Globe & Mail's Questions April 2018 - Matthew McClearn

1. **Which persons are responsible for running the Fair Hydro Trust?**

- OPG's Board of Directors approved a separate group within the Treasury department to operate the Fair Hydro Trust. As of March 31, 2018, there are four full-time employees assigned to the Fair Hydro Trust group. This group is qualified to manage the ongoing activities of the Fair Hydro Trust, and to effectively keep ratepayer costs for running the program to a minimum.

2. **Mr. Hartwick said: "We were also successful in establishing the Fair Hydro Trust which we expect to have a positive contribution to our financial results going forward." How does the Fair Hydro Trust have a positive contribution on OPG's financial results? Please walk me through it.**

- OPG earns interest income on funds it loans to the Trust, which rank as subordinated debt of the Trust. OPG also receives a management fee for services provided to the Trust as its Financial Services Manager, including determining whether to acquire Investment Interests from the IESO, negotiating and executing all agreements, fulfilling reporting requirements, and administering the Trust's day-to-day activities.

- OPG's services in relation to the Fair Hydro Plan are an essential part of delivering value for ratepayers. For example, OPG used its expertise in managing other large funds and worked with its advisors to successfully market Fair Hydro Trust Bonds. In the February 2018 offering, there was strong investor appetite and it resulted in an interest rate of 3.357%, one of the lowest financing costs in the Canadian energy sector.

- Fees charged by OPG to the Trust are in accordance with sections 10.1 to 10.15 of *Ontario Regulation 206/17,* and are at the lower end of benchmarked companies' fees. OPG's management fees are subject to an annual review by the Ontario Energy Board (OEB). Management fees for 2017 and the January 2018 to March 2019 period have been submitted to the OEB for review.

3. **Mr. Hartwick said "The Fair Hydro Trust expects to acquire another tranche of investment interest from the IESO in March 2018." Did that transaction happen? If so, please describe that transaction.**

- Yes, on March 22, 2018, the Fair Hydro Trust purchased its second tranche of Investment Interest from the IESO in the amount of $460 million. Fifty-one percent of the funding requirement or $235 million was financed by the Trust through a revolving warehouse facility ranked as senior notes, and the remaining 49 percent or $225 million was funded through the issuance of short-term subordinated debt to OPG.
- The Trust plans to issue debt two to three times per year. The next issuance will be in late April 2018.

4. **In its October 2017 report on the Fair Hydro Plan, the Auditor General of Ontario said the Fair Hydro Trust will borrow an average of $2.5 billion a year. What's OPG's current expectation?**

- OPG's current expectation is that the average borrowing will be less than $2 billion per year. This amount is an estimate and actual borrowing is dependent on changes in various factors.

5. **When will the Fair Hydro Trust's first set of financial statements be published?**

- The first set of the Trust's financial statements is for the 12-day period ended December 31, 2017. Since the Fair Hydro Trust is a private entity, the financial statements are not required to be publicly posted. However, in support of OPG's commitment to transparent reporting, the Trust's 2017 audited financial statements will be posted on OPG.com before the end of May 2018.

6. **When will the first audited set of FHT financial statements be published?**

- As noted in the previous response, the Trust's 2017 audited financial statements will be posted on OPG.com in May 2018.

7. **Who's auditing the FHT's books?**

- OPG, as the Financial Services Manager, appointed Ernst & Young to perform the audit of the Trust's 2017 financial statements. The audit is currently ongoing.

8. **How are the borrowing of the FHT recorded on OPG's books?**

- As OPG owns the subordinated debt issued by the Trust, OPG's consolidated financial statements only reflect the senior debt issued to external investors. For OPG's 2017 financial statements, senior notes payable of $601 million is reflected as Long-term debt. This amount represents 51% of the total financing receivable asset acquired from the IESO of $1.179 billion.

9. **In its report on the Public Accounts of the province, the Auditor General wrote the following passage:**

OPG, in its analysis regarding the asset (i.e., the shortfall from paying generators more than what is collected from distributors) that OPG Trust will be purchasing from the IESO, correctly pointed out that the OPG Trust cannot classify this asset as a rate-regulated asset because this asset does not relate to the activities of OPG Trust. OPG's analysis went on to note that this asset will be classified as an intangible asset.

a) **Please provide me a copy of this analysis.**

We are providing comprehensive answers below that cover the technical accounting issues that form the basis of the analyses. If you would like additional details, a member of OPG's Accounting group would be willing to meet and walk you through the analysis.

b) **Why did OPG perform an analysis on the asset, as described above?**

OPG, as the Financial Services Manager, is responsible for the Trust's accounting and as part of this role, it analyzed what type of asset the Fair Hydro Trust is acquiring from the IESO to determine the appropriate classification. An asset's classification determines how it will be accounted for on the transaction date and subsequently thereafter, therefore it is an important step in the process. This type of analysis is typical for any business entering into a new transaction.

c) **Who at OPG performed the analysis?**

OPG's External Reporting & Accounting Policy and Treasury groups performed the accounting analysis.

d) **On what dates did that analysis begin and end?**

OPG's accounting analysis for the Fair Hydro Plan commenced in early 2017 and continued throughout 2017 as the structure, program agreements, and financing strategy for the program developed. The ongoing effort to analyze accounting implications is typical for such a material and business transaction. The accounting was finalized in January 2018, shortly after the establishment of the Fair Hydro Trust and underlying program agreements in December 2017.

e) **Did OPG conclude (as characterized above) that the Trust "cannot classify this asset as a rate-regulated asset"? If it did not, please describe its conclusions in detail.**

OPG's accounting analyses for the impact of the Fair Hydro Plan were performed under both International Financial Reporting Standards (IFRS) and United States Generally Accepted Accounting Principles (US GAAP) frameworks. The accounting impact of the transaction is required to be reported to the Province of Ontario under IFRS for the purpose of consolidating OPG's results, while US GAAP is the accounting framework used by OPG in preparing its financial statements. The use of different accounting frameworks by a parent entity (the Province) and a controlled entity (OPG) is not unusual, and is the reason for the analyses under both frameworks. OPG's analyses considered whether the asset is a financial asset, regulatory asset, or an intangible asset.

The excerpt referred to in this question relates to OPG's accounting analysis under IFRS, in which OPG concluded that the asset the Fair Hydro Trust acquired from the IESO is an intangible asset. Under US GAAP, this same asset has been classified as a financial asset, more specifically a financing receivable. The difference in classification is not unusual between two applicable bases of accounting as both sets apply their own standards and practices. Professional judgement was exercised in making these determinations and OPG received an unqualified audit opinion for its 2017 consolidated financial statements under US GAAP. Our auditors have confirmed that they agree with our interpretations under both sets of GAAP. It is important to note that the classification of the asset as an intangible under IFRS and as a financing receivable under US GAAP does not result in any material impact to OPG's income.

To reiterate, the asset the Fair Hydro Trust is acquiring does not have the same classification as the IESO's asset because the nature of the assets are different. In particular, the IESO's asset relates to a regulatory asset from the variance resulting from the electricity market settlements of the Fair Hydro Plan, whereas the Trust's asset results from the financing services it is providing in support of the Fair Hydro Plan.

10. **In OPG's 2017 financial results, OPG disclosed that "OPG's reputation could potentially be adversely impacted through its involvement as the Financial Services Manager under the Fair Hydro Act, and through stakeholder opinions related to this involvement."**

    Why does OPG's involvement as the Financial Services Manager pose a potential threat to OPG's reputation? Please explain. What "stakeholder opinions" are being referred to here?

OPG is committed to managing risks and pursuing opportunities to achieve its strategic imperatives and business plan objectives.

OPG identifies, assesses, prioritizes and manages risks as an integral part of its management system. This is a normal part of our business. Because the Ontario Government's Fair Hydro Plan has received a lot of public attention, it is prudent for OPG to identify and mitigate any and all risks associated with this plan, including ensuring that its stakeholders understand its role.

OPG has operations across Ontario and has relationships with numerous community stakeholders. OPG has been working with these stakeholders to explain our role as the Financial Services Manager of the Fair Hydro Plan on behalf of the Government.

Through our stakeholder engagement process, we have been able to ensure that our stakeholders are informed of the Fair Hydro Trust structure and understand that they can direct any questions to our management team.

11. **Is OPG profiting off of the Fair Hydro Trust interest?**

The income is for OPG providing services to the Trust. The FHT was set up as a commercial transaction in order to obtain financing to fund the rate reduction. OPG is doing the work at the lowest cost.

OPG's services in relation to the Fair Hydro Plan are an essential part of delivering value for ratepayers. For example, OPG used its expertise in managing other large funds and worked with its advisors to successfully market Fair Hydro Trust Bonds. In the February 2018 offering, there was strong investor appetite and it resulted in an interest rate of 3.357%, one of the lowest financing costs in the Canadian energy sector.