KEY ISSUES AND QUESTIONS RELATED TO THE GLOBAL ADJUSTMENT SMOOTING PROPOSAL
(Input from COE, PEMD, OPCD, OFA-MOF)

OVERALL COMMENTS:

- Need to understand the models and the assumptions embedded in them to assess the validity of the estimated impacts/forecasts. It will be important to understand the sensitivity of the models and the financial impacts to the assumptions. Sensitivity analysis would allow the government to make better informed decisions and to develop a risk based outlook to manage potential fluctuations in the cost of these initiatives.

- Given the scale and scope of the initiatives that are being proposed, it is important to note that there will be significant incentives/disincentives being introduced. It will be important to understand how these may impact the behaviour of various key stakeholders going forward and hence the assumptions built into the models and the financial estimates.

- The submission states that the electricity prices are projected to increase above inflation for the foreseeable future. While there are a number of initiatives referenced in the deck to bend the cost curve, it is not clear what the estimated impact of these changes would be. Are these measures projected to limit the increases in the price of electricity at or below inflationary increases? Otherwise, the widening gap will continue to drive need for government action, creating future pressures on the Fiscal Plan.

- With so many proposed changes impacting different consumers, and costs shifting from the rate-base to government funding, it will be important to understand the profile/net impact of the changes on different customer groups and geographies. Need to know the net winners and net losers.

- Energy noted that 2017-18 fiscal impacts were full year, also noted that many initiatives will likely take 3 to 6 months to roll out. Request the Ministry of Energy to refine estimates for 2017-18 fiscal year to reflect the appropriate partial year cost of these initiatives.

GLOBAL ADJUSTMENT (GA) SMOOTHING:

There are three main risks to consider in relation to this initiative:

1. ***Accounting Risks and the Impact on the Fiscal Plan***

    - The submission assumes that the proposed GA smoothing will receive the favourable accounting treatment: the provincial debt would increase, but net debt would not change and the fiscal plan would not be impacted (there would be an increase in interest-on-debt and an increase in income from government business enterprises).
        - There are a number of complex issues that need to be addressed and stringent criteria to be met to achieve a satisfactory path forward. Several requirements are high risk.

    - No discussion with OAG; in previous Annual Reports, the OAG has raised concerns about the appropriateness of recognizing rate regulated assets and liabilities.

- The structure, term and timing of the financing for GA smoothing are highly dependent on the IESO's forecast of GA costs.
    - For example, decreased market prices of electricity would lead to higher GA costs to ensure payments to generators. While customers traditionally pay both the reduced market price and higher GA to recoup these costs, the entity financing the GA would need to have increased borrowing.
    - Volatility in prices and GA could lead to much variability in the amount borrowed.
        - What would the financial impact/borrowing requirements be under various price scenarios?
    - Cost is highly dependent on actual interest rates over time.
        - The current projections use nominal interest rates of 5%. The average interest rate in Canada between 1990 and 2017 was 5.94% (from high of 16% in Feb 1991 to 0.5% in April 2009), which includes the last decade that has experienced historically low interest rates. Given the 30 yr projected time horizon, the impacts and funding requirements at different interest rates and scenarios for electricity prices are unclear.
        - Sensitivity analysis needed re: interest rates – what would be the impact if the average interest rate was 6%? or higher?
    - So if this key assumption re: favourable accounting treatment is incorrect, the impacts would be significant and can vary depending on the market changes. In addition to having a significant fiscal impact, the proposed plan would also introduce significant volatility to the medium- to long-term fiscal plan (as interest rates, energy prices, consumer behaviour changes, etc.).

- Increased borrowing over time would strain the province's ability for continued borrowing.

- Annual borrowing could range from $1.6B to $3B with accumulated debt peaking at $38.5B depending on the scenario chosen (based on Feb 22 scenario).

- *See appendix on page 8 for additional accounting questions related to Global Adjustment.*

2. *Program Design Elements and Implications*

- Earlier drafts were based on the premise that the GA would apply to customers participating in the Regulated Price Plan (RPP). However, given there are eligible customers who have opted out of RPP, the proposal has since been revised to have GA apply to all eligible customers in the Regulated Price Plan regardless of their current participation. If so:
    - What sort of mechanisms will the Ministry of Energy put in place to ensure that those consumers who benefit from this measure can't opt-out in the future when the payments start increasing?
        - If the consumers who benefit from this initiative are allowed to opt-out later as $ higher payments are needed to pay for the deferred GA amount, the government may face a vicious cycle (as more people opt out, the recovery $/% per remaining household increases, which further creates incentives to opt out of the RPP), possibly stranding the balance as unfinanced debt.

- The analysis is performed on a "typical" customer – a Toronto Hydro customer with 750 kWh monthly consumption, however issues may arise in this assumption:

- The Delivery Cost component of a hydro bill varies across distributors even at the same monthly consumption amount. However the electricity component of the bill - which is targeted by GA Smoothing proposals - would stay the same as RPP prices are applied province-wide.
- The proportionate impact of changes targeting the Electricity component of the bill would vary from LDC to LDC.
  - What are the estimated impacts of the proposal on various groups of customers that are served by various LDCs across the province?
  - What is the range and distribution of the differences in relief that is being provided?

- Unlike OREC or the former OCEB program which apply a rebate/benefit on a proportion of the total bill, this GA smoothing proposal would have varying levels of proportionate impact.
- ENERGY's deck uses Toronto Hydro, a higher cost distributor, as an example. As a result, a 25% impact bill impact from GA smoothing for Toronto Hydro would have a much greater impact for other, lower-cost, distributors, where the electricity component of the bill is larger in proportionate terms.
- This across the board reduction for GA costs would not be targeting those with higher electricity bills, as it would be reducing the electricity component equally on a dollar value basis for all customers.
  - Has the Ministry of Energy consider alternative options? Has there been any consideration given/modelling done on an OREC-type program, with the objective of providing a 25% reduction to electricity bills across the board?

3. *Legal Risk*

- This proposal subsidizes near-term consumers at the expense of long-term and future consumers.

- Legal advice on the constitutional risk posed by the proposal to defer the current costs to consumers of the global adjustment, to be paid for by consumers in future years, noted a moderately high constitutional risk of resulting in an unconstitutional tax. It creates a refinancing structure which results in future consumers paying disproportionately more of the GA cost and therefore cross-subsidizing near-term consumers.
  - This advice was based on a review of the proposal from February 9, 2017. The Ministry's draft Cabinet submission indicates this risk could be eliminated, either up front or retroactively, by the imposition of a valid tax.

Are there specific program design/implementation elements being considered to address/minimize the legal risks?

ADDITIONAL QUESTIONS RELATED TO GLOBAL ADJUSTMENT

Questions for IESO and Auditors:

- What is your assessment of risk on both recognizing a regulatory asset and then selling it to OPG Trust? What factors into your assessment? Are you aware of any other entities following public sector accounting standards, presenting regulatory assets on their financial statements?
- Is there anything else that could be done with the proposed structure to reduce the risk?
- What is your assessment of risk of the structure as a whole?
- Based on your understanding of the facts and assumptions, are you expecting to be able to issue a formal accounting opinion on both the ability of IESO to record a regulatory asset and the ability for IESO to sell it to OPG Trust?

Questions for OPG and Auditors:

- What is your assessment of risk with respect to recognizing an intangible asset for the purchase of the regulatory asset from IESO and being able to consolidate OPG Trust with OPG?
- Is there anything else that could be done with the proposed structure to reduce the risk?
- What is your assessment of risk of the structure as a whole?
- What are the most significant risks in being able to maintain the consolidation of OPG Trust with OPG over the duration of the structure?
- Financing – if the OEB or the legislation caps the rate at which financing costs can be passed on to the ratepayers, does that impact the analysis on consolidation of OPGTrust with OPG?
- One of the OPG slides speaks to the need for a provincial guarantee if a change in legislation puts the private debt holders at risk of recovery – what is the cost of this guarantee (e.g. rate differential)? Is this guarantee necessary to obtain any external funding? Are there alternatives to a provincial guarantee?
- What would the admin costs be to manage this structure?
- With the increased debt take on, will OPG (consolidated) be able to maintain its operations and meet its liabilities from revenues received from sources outside of the Province (e.g. the key criteria to remaining a GBE)

Questions for Energy and OPG:

- What is the timeline to complete revised modelling re: the cost of the overall program to the Province (with external financing and an equity injection from the Province to OPG as well as estimate for administrative costs)

Questions for MOF/OFA

- What impact would a provincial guarantee for the 3rd party debt have, if any, on the Province's cost of borrowing?
- Has the OFA had any discussions with OPG re: how and when the equity injection would be provided to OPG – does that timing create any concerns for OFA re: key performance indicators (e.g. impact on IOD?)