suggested under section 10(1).

- **Paragraph 11(2)3:** Amend the formula for calculating the allocation of global adjustment for a month to each Class B market participant by subtracting the global adjustment smoothing amount for a month from "M", which has the same meaning as under section 10(1). The global adjustment smoothing amount could be designated as "X", such that the formula would be [(M-X-N) x U]/(P-Q). Define "X" as suggested under section 10(1).

- **Paragraph 16(7)4:** Consider amending the description of "Global Adjustment" that is required to be included on certain invoices so as to inform consumers that their portion of the global adjustment for the month (i) may have been reduced by the application of a global adjustment smoothing amount from the Financing Trust, or (ii) may include amounts payable to the Financing Trust in respect of global adjustment smoothing amounts previously applied.

- **Section 20(1):** This section establishes an obligation for the Ontario Electricity Financial Corporation and every licensed distributor that is a market participant to give the IESO such information as the IESO may require for the purposes of the Regulation in the form specified by the IESO and before the expiry of the period specified by the IESO. Consider amending to extend this obligation to the Financing Trust.

- **Section 20(6):** This section provides that on request by the OEB, the IESO, a licensed distributor, an embedded generator, a retailer or the OEFC shall give the OEB such information relating to this Regulation as the OEB may require, in the form and within the period specified by the OEB. Consider amending to extend this obligation to the Financing Trust.

D. Amendments Under OEB Act to Implement Cost Recovery for Financing Trust

Amendments to the *Ontario Energy Board Act*, including amendments to O. Reg. 95/05 (Classes of Consumers and Determination of Rates) and the introduction of a new regulation, would be needed to implement a cost recovery process for the Financing Trust in relation to the global adjustment smoothing mechanism, potentially with limited OEB oversight, as follows:

(i) Ontario Energy Board Act:

- **Section 78(3.3):** This provision establishes an obligation for the OEB, when determining rates for the retailing of electricity, to take into account balances in variance accounts established under section 25.33 of the Electricity Act and to make adjustments "with a view to eliminating those balances within 12 months or such shorter time periods as the Minister may direct." Consider whether any amendments are needed, and confirm this works with the framework being proposed.

- **Section 78.7 (New):** We understand that the Province may want the OEB to have an oversight role. One possible approach would be to establish a new statutory section establishing that the IESO shall make payments to the Financing Trust with respect to the internal administrative costs incurred by the Financing Trust in connection with the purchase and management of the Regulatory Asset and the Financing Trust. Such payments by the IESO would need to be made in accordance with the order of the OEB then in effect, which orders shall be made by the OEB in accordance with rules prescribed under a new regulation.

    - The new regulation would need to be clear that the OEB does not have jurisdiction to consider the principal amount or any interest, financing costs, third party fees or expenses. Rather, OEB's role would be limited to considering the internal administrative costs of the Financing Trust and ensuring the Financing Trust receives an appropriate fee for its services, all of which would be recovered by the Financing Trust from the IESO, which would collect those amounts in the global adjustment. Note that, if this approach is accepted, the IESO and distributors and retailers would need the authority to collect such amounts as part of the GA and IESO would need the authority to pay such amounts to the Financing Trust. As such, additional amendments would be needed under O. Reg. 429/04.

- **Note:** Section 79.16 of the OEB Act does not require changes, but the significance of this provision should be understood.

    - Section 79.16 gives the OEB responsibility for determining electricity commodity prices for eligible consumers. Eligibility is determined under Reg. 95/05 (Classes of Consumers and Determination of Rates), which is also known as the Regulated Price Plan (RPP) Regulation.
    - Section 4(2) of the RPP Regulation defines RPP-eligible consumers as low volume consumers (i.e. those who annually use less than 150,000 kWh

or such other amount as prescribed), consumers with demand of 50 kW or less, residential consumers that have accounts with distributors, consumers who annually use 150,000 to 250,000 kW of electricity, and consumers who have accounts with distributors if in the farming business.

- Paragraph 6(1)3 of the RPP Regulation provides that "In determining the rates (for RPP-eligible consumers), the Board shall forecast the cost of electricity to be consumed by the consumers to whom the rates apply, taking into consideration adjustments required under section 25.33 of the *Electricity Act, 1998* and shall ensure that the rates reflect those costs."
- The Ontario Energy Board has developed a Regulated Price Plan Manual (revised February 16, 2016) to describe the processes and methodologies it uses for determining electricity commodity prices that are charged to RPP consumers pursuant to Section 79.16 of the OEB Act and paragraph 6(1)3 of the RPP Regulation.

(ii) O. Reg. 95/05 (Classes of Consumers and Determination of Rates)

- **Paragraph 6(1)3:** Amend so as to require the Board, when forecasting the cost of electricity to be consumed by the consumers to whom the rates apply, to take into consideration not only the adjustments required under section 25.33 of the Electricity Act but also the application or prior application of global adjustment smoothing amounts determined by the IESO in accordance with Minister directives under section ■ of the Electricity Act, and to ensure that the RPP rates reflect those amounts. **[NTD: See above note re use of Minister directives]**

(iii) New Regulation (Payments to the Financing Trust)

- If the OEB is to be given the role of reviewing and approving the recovery of OPG's internal administrative costs for the Financing Trust under the potential section 78.7 (see above), then this regulation should describe the process and criteria pursuant through which the OEB would determine the amounts that the IESO would be required to collect through the global adjustment, in accordance with section 25.33 of the Electricity Act, and pay to the Financing Trust in respect of the provision of global adjustment smoothing amounts. This part of the regulation should establish:

    - any reporting requirements from the Financing Trust and/or the IESO to the OEB in connection with the global adjustment smoothing mechanism;
    - the frequency of the OEB making determinations under this part of the regulation;
    - the process through which the OEB shall make these determinations, which should be a streamlined administrative process rather than a public hearing process or, if a hearing is needed, then the scope of the proceeding should be clearly and narrowly constrained so as to deter intervenor involvement, lengthy proceedings and reduce/eliminate risk to recovery by Financing Trust;

- the basis for the OEB's determinations as to the payments that shall be made to the Financing Trust, which should specify that:
  - the Financing Trust shall recover its prudently incurred internal administrative costs on a forecast basis each year;
  - the Financing Trust shall receive an appropriate fee each year (with some guidance as to what would be appropriate); and
  - the approved payment amounts shall be collected by the IESO through the global adjustment and paid to the Financing Trust in accordance with the order of the OEB then in effect. Note that O. Reg. 429/04 would likely need amendments to permit IESO (and distributors and retailers) to collect these amounts through the global adjustment.

WHITE PAPERS – WORKING DRAFT #7

Independent Electricity System Operator ("IESO" or the "Company") is considering making changes in its accounting policies to reflect the balances of market participants within the IESO-administered markets (see separate technical analysis) and the economic impacts of rate regulation, as the Company believes that the changes would result in a more appropriate presentation of events or transactions in its financial statements.

Issues being considered in this document are:

Issue #1: Can the IESO adopt the guidance in ASC 980 *Regulated Operations (US GAAP in FASB)*?

Issue #2: Can the IESO recognize deferral or variance accounts related to the deferral of the annual Global Adjustment account as a regulatory asset on its statement of financial position?

Issue #3: Can the IESO derecognize the variance accounts related to the deferral of the annual Global Adjustment account?

1. Adoption of the guidance in ASC 980 Regulated Operations

Background and Assumptions for issues #1 and #2

The facts, circumstances, and assumptions relevant to the specific transactions are as follows:

1. The IESO's legal status is a not-for-profit, non-taxable, corporation established pursuant to Part II of the *Electricity Act, 1998*. IESO is classified as an Other Governmental Organization and prepares its financial statements in accordance with Canadian public sector accounting standards (PSAB).
2. The IESO is required to submit its proposed expenditures, revenue requirements and fees yearly to the OEB for review and approval.
3. IESO is rate regulated by the OEB in accordance with the *Electricity Act, 1998* and the *Ontario Energy Board ("OEB") Act, 1998* but currently does not recognize the economic impacts of rate regulation in its general purpose financial statements.
4. The OEB issued a Decision and Order on March 28, 2013 that permits IESO to recover the MDMR costs (the Smart Metering Charge) (see Appendix B). *(i.e. Costs incurred in the past will be fully recovered through future rates)*
5. Furthermore, in accordance with the *Electricity Act, 1998* and the *OEB Act, 1998*, the IESO has approved variance accounts to record all amounts payable or receivable by it in connection with the amounts paid to generators, the Financial Corporation, distributors and to entities with whom the IESO has a procurement contract. (i.e. costs incurred in the past will be fully recovered through future rates)
6. The province is contemplating deferring the recovery of a portion of the annual Global Adjustment account (comprised primarily of the electricity costs paid to the generators) over a period of 25-30 years, so that costs incurred would be fully recovered through future rates.
7. The *Electricity Act, 1998* and the *OEB Act, 1998* would be amended through legislation to require the deferral of the recovery of the Global Adjustment account and the future recovery in rates charged to customers.
8. The OEB would grant generic deferral or variance accounts to capture the difference between the amounts paid to generators and others, and the amounts collected in rates. Furthermore, the interest and ancillary costs related to the contemplated transaction would also be included in future rates charged to customers. In summary, the legislation would create a right to collect the incurred cost.
9. The IESO would change its accounting policies to permit the recognition of the economic impacts of rate regulation as from the 2016 financial year. IESO would adopt the guidance of ASC 980 *Regulated Operations* to better reflect the economic substance of its operations and enhance the transparency and accountability of its financial reporting.

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Appropriate Accounting Principle for issue #1

PSAS requires

PS2120.02, "*a change in an accounting policy may be made... if it is considered that the change would result in a more appropriate presentation of events or transactions in the financial statements of the government.*"

PS1150.05 "*When the primary sources of GAAP do not deal with the accounting and reporting in financial statements of transactions or events encountered by the public sector reporting entity, or additional guidance is needed to apply a primary source to specific circumstances, the selection of an appropriate accounting policy requires the exercise of professional judgment. In these circumstances, a public sector reporting entity should adopt accounting policies and disclosures that are consistent with:*

(a) the primary sources of GAAP; and

(b) the application of the concepts described in FINANCIAL STATEMENT CONCEPTS, Section PS 1000."

PS1150.19 "*Pronouncements issued by other bodies authorized to issue accounting standards may be useful sources to consult. For example, accounting pronouncements published with the authority of the Canadian Accounting Standards Board (AcSB), International Accounting Standards Board (IASB), US Federal Accounting Standards Advisory Board (FASB), US Governmental Accounting Standards Board (GASB), or International Public Sector Accounting Standards Board (IPSASB) are often important sources to consult on matters not covered by primary sources of GAAP or for assistance in applying a primary source of GAAP to specific circumstances.*"

PS1150.08 "A public sector reporting entity consults sources other than primary sources of GAAP to assist in selecting accounting policies and disclosures only when these sources comply with paragraph PS1150.05. The public sector reporting entity evaluates sources in selecting the appropriate accounting policies and disclosures based on all of the following criteria:

(a) The specificity of the source — A source that deals with the specific circumstances is likely to be more relevant than one from which the public sector reporting entity must analogize.

(b) The authority of the issuer or author — A source issued by an accounting standard setter in its own jurisdiction is likely to be more relevant than a source issued by others in the same jurisdiction.

(c) The continued relevance of the source — The passage of time may diminish the relevance of certain sources.

(d) The development process for the source — A source developed after extensive consultation and debate is likely to be more relevant than a source developed without such discipline."

PS1150.10 "PSAB considers a source to be consistent with the concepts in paragraph PS 1150.05(b) when the guidance in that source is compatible with the (i) qualitative characteristics of financial information, (ii) the elements of financial statements, and (iii) the recognition and measurement criteria in paragraph PS 1150.05(b)."

PS1000.58 "In the absence of appropriate public sector recognition and measurement criteria for intangibles, all intangibles, including those that have been purchased, developed, constructed or inherited in right of the Crown, are not recognized as assets in government financial statements. The intangible often called "human capital" that embodies the talent or intellectual capital of government employees is not recognized as an asset under existing accounting principles."

PS3210.03 "Assets are economic resources controlled by a public sector entity as a result of past transactions or events and from which future economic benefits are expected to be obtained."

PS3210.04 "Assets have three essential characteristics:

(a) They embody future economic benefits that involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows, or to reduce cash outflows.

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(b) *The public sector entity can control the economic resource and access to the future economic benefits.*

(c) *The transaction or event giving rise to the public sector entity's control has already occurred."*

Issue #1: Can the IESO adopt the guidance in ASC 980 *Regulated Operations*?

PSAS does not address accounting concepts in a rate regulated environment. Since there is no guidance in PSAS regarding the recognition and measurement of regulatory assets and liabilities, IESO may consider other sources based upon PSAS 1150.05 in the GAAP hierarchy to determine appropriate accounting policies in a rate regulated environment.

Within AcSB, Accounting Standards for Private Enterprises (ASPE) defines a rate regulated entity but provides no guidance on regulatory assets and liabilities, however requires disclosure of such balances if they are recognized. IASB has not completed their project on rate regulated activities and current standards only include a holding standard based upon what was done under previous GAAP. It will be important for the IESO to monitor the IASB's ongoing project on rate regulated activities as this may affect the recognition, measurement, presentation and disclosures of the regulatory assets and liabilities. Both FASB and GASB have guidance on accounting in a regulatory environment. IPSASB does not provide any guidance on accounting by rate regulated entities.

It is important to note that rate regulated entities that prepare their general purpose financial statements in accordance with ASPE (e.g. the three Fortis subsidiaries in Ontario), as well as those rate regulated entities that are eligible to elect to apply the requirements of IFRS 14 and elected to do so when they adopted IFRS, generally all recognize regulatory deferral and variance accounts in accordance with US GAAP accounting principles set out ASC 980 *Regulated Operations.*

Statement 62 issued by GASB in December 2010 is effective for financial statements for periods beginning after December 15, 2011. The objective of the Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the Financial Accounting Standards Board (FASB) Statements and Interpretations issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements. Paragraphs 476–500 may be applied to activities reported in business-type activities that have regulated operations that meet all of the three criteria in paragraph 476 as follows:

(a) The regulated business-type activity's rates for regulated services provided to its customers are established by or are subject to approval by an independent, third-party regulator or by its own governing board empowered by statute or contract to establish rates that bind customers.

(b) The regulated rates are designed to recover the specific regulated business-type activity's costs of providing the regulated services.

(c) In view of the demand for the regulated services or products and the level of competition, direct and indirect, it is reasonable to assume that rates set at levels that will recover the regulated business-type activity's costs can be charged to and collected from customers. This criterion requires consideration of anticipated changes in levels of demand or competition during the recovery period for any capitalized costs.

The criteria above and the guidance in paragraphs 476-500 are based on ASC 980 *Regulated Operations.*

It is also important to note that in its statement of financial position, the Ontario Electricity Financial Corporation ("OEFC") recognizes a net unamortized liability balance for power purchase contracts, as detailed in the summary of significant accounting policies:

"The liability for power purchase contracts was originally calculated by discounting estimated losses over the life of the contracts. Under the *Electricity Restructuring Act, 2004*, OEFC began receiving actual contract prices for power from electricity consumers, effective January 1, 2005, and no longer incurs losses on these power purchase contracts. At that time, the Ministry of Finance estimated that the bulk of the liability would be eliminated over 12 years as existing electricity contracts expire. As a result, the bulk of the liability is being amortized to revenue over that period."

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Although this liability is not defined as a regulatory liability in the OEFC's financial statements, the argument can be made that it substantively meets the criteria under ASC 980.

In summary

Rate regulated entities in North America reporting under ASPE, IFRS (entities which have elected to use IFRS 14) and GASB generally all recognize regulatory deferral and variance accounts in accordance with US GAAP accounting principles based on ASC 980 *Regulated Operations* (see Appendix A for the accounting framework used by the Canadian rate regulated entities).

Evaluation of Other Sources of GAAP

As required by PS 1150.05(b), we need to analyze whether the concepts in the other source (i.e. ASC 980) are compatible with the (i) qualitative characteristics of financial information, (ii) the elements of financial statements, and (iii) the recognition and measurement criteria in PS 1000.

When looking to other sources of GAAP, PSAS requires the other sources of GAAP to be evaluated

1. *as to whether they are consistent with accounting policies and disclosure within PSAS,*
2. *as to whether they are consistent with the application of concepts in PS 1000 and*
3. *as to all of the following criteria:*
   - *(a) Source deals with the specific circumstance*
   - *(b) Source is issued by an accounting standard setter*
   - *(c) Source continues to be relevant*
   - *(d) Source uses a consultative process and deliberation when developing policies*

(i) Qualitative Characteristics of Financial Information

FASB	PSAS 1000	Evaluation
Concepts and objectives are for both business and non-business organizations as well as governmental units (Concept #4.3 to 4.5)	Public, legislators, councilors, investors, analysts, other governments (par. 14)	FASB considers governmental units
Financial reporting should: – Be useful in making resource allocation decisions – Be useful in assessing services and ability to provide services – Be useful in assessing management stewardship and performance – Provide information about economic resources, obligations, net resources and changes in them (Concept # 4.33-.54)	Financial statements should be relevant to the needs of the users and reliable. Relevance is achieved through timeliness, predictability and accountability value. Reliable information has the following characteristics: representational faithfulness, completeness, neutrality, conservatism and verifiability. (par. 28-29)	Similar

(ii) Elements of Financial Statements

FASB	PSAS	Evaluation
Assets (Concept #6.25-.34)		

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Probable future economic benefits obtained or controlled by the entity as a result of past transactions or events.	Economic resources controlled by a government as a result of past transactions or event and from which future economic benefits are expected to be obtained. (par. 35)	Essential characteristics similar
Liabilities (Concept #6.35-.43)		
Probable future sacrifices of economic benefits arising from present obligations of the entity to transfer assets or provide services in the future as a result of past transactions or events.	Present obligations to others arising from past transactions or events, the settlement of which is expected to result in the future sacrifice of economic benefits with little or no discretion to avoid settlement. (par. 44)	Essential characteristics similar
Revenues (Concept #6.78-.79)		
Inflows from delivering or producing goods, rendering services or other activities that constitute the entity's central operations.	Increases in economic resources resulting from operations, transactions and events of the accounting period. (par. 46)	Similar
Expenses (Concept # 6.80-.81)		
Outflows from delivering or producing goods, rendering services or carrying out other activities that constitute the entity's central operations.	Decreases in economic resources resulting from operations, transactions and events of the accounting period. (par. 49)	Similar

(iii) Recognition Criteria

FASB	PSAS	Evaluation
To be recognized, an item must meet the definition of an element of the financial statements, must be measurable with sufficient reliability, be relevant and be reliable. (Concept # 5.64)	Item must have an appropriate basis of measurement, a reasonable estimate can be made of the amount and if the item involves obtaining or giving up future economic benefits, it is expected those benefits will be obtained or given up. (par. 55)	Similar

(iii) Measurement Criteria

FASB	PSAS	Evaluation
Measurement basis dependent upon nature of item. Historical cost basis, replacement cost, market value. (Concept # 5.65-.70)	Primarily using historical cost basis. Replacement cost and realizable value are also used, but in limited circumstances. (par. 60)	Similar

Criteria of PS 1150.08

Criteria	Evaluation
Source deals with the specific circumstance	Yes, ASC 980 Regulated Operations

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Source is issued by an accounting standard setter	Yes, FASB
Source continues to be relevant	Yes, still used by rate regulated entities
Source uses a consultative process and deliberation when developing policies	Yes, comprehensive consultative process and deliberation

Evaluation whether a deferral of the Global Adjustment account meet the definition of Assets as per Section PS3210

PS3210 defines assets as *"economic resources controlled by a public sector entity as a result of past transactions or events and from which future economic benefits are expected to be obtained."* (par. 03)

The analysis of the three essential characteristics as defined by PS3210.4 are analyzed in the next table.

Characteristics	**Additional guidance**	**Comments**
They embody future economic benefits that involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows, or to reduce cash outflows. (par. 4(a))	The essence of assets are their future economic benefits. Assets embody future economic benefits that allow public sector entities to achieve their objectives. The future economic benefits embodied in assets involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows or to reduce cash outflows. (par. 11) The future economic benefits embodied in an asset may also be in the form of generating future cash inflows. Cash inflows benefit the public sector entity because cash can be used to purchase or to provide goods and services, redistribute wealth or settle liabilities. (par. 13)	The economic benefit embodied in the variance accounts (i.e regulatory asset) is the right to collect the incurred costs from ratepayers in order to settle the liability for the energy already consumed by the ratepayers. The electricity Act, 1998 ("EA") section 25.33(1) states: *"The IESO shall, through its billing and settlement systems, make adjustments in accordance with the regulations that ensure that, over time, payments by classes of market participants in Ontario that are prescribed by regulation reflect,* *a) amounts paid to generators, the Financial Corporation and distributors, whether the amounts are determined under the market rules or under section 78.1, 78.2 or 78.5 of the Ontario Energy Board Act, 1998; and* *b) amounts paid to entities with whom the IESO has a procurement contract, as determined under the procurement contract."*
The public sector entity can control the economic resource and access to the future economic benefits. (par. 4(b))	Economic resources can arise from, but are not limited to, the following: government's own legislation (for example, taxes, fines and penalties); (par. 08(c)) A public sector entity controls the economic resource and access to the future economic benefits when it: a. can benefit from the economic resource through its capacity to	The economic resources is the right created by the legislation that the energy costs IESO incurs will result in future cash flows. In the regulatory environments, incurring costs creates an enforceable right to set rates at a level that permits IESO to recover those costs. The adjustment of future rates is the mechanism the OEB uses to

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	provide goods and services, to provide future cash inflows or to reduce cash outflows; b. can deny or regulate access to those benefits by others; and c. is exposed to the risks associated with the economic resource. (par.16)	implement the right. Currently, the EA section 25.33(5) states: *"The IESO shall establish and maintain such variance accounts as may be necessary to record all amounts payable or receivable by it under this section."* The legislation would be amended to permit IESO to collect specifically the deferral of the energy costs and the related interest and administrative costs.
The transaction or event giving rise to the public sector entity's control has already occurred. (par.4(c))	It is the occurrence of a past transaction or event on or before the financial statement date that distinguishes a present economic resource controlled by a public sector entity from an economic resource that may be controlled by a public sector entity in the future. (par. 25) The past transaction or event that gives rise to control of an economic resource resulting from exchange agreements or contracts usually occurs at the point of exchange. This arises when substantially all the benefits and risks of ownership have been transferred to the public sector entity and normally coincides with the disbursement of funds, exchange of other assets or assumption of liabilities. (par. 26)	The past event giving rise to IESO's control occurs as the energy cost is incurred, as IESO has a right to collect it from the ratepayers.
Conclusion: The right to collect the deferral of the energy costs and the related interest and administrative costs meets the definition of assets.		

When concepts are in conflict with PSAS then PSAS prevails (PS 1150.12). For example, PSAS does not recognize intangible assets (PS 3150.03, .14 and PS1000.58). So if regulatory assets are considered to be intangible assets, they would not be allowed to be recognized through another source of GAAP.

It is worth noting that the economic impacts of rate regulation are not recognized under US GAAP as intangible assets as the FASB has specific guidance to deal with this type of asset. It is also worth noting that the IASB has an ongoing project on rate regulated activities and are currently developing an accounting model based on the principles of IFRS 15 *Revenue from contracts with customers* to provide a principle-based framework for recognizing regulatory assets (see Agenda Ref. 9 for the IASB meeting on February 23, 2017). Furthermore, the Summary Comment Letter Analysis related to the ED/2009/8 on Rate Regulated Activities published by the IASB in July 2009 states on page 2 of 50

"The IFRIC observed that it had previously discussed whether a regulatory asset should be recognized in the context of service concession arrangements, either as deferred costs or as an intangible asset to reflect an expectation that the entity will recover these costs as part of the price charged in future periods. It had concluded that entities applying IFRSs should recognize only assets that qualified for recognition in accordance with the IASB's *Framework for the Preparation and Presentation of Financial Statements* and

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relevant accounting standards, such as IAS 11 *Construction Contracts*, IAS 18 *Revenue*, IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*."

Therefore, we can conclude that ASC 980 is NOT in conflict with PS 3150.03, .14 and PS1000.58 with respect to intangible assets.

Conclusion:
FASB is appropriate to use as "*other source of GAAP*". FASB standard ASC 980 has extensive guidance for rate regulated entities including the recognition of regulatory assets and use of rate regulated accounting by IESO would be consistent with current reporting practices of H1, OPG and OEFC.

Appropriate Accounting Principle for issue #2

ASC 980 Regulated Operations

- 980-10-15-2 *"The guidance in the Regulated Operations Topic applies to general-purpose external financial statements of an entity that has regulated operations that meet all of the following criteria:*

  (a) The entity's rates for regulated services or products provided to its customers are established by or are subject to approval by an independent, third-party regulator or by its own governing board empowered by statute or contract to establish rates that bind customers.

  (b) The regulated rates are designed to recover the specific entity's costs of providing the regulated services or products. This criterion is intended to be applied to the substance of the regulation, rather than its form. If an entity's regulated rates are based on the costs of a group of entities and the entity is so large in relation to the group of entities that its costs are, in essence, the group's costs, the regulation would meet this criterion for that entity.

  (c) In view of the demand for the regulated services or products and the level of competition, direct and indirect, it is reasonable to assume that rates set at levels that will recover the entity's costs can be charged to and collected from customers. This criterion requires consideration of anticipated changes in levels of demand or competition during the recovery period for any capitalized costs."

- 980-10-20 Glossary, Definition of incurred costs *"A cost arising from cash paid out or obligation to pay for an acquired asset or service, a loss from any cause that has been sustained and has been or must be paid for."*

- 980-10-05-8 "*Unless an accounting order indicates the way a cost will be handled for rate-making purposes, it causes no economic effects that would justify deviation from the GAAP applicable to business entities in general. The mere issuance of an accounting order not tied to rate treatment does not change an entity's economic resources or obligations. In other words, the economic effect of regulatory decisions—not the mere existence of regulation—is the pervasive factor that determines the application of GAAP.980-340 – Other Assets and Deferred Costs."*

- 980-340-25-1 "*Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An entity shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:*

  (a) It is probable (as defined in Topic 450) that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.

  (b) Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.

  A cost that does not meet these asset recognition criteria at the date the cost is incurred shall be recognized as a regulatory asset when it does meet those criteria at a later date."

- 980-340-40-1: "*If at any time an entity's incurred cost no longer meets the criteria for the capitalization*

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of an incurred cost (see paragraph 980-340-25-1), that cost shall be charged to earnings."

- 980-350-50-1: *"In some cases, a regulator may permit an entity to include a cost that would be charged to expense by an unregulated entity as an allowable cost over a period of time by amortizing that cost for rate-making purposes, but the regulator does not include the unrecovered amount in the rate base. That procedure does not provide a return on investment during the recovery period. If recovery of such major costs is provided without a return on investment during the recovery period, the entity shall disclose the remaining amounts of such assets and the remaining recovery period applicable to them."*
- 980-340-55-2: *"In some cases, a regulator may approve rates that are intended to recover an incurred cost over an extended period without a return on the unrecovered cost during the recovery period."*
- 980-340-55-3: *"The regulator's action provides reasonable assurance of the existence of an asset (see paragraph 980-340-25-1). Accordingly, the regulated entity would capitalize the cost and amortize it over the period during which it will be allowed for rate-making purposes. That cost would not be recorded at discounted present value. An exception to this general rule is provided for costs of abandoned plants."*

Issue #2: Can the IESO recognize deferral or variance accounts related to the deferral of the annual Global Adjustment account as a regulatory asset on its statement of financial position?

As described in issue #1, US GAAP includes special accounting provisions that are applicable to entities with activities that are subject to rate regulation. The result is that rate regulated entities are required to recognize regulatory assets and liabilities provided the following three criteria are met:

Criteria	Comment	Evaluation
The entity's rates for regulated services or products provided to its customers are established by or are subject to approval by an independent, third-party regulator or by its own governing board empowered by statute or contract to establish rates that bind customers.	IESO has unrecognized variance accounts related to the MDMR (smart meters), that have been approved by the OEB in accordance with the Electricity Act and the OEB Act (see Appendix B). It is important to note that Hydro One and OPG are both consolidated into the province's books, are both regulated by the OEB and their respective regulatory assets and liabilities are reported in the province's books.	Met
The regulated rates are designed to recover the specific entity's costs of providing the regulated services or products.	Currently, the rates approved by the OEB are designed to recover the IESO's costs of providing the regulated services and the pass-through related to the energy purchased from the generators. The contemplated transaction is based on the fact that the OEB would grant generic deferral or variance accounts to capture the difference between the amounts paid to generators and others, and the amounts collected in rates. Furthermore, the interest and ancillary costs related to the contemplated transaction would also be included in future rates charged to customers. In summary, the legislation would create a right to collect the incurred costs.	Met

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In view of the demand for the regulated services or products and the level of competition, direct and indirect, it is reasonable to assume that rates set at levels that will recover the entity's costs can be charged to and collected from customers. This criterion requires consideration of anticipated changes in levels of demand or competition during the recovery period for any capitalized costs."	Since the deferral or variance accounts would be sold to the OPG Trust at least on a monthly basis and cash would be received on the same day, this criteria would be met. This criteria would need to be monitored on a yearly basis to ensure that IESO and the OPG Trust would be able to recover the future deferred amount taking into account the levels of demand or competition during the recovery period.	Met
Conclusion: Since the three criteria are met, IESO should be able to adopt the guidance in ASC 980.		

Conclusion: Based on the assumptions mentioned above, IESO should be able to recognize a regulatory asset for the deferral of the annual Global Adjustment account. As mentioned in the ASC 980 guidance above, it is important that an accounting order be issued by the OEB which indicates the way the incurred costs would be handled for rate-making purposes as the OEB's action provides reasonable assurance of the existence of a regulatory asset.

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2. Derecognition of the regulatory assets

Background and Assumptions for issue #3

The facts, circumstances, and assumptions relevant to the specific transactions are as follows:

1. The annual Global Adjustment account that would be deferred in the deferral or variance accounts (the "Asset") would be significant.
2. The IESO does not currently have the financial capability to finance the Asset and is contemplating selling the Asset to a Trust to be set-up by OPG (the "OPG Trust").
3. The OPG Trust would be consolidated by OPG.
4. Proposed terms of the sale agreement between the IESO and the OPG Trust:
   - The sale contract would be structured as an absolute sale, which would assign future economic benefits or cash flows related to the Asset exclusively to the OPG Trust.
   - The arrangement would be structured whereby there is no recourse or obligations remaining of IESO related to the Asset.
   - The arrangement is not considered to be a financing transaction as IESO would have no obligations to the OPG Trust after the Asset is sold to the OPG Trust.
   - IESO would not retain any rights or benefits from the Asset.
   - IESO would not have any rights to interest or penalties on the Asset once it has been transferred to the OPG Trust.
   - The contract would be clear that IESO cannot pledge the Asset as collateral to obtain future cash flows or financing.
   - IESO would continue to collect related cash flows on the OPG Trust's behalf and remit those cash flows to the OPG Trust without material delay. In addition, IESO would not be entitled to reinvest such cash flows, except for investments in cash or cash equivalents during the short settlement period from the collection date to the date of required remittance to the OPG Trust, and interest earned on such cash and cash equivalents is passed to the OPG Trust. The contract would define IESO's role strictly as that of agent, under a pass-through arrangement.
   - Servicing, origination, and arrangement fees, would be collected by IESO in rates charged to ratepayers as part of its market dealings.
   - The Asset would be sold to the OPG Trust at least, on a monthly basis and cash would be received on the same day.

Appropriate Accounting Principles for issue #3

Public Sector Accounting Standard ("PSAS") 3210, *Assets*, defines an asset as "*...economic resources controlled by a government as a result of past transactions or events and from which future economic benefits are expected to be obtained.*" [par. 3]

.04 "Assets have three essential characteristics:

(a) they embody future economic benefits that involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows, or to reduce cash outflows;

(b) the public sector entity can control the economic resource and access to the future economic benefits; and

(c) the transaction or event giving rise to the public sector entity's control has already occurred."

.22 "Control of an economic resource and of access to the future economic benefits are essential characteristics of an asset, whereas possession or ownership is not."

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.24 *"A public sector entity may act as trustee when it administers trusts on behalf of the beneficiaries specified in the agreement or statute. As trustee, the public sector entity merely administers the assets, following the terms and conditions set out in the agreement. It does not control the asset because it does not have access to the future economic benefits. Those benefits flow to the beneficiaries."*

As noted in PS1000 Financial statement concepts:

".37 An item is not an asset of a government if it lacks one or more of the essential characteristics listed in the preceding paragraph. Thus, for example, an item does not qualify as an asset of a government if the item involves:

(a) no future economic benefit;

(b) future economic benefit, but the government cannot obtain it; or

(c) future economic benefit that the government may obtain, but the events or circumstances that give the government control of the benefit have not yet occurred."

Issue #3: Can the IESO derecognize the variance accounts related to the deferral of the annual Global Adjustment account upon sale to OPGTrust?

PS3210 does not specifically address the derecognition of a regulatory asset. The concept of a regulatory asset does not exist under PSAS.

It is also well understood in this industry that regulatory assets do not meet the definition of intangible asset or financial asset. Specifically, regulatory assets do not meet the definition of financial asset because they are imposed on customers through the tariff (i.e., imposed by the OEB) and do not represent a right to receive payments from another party as a result of a contract.

More generally, PSAS.3210.37 suggests that an asset would no longer be recognized when it fails to meet the definition of an asset.

Based on PS1000.37(b), an item does not qualify as an asset of a government if the item involves future economic benefit, but the government cannot obtain it.

Based on the assumptions mentioned above, ALL risks and rewards would be transferred to the OPG Trust including the following:

- the contract would define IESO's role strictly as that of agent, under a pass-through arrangement;
- all cash flows related to the Asset would be transferred without material delay to the OPG Trust;
- rights to interest or penalties on the Asset would be for the benefits of the OPG Trust;
- IESO cannot pledge the Asset; and
- no recourse or obligations remaining of IESO related to the Asset.

Conclusion: Based on the proposed terms of the sale agreement between the IESO and OPG Trust mentioned above, the deferral or variance accounts would be derecognized at the point where the IESO would derive no future economic benefit from it. This would occur where the IESO ultimately transfers the rights, risk and rewards related to those deferral or variance accounts to the OPG Trust. This would occur on the reception of cash from the OPG Trust.

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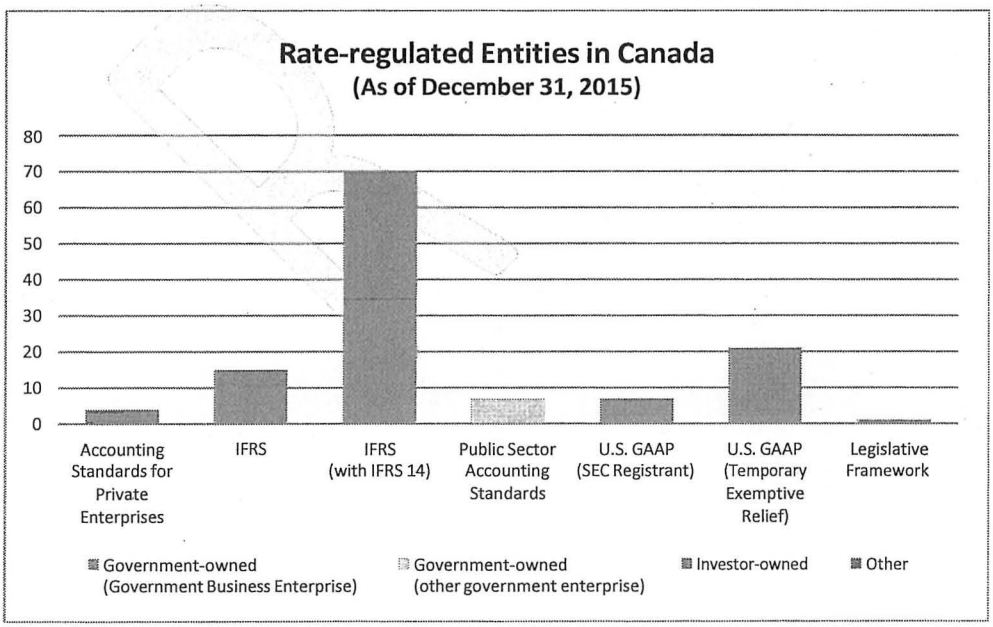
Appendix A:

Extract from the "Accounting Standards Advisory Forum Agenda Ref: 3A dated September 29, 2016" available on the IFRS website

Canadian Rate-regulated Entities

18. The accounting framework landscape for Canadian rate-regulated entities is currently diverse. For annual periods beginning on or after January 1, 2015, rate-regulated entities that are Canadian publicly accountable enterprises are required to apply IFRS. Rate-regulated entities that adopted IFRS for the first time after IFRS 14 *Regulatory Deferral Accounts* was issued continue to recognize these balances. Government Business Enterprises (which operate to generate a profit or on a break-even basis) that are also rate-regulated entities are also directed to apply standards applicable to for-profit entities, and thus apply IFRS. Canadian securities legislation permits dual-listed entities (i.e., Canadian entities also registered with the U.S. Securities and Exchange Commission) to apply U.S. GAAP in the normal course. Temporary exemptive relief is also available from the Canadian Securities Administrators that permits rate-regulated entities that are not dual-listed to apply U.S. GAAP in place of IFRS. If a rate-regulated entity is not a publicly accountable enterprise or a Government Business Enterprise, additional accounting framework options may also include Accounting Standards for Private Enterprises or Public Sector Accounting Standards. A non-GAAP reporting framework is used when legislated by the provincial owner of a government-owned rate-regulated entity.

19. As of December 31, 2015, there were approximately 125 rate-regulated entities in Canada. These entities mainly range in size from small entities owned by municipal governments to large investor-owned entities or entities owned by provincial governments.



Source: Information compiled based on audited financial statements for fiscal year 2015, or information from rate filings that confirmed the accounting framework used by these entities. Due to data collection constraints, the population could be slightly larger.

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20. The chart above highlights two key points:

(a) The majority of investor-owned entities have chosen U.S. GAAP over IFRS. A few entities that are not reporting issuers apply Accounting Standards for Private Enterprises. Both U.S. GAAP and Accounting Standards for Private Enterprises permit the recognition of balances arising from rate regulation. Several entities that apply U.S. GAAP have told us this choice was influenced by the need to provide their users with financial statements that accurately reflect the economics of their business. Further, some entities presently using the temporary exemptive relief described in paragraph18 have said they are considering incurring the cost and effort necessary to become a registrant of the U.S. Securities and Exchange Commission in order to have the permanent ability to apply U.S. GAAP. While such a decision could be primarily for business reasons such as the entity expanding its operations into the U.S., it could also be attributed to the continuing uncertainty about the ultimate outcome of the IASB's Rate-regulated Activities project and the approaching expiry date of the securities regulators' exemptive relief.

(b) Public sector entities that are Government Business Enterprises tend to apply IFRS. The majority of these entities is made up of several large provincially-owned utilities, and many small municipally-owned local distribution utilities that do not issue debt or list in the U.S. stock market, and are not subject to Canadian securities legislation. As a result, they cannot apply U.S. GAAP. As shown in the chart, many of these entities adopted IFRS for the first time after the IASB issued IFRS 14, which allowed them to continue their previous accounting practices for rate-regulated activities.

21. Within the pool of government-owned rate-regulated entities, there are entities that do not meet the characteristics of Government Business Enterprises and are required to apply Public Sector Accounting Standards.

22. The data on the different accounting frameworks in Canada is unique. It demonstrates that when given a choice, rate-regulated entities select an accounting framework that captures the effects of rate regulation on their financial position and financial performance in order to communicate more decision-useful information to users.

http://www.ifrs.org/Meetings/MeetingDocs/ASAF/2016/September/1609-ASAF-03A-Rate-regulated-Activities-Canada.pdf

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Appendix B:

Extract from the "DECISION and ORDER issued by the OEB on March 28, 2013" available on the IFRS website

Proceeding on the Ontario Energy Board's own motion to review the options for and ultimately determine the appropriate allocation and recovery of the Smart Metering Charge pursuant to section 19 of the Ontario Energy Board Act, 1998.

THE BOARD ORDERS THAT:

Effective May 1, 2013, the Smart Metering Entity charge to be levied and collected by the Smart Metering Entity from all Distributors identified in the Board's annual Yearbook of Electricity Distributors shall be $0.788 per month for each Residential and General Service <50kW customers for each distributor. The Smart Metering Entity charge shall be in effect from May 1, 2013 to October 31, 2018. The number of Residential and General Service <50kW customers to which the Smart Metering Entity charge will be applied to shall be in accordance with the methodology set forth in the Settlement Agreement attached as Appendix A.

http://www.ontarioenergyboard.ca/oeb/_Documents/EB-2012-0100/dec_order_IESO-SME_20130328.pdf

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OEB comments

PART II

This confidential draft document is provided for discussion purposes only. It should not be construed as representing the position adopted by the Government of Ontario on any of the topics included or not included in this document. Any notes included in this document are intended only to help facilitate a discussion of the topics to which they relate.

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A PROPOSAL TO CREATE REGULATION

made under the

ONTARIO FAIR HYDRO PLAN ACT, 2017

FAIR ADJUSTMENT UNDER PART II OF THE ACT

Definitions

1. In this Regulation,

"billing period" means a period of time in respect of which an invoice for electricity is issued by an electricity vendor , a specified consumer or a unit sub-meter

provider providing unit sub-metering for a specified consumer;

"Toronto Hydro" means Toronto Hydro-Electric System Limited.

Hypothetical regulated rate consumer

2. For the purposes of subsection 7 (1) of the Act, a hypothetical regulated rate consumer meets the following criteria:

[OLC Note: Section 7 of the Act refers to "a hypothetical regulated rate consumer who meets the

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prescribed criteria" so we need to prescribe criteria under this section.]

1. The consumer purchases electricity directly from Toronto Hydro.

2. The consumer has an account with Toronto Hydro that falls within the residential-service rate classification as specified in a rate order made by the Board under section 78 of the *Ontario Energy Board Act, 1998*.

3. The consumer is invoiced by Toronto Hydro on a monthly basis.

[OLC Note: To help me understand how the various terminology is meant to operate, does para. 3 above mean that the "billing period" is one month?]

[OEB Note to Draft: *Yes, for the hypothetical consumer this means that the consumer's billing period covers a month.]*

4. The consumer is not invoiced by Toronto Hydro for electricity on an equal monthly payment plan, an equal billing plan or a net metered basis.

5. The consumer is not a rate-assisted consumer within the meaning of section 79.2 of the *Ontario Energy Board Act, 1998*.

6. The consumer uses 750 kilowatt hours of electricity in each billing period.

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7. The consumer's time-of-use consumption profile in each billing period is described as follows: *[**OEB Note to Draft:** We have noted the addition of the word "described". Not quite sure why that is necessary, since the profile is as set out below. Contrast with other paragraphs that don't refer to "describe". As long as the addition of the word "describe" doesn't change the meaning (i.e., that the consumer's TOU profile is as*

set out in (i) to (iii)), then we are OK with that.]

i. 65 per cent of the consumer's usage occurs during off-peak periods associated with the regulated price referred to as $RPEM_{OFF}$ in section 3.4 of the "Standard Supply Service Code for Electricity Distributors" issued by the Board.

ii. 17 per cent of the consumer's usage occurs

during mid-peak periods associated with the regulated price referred to as $RPEM_{MID}$ in section 3.4 of the "Standard Supply Service Code for Electricity Distributors" issued by the Board.

iii. 18 per cent of the consumer's usage occurs during on-peak periods associated with the regulated price referred to as $RPEM_{ON}$ in section 3.4 of the "Standard Supply Service

Code for Electricity Distributors" issued by the Board.

Regulated rate consumers, first fair adjustment under s. 7 of the Act

3. (1) The Board shall apply the following methodology for the purposes of section 7 of the Act:

1. Subject to subsections (2) and (3), determine the total invoice amount, consisting of the following types of amounts, that would be invoiced in

respect of a billing period to a hypothetical regulated rate consumer who meets the criteria set out in section 2:

i. The commodity price of the electricity under the comparison rates described in subsection 7 (3) of the Act.

ii. The rates and charges as of May 1, 2017 as set out in the applicable rate order issued by the Board under subsection 78 (3) of the

Ontario Energy Board Act, 1998, except for the rates and charges related to any rural or remote rate protection compensation required under subsection 79 (4) of the *Ontario Energy Board Act, 1998* or any compensation required under subsection 79.2 (10) of that Act.

iii. The rates and charges as of April 30, 2017 as set out in the applicable rate order issued by the Board under

subsection 78 (3) of the *Ontario Energy Board Act, 1998,* related to any rural or remote rate protection compensation required under subsection 79 (4) of the *Ontario Energy Board Act, 1998* or any compensation required under subsection 79.2 (10) of that Act.

iv. The amount of any harmonized sales tax payable by the consumer under Part IX of the *Excise Tax Act* (Canada) in respect

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of the amounts mentioned in subparagraphs i, ii and iii.

2. Subject to subsections (2) and (3), determine the rates that, ~~when applied~~ for the purposes of ~~as the commodity price of the electricity in~~ subparagraph ~~1~~ i would result in the hypothetical regulated rate consumer who meets the criteria set out in section 2 being invoiced a total invoice amount in respect of a billing period, consisting of the following types of amounts,

that is 25 per cent less than the total invoice amount determined under paragraph 1: *[**OEB Note to Draft**: (1) The "rates" that we are determining – in essence solving for under section 7 of the Act – are those that pertain to the commodity price in subparagraph i below and not those that pertain to the commodity price in subparagraph 1i above. The commodity price in subparagraph 1i above is the commodity price under the*

"comparison rates". (2) On further reflection, we are not sure that "when applied as" the commodity price works as well as we originally thought. The idea should be that the commodity price is the price under the rates that we are determining under this paragraph (in the same way that the idea is expressed in 3(1)1i)). Not convinced that "when applied to" works either. So we have tried something else, but are

certainly open to further suggestions.]

i. The commodity price of the electricity.

ii. The rates and charges as of May 1, 2017 as set out in the applicable rate order issued by the Board under subsection 78 (3) of the *Ontario Energy Board Act, 1998,* except for the rates and charges related to any rural or remote rate protection compensation

required under subsection 79 (4) of the *Ontario Energy Board Act, 1998.*

iii. The rates and charges as of July 1, 2017 as set out in the applicable rate order issued by the Board under subsection 78 (3) of the *Ontario Energy Board Act, 1998*, related to any rural or remote rate protection compensation required under subsection 79 (4) of the *Ontario Energy Board Act, 1998.*

iv. The amount of any harmonized sales tax payable by the consumer under Part IX of the *Excise Tax Act* (Canada) in respect of the amounts mentioned in subparagraphs i, ii and iii.

(2) The following types of amounts shall be excluded from the total invoice amount determined under paragraph 1 or 2 of subsection (1).

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1. The balance of any amounts carried forward from previous invoices in respect of previous invoice periods.

2. Penalties or interest.

3. Charges that do not relate to the consumption~~use~~ of electricity.
[OEB Note to Draft: *In our last set of comments, we noted that ORECA refers to "consumption" and not "use". We note that you have retained "use" here, and would ask for confirmation as to whether you*

intend for this to be interpreted in a manner different than we would interpret ORECA? If so, we would require greater clarity on that point.]

4. Any of the following charges that may be set out in an order issued by the Board under subsection 78 (3) of the *Ontario Energy Board Act, 1998:*

   i. A fixed monthly service charge payable by a generation facility within the meaning of section 56 of the

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Ontario Energy Board Act, 1998 and classified as "microFIT".

ii. A charge labelled as a "specific service charge" or "retail service charge".

(3) For the purposes of determining the total invoice amount mentioned in paragraph 1 of subsection (1), the Board shall not take into account any financial assistance under the *Ontario Rebate for Electricity Consumers Act, 2016* but the Board shall do so

for the purposes of determining the total invoice amount mentioned in paragraph 2 of subsection (1).

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Other specified consumers, first fair adjustment under s. 8 of the Act

*[**OEB Note to Draft:** We raised some questions about whether this section is entirely compatible/workable in all respects with O. Reg. 429/04. No changes have been proposed to this section relative to our proposed draft (where we noted but did not attempt to resolve) this question, and are wondering whether you are satisfied on that point or whether it remains outstanding.]*

4. (1) For the purposes of section 8 of the Act, the Board shall determine a dollar per megawatt hour amount that represents the difference between the following:

1. The comparison rates mentioned in subparagraph 1 i of subsection 3 (1).

2. The rates determined by the Board under paragraph 2 of subsection 3 (1).

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(2) The adjustment to be applied by electricity vendors in respect of each billing period with respect to specified consumers who are not regulated rate consumers shall be determined as follows:

1. The electricity vendor shall multiply the dollar per megawatt hour amount determined by the Board under subsection (1) by the total volume of electricity consumed by the specified consumer during the billing period.

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2. The electricity vendor shall deduct the amount determined under paragraph 1 from the amount otherwise payable by the specified consumer in respect of the billing period relating to adjustments made under section 25.33 of the *Electricity Act, 1998*.

(3) For the purposes of paragraph 1 of subsection (2), the total volume ~~amount~~ of electricity consumed by a specified consumer in a billing period shall be, ***[OEB Note to Draft:*** *Change for*

consistency with the change that you made to paragraph 1 of subsection (2)]

(a) in the case of a specified consumer that is a market participant as defined in the *Electricity Act, 1998*, the net volume of electricity withdrawn from the IESO-controlled grid by the specified consumer during the billing period, as determined in accordance with the market rules made under section 32 of the *Electricity Act, 1998*; and

(b) in any other case, the volume of electricity distributed to the specified consumer during the billing period by the electricity vendor, adjusted for losses as required by the Retail Settlement Code issued by the Board under the *Ontario Energy Board Act, 1998* and Ontario Regulation 429/04.

(4) For greater certainty, if the amount determined under paragraph 2 of subsection (2) in respect of a billing period is a

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negative amount, that amount shall be a credit for the specified consumer for that billing period.

Subsequent adjustments, regulated rate consumers, cl. 11 (1) (a) of the Act

5. (1) For the purpose of determining the electricity rates payable by regulated rate consumers for the period beginning on May 1, 2018 and ending on April 30, 2019, the Board shall,

(a) if the rate of inflation is a negative amount, maintain

electricity rates for regulated rate consumers at the rates determined under paragraph 2 of subsection 3 (1); or

[ENE LSB Note: Is this in keeping with the policy intention? Maintaining rates as per July 1, 2017 if the rate of inflation is negative is more than likely to result in bills rising (and, of course, by more than the rate of inflation). If Toronto Hydro's distribution rates rise by 5% (and, say, 2% on the bill as a consequence) when inflation is