Comments on Ministry of Energy's February 15 Deck to Cabinet
"Electricity Price Mitigation" and
February 16 Draft Deck "Rate Mitigation Options for Class B Electricity Consumers"

The Ministry of Energy (Energy) is providing options for potential price mitigation initiatives.

OVERVIEW

- Energy's proposals involve enhancement of existing rate relief programs and introduction of new initiatives. In addition, Energy proposes that costs of rate mitigation measures be shifted from the rate base to the tax base. Based on Energy's analysis this can range from $650M to almost $800M when fully implemented (table on following pages).
- The largest impacts on rates and largest potential fiscal exposures are from the proposed deferred recovery (or smoothing) of Global Adjustment costs (about $1.4 to $3.1 billion fiscal impact per fiscal year in the short-to-medium term, depending on the option).
  - Additional work is required to determine a financial structure for implementation of Global Adjustment smoothing that will avoid fiscal and net debt impacts and be compliant with government accounting standards.
- Energy's proposals would be in addition to existing electricity price mitigation efforts that, over the past five years, have averaged about $1.5 billion per year. This is expected to increase to about $2 billion with the introduction of the Ontario Rebate for Electricity Consumers (OREC) in 2017-18. (See table below)
  - The government introduced OREC, which is providing a rebate amount equal to the 8% provincial portion of the Harmonized Sales Tax (HST), saving $11 per month starting January 1, 2017, for eligible small businesses, farms and residential consumers, and has expanded the Rural or Remote Electricity Rate Protection (RRRP) program, saving eligible RRRP customers about $45 per month, when combined with OREC.
- The existing program costs are summarized in the table below:

($M)	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17[1]	2017-18[1]
OCEB	1,033	994	1,006	1,078	860	-	-
OREC	-	-	-	-	-	300	1,100*
Ending DRC[2]	-	-	-	-	85	330	330
NIERP	120	120	115	108	120	120	120
NOEC	23	24	25	24	26	25	25
OEPTC[3]	354	406	418	429	444	450	460
TOTAL	**1,530**	**1,544**	**1,564**	**1,639**	**1,535**	**1,225**	**2,035**

1. 2016-17, 2017-18 based on forecasted numbers
2. 2015-16 estimated for 3 months of reduced DRC revenue
3. OEPTC amounts in all years based on energy component of the rebate.

* Sourced from Energy PRRT submission

OCEB – Ontario Clean Energy Benefit
NIERP – Northern Industrial Electricity Rate program
DRC – Debt Retirement Charge
OREC – Ont. Rebate for Electricity Consumers
NOEC – Northern Ontario Energy Credit
OEPTC – Ont. Energy & Property Tax Credit

Staff Comment: Given the potentially significant fiscal impact of Energy's new proposals and implicit desire for an 'on-bill credit'. The above off bill credits supporting electricity costs (NOEC, OEPTC) can potentially be reduced or eliminated to help offset the fiscal pressures of these new measures.

- To target customers not benefiting from the proposals outlined on the February 15 Deck to Cabinet, additional measures were introduced in a February 16 draft deck targeting Class B customers.

ENERGY'S BROAD POLICY THEMES / RATIONALES – BASED ON FEBRUARY 15 DECK TO CABINET

Energy is taking aim at electricity prices in three overarching ways:

1. Helping the most vulnerable by enhancing electricity support programs and shifting cost onto the tax-base.
    a) **Enhance Rural or Remote Rate Protection Plan (RRRP)**
    b) **Enhance Ontario Electricity Support Program (OESP)**
    c) **Establish an LDC Affordability Fund**
    d) **Implement On-Reserve First Nations Delivery Credit**
2. Ongoing activities to bend the future cost curve of electricity:
    a) Leverage the Ontario Energy Board to find Local Distribution Companies (LDC) Efficiencies and Rates
    b) Continue to move forward with IESO Market Renewal Initiatives
3. Smoothing the global adjustment (GA) to provide significant and immediate rate relief through cost deferral of the GA.
    a) GA Smoothing – Identifying Potential Structures
    b) GA Smoothing – Rate Mitigation Options
        - **Option 1 - GA Smoothing for RPP Only (Borrow $2.2 billion in 2017, Residential Bills Lowered 25%)**
        - **Option 2 - GA Smoothing for RPP Only (Borrow $1.6 billion in 2017, Residential Bills Lowered 20%)**
        - **Option 3: GA Smoothing for RPP Only (Borrow $1.4 billion in 2017, Residential Bills Lowered 18%)**

ENERGY'S BROAD POLICY THEMES / RATIONALES – BASED ON FEBRUARY 16 DRAFT DECK

In addition, to address rate pressures on Class B consumers (not affected by RPP-targeted measures above), Energy has a few additional Class B proposals:

i. GA Smoothing for All;
    a) **GA Smoothing for All (Borrow $3.3 billion in 2017, Residential Bills Lowered by 20%)**
    b) **GA Smoothing for All (Borrow $2.3 billion in 2017, Residential Bills Lowered by 16%)**

ii. Lower the Cost of Global Adjustment (GA) by funding a portion of Conservation through the GGRA;

iii. Remove Debt Retirement Charge Early (DRC) for Non-RPP Class B Consumers;

iv. Extend 8% Rebate to include Class B Consumers; and

v. Provide Tax-Based Assistance Package for Class B Consumers (i.e., SMEs).

FISCAL EXPOSURE ELECTRICITY PRICE MITIGATION – FEBRUARY 15 DECK TO CABINET

SUPPORT PROGRAMS TARGETTING MOST VULNERABLE USERS:						
($M)		**2016-17**	**2017-18**	**2018-19**	**2019-20**	**2020-21**
1A. RRRP	**Status Quo[1,2]**	-	243	250	256	263
	Enhancement[2]	-	211	200	190	181
	TOTAL[2]	-	454	450	446	444
1B. OESP	**Status Quo[1,3]**	-	119	159	193	223
	Enhancement[3]	-	59	80	97	111
	TOTAL	-	178	239	290	334
1C. Establishing a New LDC Affordability Fund		200	-	-	-	-
1D. On-Reserve First Nations Delivery Credit		-	20	20	20	20
TOTAL FISCAL IMPACT:		**200**	**652**	**709**	**756**	**798**
Other Proposals						
2A. OEB – LDC Efficiencies and Rates		n/a	n/a	n/a	n/a	n/a
2B. IESO – Market Renewal		n/a	n/a	n/a	n/a	n/a

1. Previously funded by the Rate Base.
2. Status Quo and Enhancement amounts sourced from previous ENERGY decks; Totals from the finalized Cabinet Submission Deck.
3. Energy's February 15 deck, reports only the total OESP fiscal impact based on a 50% increase to benefits. Fiscal impacts for the status quo and enhancement based on the relative proportions (one third and two thirds respectively).

GLOBAL ADJUSTMENT SMOOTHING/DEFERRAL OPTIONS:						
($M)		**2017-18**	**2018-19**	**2019-20**	**2020-21**	**2021-22**
3b Option 1: GA Smoothing for RPP Only – Residential Bills Lowered 25% (with Tax-Base Funded 8% Rebate and Social Programs, 2% increase)		2,266	2,372	2,633	3,096	2,775
3b Option 1: Interest Portion		*29*	*145*	*266*	*401*	*559*
3b Option 2: GA Smoothing for RPP Only – Residential Bills Lowered 20% (with Tax-Base Funded 8% Rebate and Social Programs, 2% increase)		1,574	1,632	1,844	2,282	1,988
3b Option 2: Interest Portion		*20*	*100*	*184*	*278*	*395*
3b Option 3: GA Smoothing for RPP Only – Residential Bills Lowered 18% (with Tax-Base Funded 8% Rebate and Social Programs)		1,487	1,585	1,524	1,503	1,429
3b Option 3: Interest Portion		*19*	*95*	*176*	*254*	*331*

Note:: Potential to avoid fiscal impact would depend heavily on decision on accounting treatment. Based on an annual interest rate of 5% compounded monthly.

Rate Mitigation for Class B – February 16 Deck						
($M)	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**2020-21**	**2021-22**
i. GA Financing for All (See above) [1]	-	-	-	-	-	
ii. Fund a portion of Conservation through GGRA	-	225-330	225-330	225-330	225-330	225-330
iii. Eliminate DRC for Non-RPP Class B						
a. Shift Class B DRC to Class A [2]	-	197	-197			
b. Reduce DRC by $3.50/MWh	-	148				
c. Remove DRC completely for Class B	-	295				
iv. Extend 8% Rebate	-	762	749	770	801	TBC
v. Tax-based Initiatives	-	TBC	TBC	TBC	TBC	TBC

1. Energy Deck assumes GA smoothing does not have a fiscal impact because it is assumed that both legal authority and accounting treatment are met.
2. Estimates assume elimination of DRC is retroactive to January 1, 2017 and could be reflected in bills as early as April 1, 2017. According to Energy's deck, legislative / regulatory amendments to shift the cost to Class A would come into effect by January 1, 2018. Extension of DRC would lead to fiscal benefit $197M in 2018-19.

STAFF COMMENTS ON ENERGY PRICE MITIGATION OPTIONS – FEBRUARY 15 DECK TO CABINET

1A) RRRP Enhancement: Distribution Charge Relief for top 1/8 of distribution rate classes

Proposal:

- Cap distribution costs to about $38/month for all customers in this group.
- Move RRRP costs to the tax base from the rate base saving approximately $1.60/month on the average residential bill.

Staff Comments:

- The goal of the proposal appears to be to remove rate pressures from all residential consumers by shifting costs to the tax base (contributing towards the overall, e.g., 25% reduction target) and to enhance benefits.
- Energy characterizes this enhanced relief as an acceleration toward the OEB initiative for LDCs to have fixed distribution delivery rates,
  - The proposal is a subsidization of high cost distribution as the cap is based on the lowest average distribution rate paid by consumers in this group of LDCs.
  - Fixed distribution delivery rates will benefit higher volume users, who will benefit proportionately more than the cost to lower volume users.
  - Will not impact other delivery charges (e.g., transmission).
- Moving existing RRRP costs to the tax base does not provide mitigation beyond the approx. $1.60/month for the typical Ontario household (about 1% of the typical 750 kWh/month customer's bills).
- Energy does not clarify if the cap would increase every year to reflect increasing costs.
- RRRP is not income-tested and may be providing additional benefit to non-vulnerable consumers, in contradiction to the policy goal outlined in Energy's deck.
- Increased fiscal exposure if rates that the OEB attributes to the LDCs over time rise faster than the increase in cap.
- Hydro One R2 customers would be receiving this enhancement on top of existing expanded RRRP savings.

1B) Enhance OESP and fund through the rate base

Proposal:

- Provide greater support for lower income Ontarians by expanding OESP benefits by 50%. Preliminary proposals with the OEB will extend the benefits to additional groups.
- Move OESP costs to the tax base from the rate base saving approximately $0.83/month on the average residential bill.

Staff Comments:

- Moving existing OESP costs to the tax base does not provide mitigation beyond the approx. $0.83/month for the typical Ontario household (about 0.5% of the typical 750 kWh/month customer's bills).
- Energy policy rationale for moving such programs to the tax base is to contribute to the rate mitigation target and not have social programs cross-subsidised by other ratepayers.
  - Note that when OESP was planned, Energy noted that low income support was provided in other rate-regulated jurisdictions and was found to be justifiable so long as it was part of a comprehensive regulatory structure and provided some benefits to other ratepayers, which it was found to do.

- TPD has raised the issue that changes to the design of the OESP should be discussed with the Canada Revenue Agency to ensure that it does not become a taxable benefit. When OESP was created, TPD worked with Finance Canada and Energy to ensure that it was not considered a taxable benefit.
    - Federal government may be unwilling or unable to administer OESP due to complexity and the significant restrictions that apply to using federal tax forms.
    - Energy has stated that it has been in discussions with CRA. A status update from Energy should be sought.
- Would provide on-bill benefits.
- Could contemplate phase-in to manage fiscal impact.
- Could look at phasing out existing fiscally-funded programs also targeted to low income or identified groups (e.g., OEPTC, NOEC).
    - These existing programs are not on the bill, so less direct and less visible electricity cost mitigation.
- Phase-out to reflect time to increase application based OESP reaching an increasing portion of eligible households.
- As program eligibility is based on income and household size, it's unclear how on-bill benefits would accrue to those living in rental accommodations where electricity bills are included in rent.
- No fiscal impact estimations provided for the costs to add additional groups for eligibility.

1C) Establish an LDC Affordability Fund

Proposal:

- An Affordability Fund would be accessible to LDCs only, and would target those customers who are most in need, such as those who are facing disconnection and who cannot qualify for the low-income programs.
- The fund would provide support for energy efficiency improvements, the Fund could help these customers reduce their future bills and avoid future disconnections.

Staff Comments:

- Energy's deck did not explain why these programs should be funded through the tax base.
- It's unclear why there is a requirements for funds to flow in 2016-17 for the fund. Energy does not provide a rationale as to why delay to the 2017-18 year would be unwise.
- The deck notes that there is a fiscal risk if monies used for the fund do not flow before FY year-end 2016/17 and for monies that are sitting in Hydro One at year-end (because of consolidation with province), and a corresponding fiscal pressure in the following years when the funds are flowed from Hydro One (H1) to ratepayers.

1D) Implement On-Reserve First Nations Delivery Credit

Proposal:

- The On-Reserve First Nations Delivery Credit would serve to eliminate the delivery charge for all-on reserve First Nation residential customers and eliminate the monthly service charge for customers of licensed distributors which charge a bundled rate.

Staff Comments:

- Energy's deck did not explain why these programs should be funded through the tax base.

  - Energy states that the OEB "suggests that the program could be funded by the tax base" but this was likely to be one of many options noted by the OEB rather than prescriptive advice on the matter.

3A and 3B) GA Smoothing

Proposal:

  - The mechanisms and entities involved to undertake GA smoothing are under consideration, with Slide 44 providing a potential financial structure.
  - Since the slide was constructed, Energy has reported that OPG has stated that its advice as per external accounting advice, is that there needs to be external debt financing and that a portion of the debt needs to be funded through an equity injection by the Province to ensure that OPG's sustainability can be demonstrated to retain its Government Business Enterprise (GBE) status.
    - GBE status is required to achieve the targeted accounting treatment.
  - The financial structure would require an analysis that can support no fiscal impact and no increase in net debt.
  - GA Smoothing options under consideration are targeted to residential and small business (RPP) customers. The GA smoothing options are illustrative and show potential rate mitigation measures to meet a targeted 25%, 20% and 18% reduction from the projected residential bill in 2017.
  - Rates would rise above the true cost of GA and eventually paid off in 2048.

Staff Comments:

- 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.
  - Cost is also highly dependent on actual interest rates over time.
- This proposal subsidizes near-term consumers at the expense of long-term and future consumers.
- The current RPP proposal does not specify if those on retail contracts would be eligible for the GA smoothing benefit.
- While not stated in the deck, Energy staff have stated that Energy's analysis includes estimated costs based only on current RPP customers, not RPP-eligible customers that have currently opted out.
  - If the GA smoothing impact is an incentive to opt back in over time, the cost of the proposal would increase.
  - Energy staff have staed that about 10 TWh of consumption load has opted out, versus about 60 TWh currently in the RPP.
  - If RPP customers are not prevented from opting out later when the recovery period starts, then the remaining RPP customers would either have to pay more, or there would be a shortfall in recovery and fiscal impact.

- As stated in the deck, this proposal is highly dependent on receiving a favourable accounting/legal treatment. Otherwise, there would be a fiscal impact.
- Increased borrowing over time would strain the province's ability for continued borrow.
- Annual borrowing could range from $1.6 Bn to $3 Bn with accumulated debt peaking at $20 Bn to $33 Bn depending on the scenario chosen.
- It should be noted, that unlike a mortgage where payments from the outset are used to pay for both interest and principal costs, the financing undertaken for GA smoothing would not pay principal amounts for the near longer term, and interest would be capitalised instead.
- Conservation efforts are hampered when across the board reductions in the cost of electricity are imposed. This will diminish price signals and other incentives to reduce consumption.
- The analysis is performed on a "typical" customer. Energy deems this to be 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.
    - 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 targeting those with higher electricity bills, as it would be reducing the electricity component equally on a dollar value basis for all customers.
    - If the objective of this proposal is to provide a 25% reduction to electricity bills across the board, an OREC-type program would be more appropriate to achieving this policy outcome, compared to the disparate reductions provided through a GA smoothing approach.

STAFF COMMENTS ON ENERGY PRICE MITIGATION OPTIONS – FEBRUARY 16 DRAFT DECK

ii. Lower the GA by funding a portion of Conservation through the Greenhouse Gas Reduction Account (GGRA)

Proposal:

- Currently, a variety of conservation programs are funded through the Global Adjustment
- Utilizing funds from the GGRA, the cost of conservation could be shifted away from the rate-base to provide price mitigation for all electricity consumers, including Class B.

Staff Comments:

- Assumes GGRA proceeds will be realized.
- Unclear if there's policy rationale to have the GA reduction across the board or targeted to RPP, Class B or Class A customers.

iii. Remove Debt Retirement Charge Early (DRC) for Non-RPP Class B Consumers

Proposal:

- Several options are proposed to target a reduction in of DRC for Class B consumers:
  a. Shifting DRC which otherwise would be paid by Class B to Class A consumers. This would require legislative amendments to extend the legislated DRC end date.
  b. Providing a reduction in DRC rather than complete elimination for Class B funded by the tax base
  c. Removing the DRC completely for non-RPP Class B.
- An additional proposal was raised to consider providing DRC relief to a targeted segment of the non-RPP Class B, such as manufacturing in particular.

Staff Comments:

- Energy's fiscal impact estimation for option a) does not include interest costs borne by deferring DRC payments to 2018-19 fiscal year. Assumes loss of $197M in 2017-18 will lead to a gain of $197 in 2018-19.
- Prior Budget 2016 language referred to the fixed end date of the DRC as "providing certainty to commercial, industrial and other users, and helping them more effectively plan their business and investment decisions". Extending the fixed end date for industrial users would be counter to this previous Budget commitment.
- MOF would need to conduct a detailed analysis for a refined fiscal estimation in all scenarios.

NOTE: Additional proposal/investigation sought to target the DRC elimination for Class B customers of specific industry classes.

- Would need to assess Legal and LDC implementation issues.
- <u>Legal.</u> Class A and Class B users are defined in regulations of the *Electricity Act* which would allow reference to such definitions in setting rates or exempting groups of users under the DRC regulation, which can be done through an LGIC regulation. Change in end date would require a legislative amendment.

- LDCs. Unclear of the viability of targeting DRC reduction for particular groups of customers within Class B, due to requirements for local distribution companies to assess the manufacturing or non-manufacturing nature of each Class B customer.
  - May need to be application based, increasing the implementation timing and burden.
  - Would likely require verification and audit provisions.
- May affect choice of Class B manufacturers larger than 1 MW that are eligible for Class A ICI to not opt to be Class A. Could increase complexity of program cost estimates and administration.
- Could be subject to trade issues – TBD.
- The Industrial Conservation Initiative (ICI) and Industrial Electricity Incentive (IEI) programs had eligibility based on industrial sector; however, this proposal to target specific Class B industries, pose additional complexity:
  - ICI participants are a relatively few large users. Many large industrials are directly connected to the transmission grid. Approximately 1,500 customers fall in this category and significant reductions in electricity costs (10%-34%) compelled compliance based on historical numbers.
    - DRC reduction are estimated to provide only a 4% savings, mitigating the desire for eligible participants to participate.
  - The IEI program has only 22 participants, and each one is required to provide a detailed application in order to be selected for the program.
    - Sheer number of applicants would overwhelm LDCs if the Class B DRC benefit is to target a particular group of participants.
  - Forecasting the potential fiscal impact of the proposal would be challenging. The impacted consumption would be Class B customers that are non-RPP and non-ICI customers which could be difficult to identify and forecast.

iv. Extend 8% Rebate to Include Class B Consumers

Proposal:

- Extend 8% rebate to all Class B electricity consumers, not just RPP customers.

Staff Comments:

- Significant new fiscal pressures applied across the board.
- Would not affect Input Tax Credits received by these businesses.
  - Input Tax Credit leakage for the original OREC program was considered minor as small businesses composed a minority of RPP customers.
- Prior Ontario Clean Energy Benefit program by which the OREC was based, targeted RPP customers. Unclear of the implementation issues for the new expanded category.
- As noted by Energy, there is the potential for Class A customers to switch to Class B in order to receive 8% savings; further hampering the province-wide conservation efforts fulfilled by the ICI program (Class A designation).

v. Tax-Based Assistance Package for Class B Consumers (ie. SMEs)

Proposal:

- Consideration could be given to provide a comprehensive package of tax-based measures to reduce prices for Class B consumers, including lowering corporate taxes for SMEs, tax credits, and Tax-based incentives.

Staff Comments:

- Unclear of the differences between this proposal and a NIER-like program provided to Class B consumers via the rate base.
- Unclear why Energy mentions efforts by external jurisdictions to reduce cost of electricity, yet fail to mention the NIER program.
- Fiscal implications would be dependent level of support offered.
- Linkages between the support programs and electricity costs is unclear.

Corporate and Electricity Finance Division / Ontario Financing Authority
February 17, 2017