Ontario

Ontario's Fair Hydro Plan – Status Update

Technical Briefing

October 17, 2017

Ontario's Electricity System

- Ontario's electricity system is a $20 billion annual sector that serves the needs of nearly 5 million homes, businesses, farms and industries – with costs transparently recovered.

- The Ontario Energy Board (OEB) is the independent regulator of Ontario's energy sector. It approves rates and prices that are reasonable to consumers and allow utilities and generators to invest in the system.

- The Independent Electricity System Operator (IESO) is a not-for-profit entity that manages the province's power system to ensure Ontarians receive power when and where they need it. It also manages contracts with non-regulated generators. In addition, the IESO plans and prepares for future electricity needs, and works with its partners to guide conservation-related efforts.

- Ontario Power Generation (OPG) is wholly-owned by the Province of Ontario and produces almost half of the electricity used in Ontario. OPG owns and operates: two nuclear stations, 66 hydroelectric stations, two biomass stations and one thermal station.

Ontario's Fair Hydro Plan

- Ontario's Fair Hydro Plan (OFHP) is delivering rate relief to residential consumers, farms, most small businesses, long-term care homes and condominiums. This includes the 8% rebate equivalent to the provincial portion of the HST that came into effect on January 1, 2017.

- OFHP is comprised of a series of initiatives, some of which will be borne by taxpayers where appropriate, such as sales tax relief and shifting electricity social programs to the tax-base, and some will be borne by ratepayers, such as spreading the generation investment costs and benefits across ratepayers more fairly.

- The government, OPG, IESO, OEB, key stakeholders and legal, financial and energy sector third-party experts continue to implement OFHP.

- Since the March 2, 2017 OFHP announcement, a number of key milestones have been reached in the implementation of OFHP, including:
  - May 1, 2017: Partial Global Adjustment (GA) refinancing incorporated into the OEB's Regulated Price Plan (RPP) report;
  - June 1, 2017: The *Fair Hydro Act, 2017* (FHA) received Royal Assent;
  - June 15, 2017: Regulations to enable new and enhanced electricity social programs and shift associated program cost from the rate-base to tax-base came into effect; and
  - July 1, 2017: The full 25 per cent reduction of electricity bill came into effect on July 1, 2017, including the 8% rebate.

Funding Electricity Social Programs and 8% Rebate From Provincial Revenues

- The government made the decision to provide rate relief to specific residential consumer groups by introducing an 8% rebate equivalent to the provincial portion of HST as well as new and enhanced electricity social programs. At the same time, the Government made a policy decision that the 8% rebate and the social programs would be more appropriately funded from the tax-base, not the rate-base.

- The new and enhanced existing electricity social programs include:
  - Enhanced Rural or Remote Rate Protection through the creation of new Distribution Rate Protection;
  - Expanded Ontario Electricity Support Program;
  - New First Nations On-Reserve Delivery Credit; and
  - New Affordability Fund.

- Local Distribution Companies have implemented these measures and benefits are flowing to customers.

Fiscal Cost to the Province ($M)	16-17	17-18	18-19	19-20	20-21	5-Year Total
RRRP Enhancements	-	459	472	484	497	1,912
Ontario Electricity Support Program	-	186	261	325	375	1,147
On-Reserve First Nation Delivery Credit	-	20	20	20	20	80
Affordability Fund	200	-	-	-	-	200
Ontario Rebate for Electricity Consumers (i.e., 8% Rebate)	300	883	860	861	871	3,775
Total Fiscal Cost to the Province	**500**	**1,548**	**1,613**	**1,690**	**1,763**	**7,114**

Note: Program costs are subject to change based on variables that affect consumption levels, such as weather.

Global Adjustment (GA) Refinancing Through the Rate-Base

- Since 2003, nearly $70 billion has been invested in the electricity system, including more than $37 billion in electricity generation to ensure the system is clean and reliable.

- The majority of the province's electricity generators are under 20-year contracts. Analysis conducted by Navigant Consulting confirms that many of these generators will be able to operate beyond their contract lives.

- Refinancing the GA, which pays for the bulk of the recent investments in the electricity system, provides significant and immediate rate relief by matching the cost of electricity investments with the expected useful life of the generation that has been built.

- Electricity consumers will benefit from the ongoing useful life of these generating assets, and will be responsible for the costs of these assets over the same timeframe.

- The GA refinancing program ensures that costs are borne by the rate-base, as the beneficiaries of the electricity system, and not the tax-base.

- In developing GA refinancing, the government considered a range of implementation options and consulted with legal, accounting, financial and energy sector third-party experts (e.g. Navigant, KPMG, EY and Deloitte) to provide advice and ensure due diligence was completed.

GA Refinancing – Update

- Since the March 2017 announcement of Ontario's Fair Hydro Plan (OFHP), the total cost of refinancing the Global Adjustment (GA) has been revised downwards substantially:
  - Current government estimates forecast the peak debt over the thirty year life of OFHP will be below $20 billion. The preliminary estimate from March 2017 was about $28 billion.

- The revised debt estimates are the result of the following factors:
  - The IESO updated its long-term cost projections for the electricity system and residential bills;
  - The OEB provided "actual data" with respect to residential bills for the May 1, 2017 to April 30, 2018 period; and
  - Based on Navigant's analysis, the interest rate assumptions for OFHP were updated (i.e., from 5% to 4.5%).

- It should be noted that a number of variables, including interest rates, electricity demand and electricity costs, will vary over the thirty year life of OFHP and cost estimates will continue to be revised to reflect these changing conditions.

- The government will continue to identify and implement initiatives to take costs out of the electricity system, which would reduce the cost of the GA refinancing program.

- Further details will be released in the 2017 Long-Term Energy Plan (2017 LTEP), which will be released on October 26, 2017.

GA Refinancing – Role of Ontario Power Generation (OPG)

- With respect to delivery, OPG has been identified as the Financial Services Manager (FSM) to develop the financing plans and act as the financing entity (i.e., Fair Hydro Plan Trust) responsible for managing the debt obligations associated with GA refinancing.
  - OPG has the necessary financing and commercial expertise to assist with refinancing the GA and will ensure that it is done in the most efficient and cost-effective manner.
  - OPG is currently in preliminary discussions with rating agencies and plans to be in the market in November 2017.

- OPG currently manages approximately $20 billion nuclear funds and as an entity regulated by the OEB, OPG also has extensive experience with regulatory deferral and variance accounts.

- OPG has also developed solid investor relationships and has a large investor base in the structured finance space who would be the target market for financing Ontario's Fair Hydro Plan (OFHP) initiative.
  - For example, the Lower Mattagami project financing attracted a broad investor base of about 80 institutional investors, including major investors in the Canadian power and utility bonds market.

GA Refinancing – Role of the Independent Electricity System Operator (IESO)

- The IESO administers $17 billion of the $20 billion annual electricity system, settling transactions between generators and consumers of electricity.
  - Market accounts and liabilities are included on IESO financial statements to provide increased transparency around the value of transactions that flow through the market.
  - The IESO is a corporation established pursuant to Part II of the Electricity Act, 1998, and prepares its financial statements in accordance with Public Sector Accounting Standards (PSAS).

- Under Ontario's Fair Hydro Plan (OFHP), IESO continues to invoice eligible customers – but not collect – the full amount of Global Adjustment (GA) every month.

- The IESO's right to recover these costs from future ratepayers, constitutes a regulatory asset. The regulatory asset, is transferred to the Fair Hydro Plan Trust.

- The IESO will reflect the impact of the GA refinancing using rate-regulated accounting:
  - Rate-regulated accounting better reflects the economic substance of IESO's operations and enhances the relevance, transparency and accountability of its financial reporting;
  - Rate-regulated accounting is well understood in the electricity sector. Other Canadian electricity entities use rate-regulated accounting – Ontario Power Generation, Toronto Hydro, Fortis Inc.; and
  - The recognition of regulatory assets brings IESO in line with 6 other independent system operators in North America – AESO (Alberta), ISO New England, NYISO (New York), MISO (Midwest United States), PJM (Eastern United States) and ERCOT (Texas).
- KPMG issued a clean opinion in the audit of IESO's December 31, 2016 financial statements that included recognition of rate-regulated assets and market accounts.

- Deloitte was also consulted and confirmed that an entity reporting under PSAS could have regulatory assets if rate-regulated. The IESO is rate-regulated by the OEB in accordance with the Electricity Act, 1998 (Electricity Act) and the Ontario Energy Board Act (OEBA).

GA Refinancing – Accounting Considerations

- The government's financial statements are prepared in accordance with Public Sector Accounting Standards (PSAS), and will continue to follow these standards for the transactions resulting from Ontario's Fair Hydro Plan (OFHP) in 2017-18 and in future years.

- PSAS is silent on the use of regulated accounting:
  - PSAS acknowledges that it does not provide guidance on all possible transactions and notes that it is necessary to refer to other sources of guidance that are consistent with the PSAS framework; and
  - US GAAP, with the most developed guidance on rate-regulated accounting, is the appropriate guidance to reference in this scenario.

- Section PS 1150.07 from the Public Sector Accounting Handbook:
  - *No rule of general application can be phrased to suit all circumstances or combinations of circumstances that may arise. As a result, matters may arise that are not specifically addressed in the primary sources of GAAP. It is necessary to refer to other sources when the primary sources do not deal with the accounting and reporting in financial statements of transactions or events that a public sector reporting entity encounters, or when additional guidance is needed to apply a primary source to specific circumstances.*

- In the development of Global Adjustment (GA) refinancing, the government consulted with several third party advisors (e.g., KPMG, EY, Deloitte) in the application of accounting standards. This is normal course of business governments take for complex transactions.

- OFHP operates under a financial and accounting framework that is appropriate for the intended purpose and in accordance with PSAS and ensures that the fairness goals underlying the program are achieved in a cost-effective manner.

Questions?