Fiscal Considerations for the Electricity Sector

Transition 2018

Foundation Briefing

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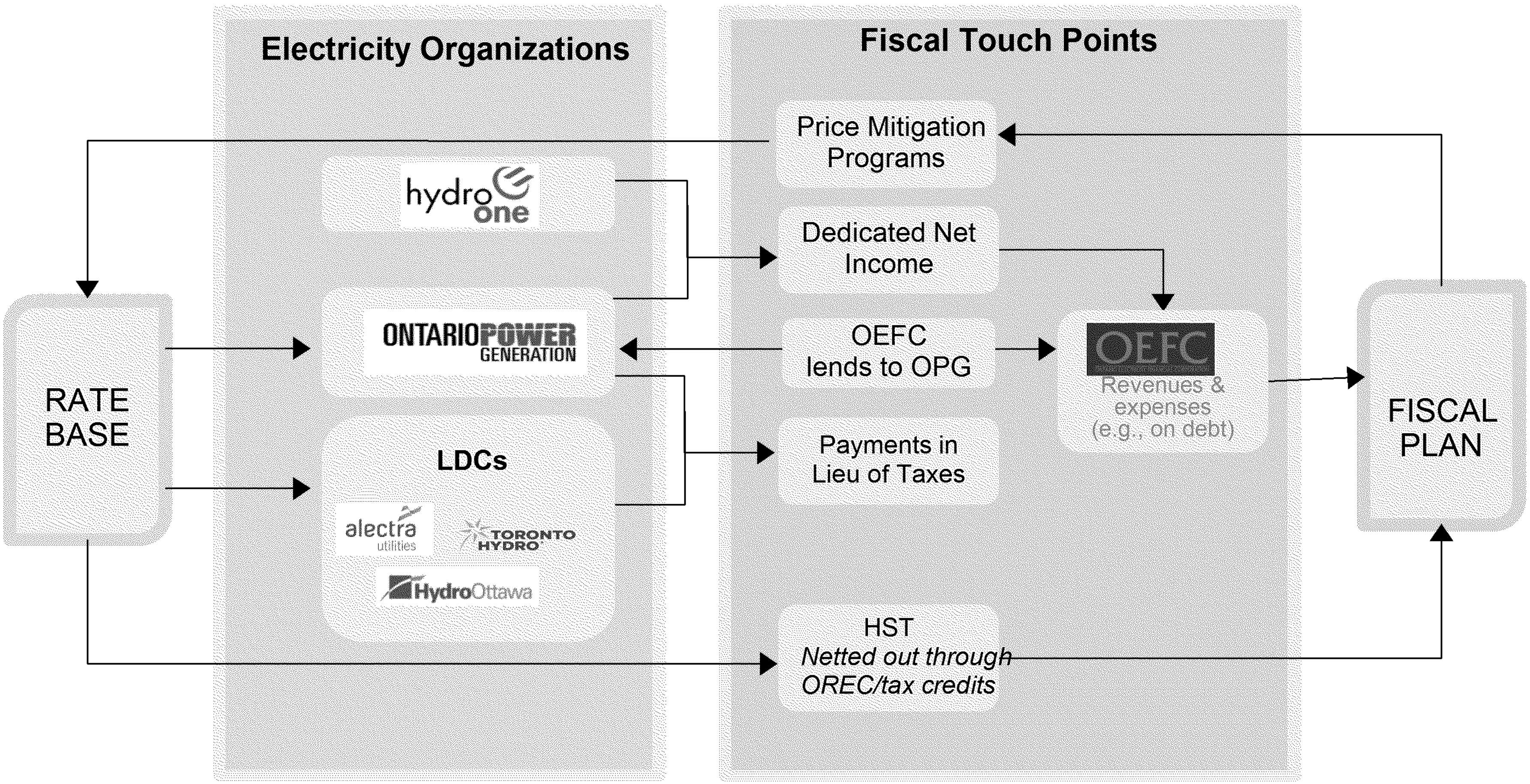
Overview

- This presentation provides an overview of how the electricity sector impacts the Government of Ontario's fiscal plan.

- The electricity sector has an impact on government revenues and expenses:
  - **Revenues**: Electricity sector organizations generate government revenue in a number of ways including Ontario Power Generation's (OPG's) net income; payment-in-lieu of taxes and HST.
    - Certain revenue generated from the electricity sector must, under the *Electricity Act, 1998*, flow to the Ontario Electricity Financial Corporation (OEFC) to service and pay down legacy liabilities of the former Ontario Hydro.
    - The OEFC also borrows and on-lends to OPG, earning a spread which helps pay down stranded debt and is consolidated on the province's financial statements.
  - **Expenditures**: Includes interest on debt and expenses on other liabilities related to the former Ontario Hydro and loans made to OPG and the Independent Electricity System Operator (IESO), and tax-base funding used to pay for a number of electricity rate assistance programs.

- These interactions are important because any policy decision made within the electricity sector framework is likely to have material, fiscal implications for the government.

Fiscal Touch Points



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Revenue from Electricity Organizations

Organization	1. Net Income	2. Payment-in-Lieu of Taxes	3. Corporate Tax	4. Gross Revenue Charge
OPG	✓	✓		✓
Hydro One	✓		✓	
Municipal LDCs		✓		
Privately owned LDCs			✓	

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Ontario Electricity Financial Corporation

- The Ontario Electricity Financial Corporation (OEFC) is one of five entities established by the *Electricity Act, 1998* as part of the restructuring of the former Ontario Hydro.
- OEFC inherited $38.1 billion in total debt and other liabilities from the former Ontario Hydro when the Ontario electricity sector was restructured in 1999.
- $20.9 billion of this was stranded debt, meaning it was not supported by assets of Ontario Hydro successor companies (e.g., OPG and Hydro One).
- OEFC uses the following revenue streams to service and retire its debt and other liabilities:
    - Debt service on outstanding notes receivable from the province, OPG and IESO.
    - Payments-in-lieu of corporate income and property taxes, and Gross Revenue Charges made by OPG and municipal electric utilities.
    - Provincial dedication of provincial corporate taxes payable by Hydro One Inc.
    - Debt Retirement Charge paid by electricity consumers - ended for residential consumers as of January 1, 2016, and removed for the rest of consumers as of April 1, 2018.
    - Dedicated income from the province in respect of OPG and Hydro One net income.
- As of March 31, 2018, stranded debt is estimated to be $1.3 billion, with a projected pay down of $0.3 billion in 2018-19.

Ontario Power Generation

ONTARIO POWER GENERATION

Net Income

- Ontario Power Generation's (OPG's) net income is consolidated onto the province's budget and public accounts, as income from government business enterprises.
  - Existing policy and practice is to dedicate the net income of OPG (in excess of the province's financing cost of its equity in OPG) to OEFC to pay down the legacy debts of Ontario Hydro.
- OPG's net income in the 2016/17 Public Accounts was $342 million.

Payments-in-Lieu of Taxes

- OPG is exempt from paying federal and provincial corporate tax. Instead, it makes payments in lieu of tax (PILs) to OEFC, which reflect both the federal and provincial corporate tax rates.
  - These payments are dedicated in the *Electricity Act, 1998* to OEFC, to service and pay down legacy Ontario Hydro debts.

Gross Revenue Charge

- OPG pays gross revenue charges (GRC) for its hydroelectric facilities. The GRC includes two components:
  1. GRC- Property Tax component: paid to OEFC to pay down legacy debts; and
  2. GRC- Water Rental component: paid to the Ministry of Finance.

Lending from OEFC

- OEFC provides financing on commercial terms to OPG for new electricity supply projects and other corporate purposes. Revenue generated above OEFC's financing cost supports the retirement of legacy Ontario Hydro debts.

Hydro One

Net Income

- Hydro One's net income, proportionate to the province's ownership share, is consolidated onto the province's budget and public accounts, as income from government business enterprises.
  - The income above the province's financing cost on its equity in Hydro One is dedicated to the OEFC to pay down the debts of Ontario Hydro.
- The province's proportionate share (then about 70%) of Hydro One income in 2016/17 was $500 million.
- Consistent with the province's commitment to use proceeds related to the book value of shares sold to pay down the province's electricity sector debt, OEFC received cash from the province to retire a proportionate share of the notes owed by the province to OEFC taken on when the province acquired the equity in Hydro One in 1999. This cash did not affect stranded debt.
- Consistent with the *Electricity Act* requirement under s.50.3, the province provided a benefit to OEFC arising from the province's divestment of Hydro One securities in 2015, 2016, and 2017.

Taxes

- Subsequent to the Hydro One Initial Public Offering (IPO) in November 2015, Hydro One no longer pays corporate tax PILS. Under the *Electricity Act, 1998*, provincial corporate taxes payable by Hydro One Inc. are due and payable by the province to OEFC.

Local Distribution Companies

Net Income

- Revenue/ net income remain with their respective shareholders (e.g., municipality, private corporation).

PILS/Taxes

- Utilities that are at least 90% publicly owned (e.g., by a municipality) are exempt from corporate taxes. Instead, they pay PILs to OEFC to put them on a level playing field with privately owned companies.
  - PILs are dedicated to OEFC to service and pay down legacy Ontario Hydro debts.
- Privately owned (by more than 10%) utilities pay federal and provincial corporate tax.
- Should municipalities sell a portion of their utility to the private sector, certain provisions arise:
  - A sale of over 10% of an MEU to the private sector results in a tax on deemed sale of the MEU's assets under the PILs system, and a transition from the PILs regime to the corporate tax system.
  - The province implemented, under the *Electricity Act, 1998*, a transfer tax on the fair market value of any LDC assets sold to the private sector. The tax is to ensure municipalities contribute their fair share to paying down the stranded debt and compensates the province for the loss of the federal portion of PILs.

Reporting: Revenues

Province of Ontario
2016/17 Public Accounts
Schedule 1: Revenues by Source

($ Millions)	2016-17 Actuals
Taxation	
Electricity Payments-In-Lieu of Taxes	334
Income from Investment in Government Business Enterprises	**5,567**
Hydro One Limited Net income	**500**
OPG Net Income	**342**
Brampton Distribution Holdco	**18**
Other	
Power Supply Contract Recoveries	838
Electricity Debt Retirement Charge	621
Net Reduction of Power Purchase Contracts	129

OEFC's payments-in-lieu of taxes from OPG and LDCs are consolidated as taxation revenue.

Net income from OPG, Hydro One and other holdings of $860M is consolidated as income from investment in government enterprises.

Proceeds from sale of NUG power under power purchase contracts, and recovery of OEFC. This is fully offset with a corresponding expense on the province's accounts. See Appendix for the expenditure line.

Debt Retirement Charge collected from consumers. As of April 1, 2018, the charge is removed from all customer bills.

In the past, contracts with non-utility generators provide for prices above market, representing a liability for OEFC. In 2005, OEFC began receiving market price for contracts, allowing for the initial recorded liability to be drawn down over time.

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Expenditures: Price Mitigation Programs

- Tax-base funding is used to pay for a number of electricity price mitigation programs. These include:

Ontario rebate for electricity consumers (OREC)

- The 13% Harmonized Sales Tax (HST) is applied to electricity bills. Provincial sales tax of 8% was not applied to electricity bills before harmonization of the sales tax.
  - The *Ontario Rebate for Electricity Consumers Act, 2016* provides a reduction equivalent to the 8% provincial portion of the HST to eligible consumers on their electricity bills. Therefore, an amount equal to the province's HST revenue is 'netted-out' by the rebate expenditures.

Other programs:

- Ontario Electricity Support Program (OESP): an income-tested, application based program that lowers electricity costs of low-income consumers by a rebate directly on bills.
- Rural or Remote Rate Protection Program (RRRP)/ Distribution Rate Protection: reduces distribution costs for rate payers in eligible rural or remote areas where costs are highest in the province.
- Ontario Energy and Property Tax Credit (OEPTC): Included (vs. the prior Property Tax Credit) to energy and expanded when the HST was introduced on electricity.
- Northern Industrial Electricity Rate (NIER) program: Provides a rebate of two cents per kWh for eligible large northern industrials.
- Northern Ontario Energy Credit: application-based tax credit program for low-to-moderate income residents in Northern Ontario.
- First Nations Delivery Credit: Provides First Nation residential customers who live on-reserve with a credit equal to 100% of their delivery charges.

Reporting: Expenditures

	(in millions)				
Operating and Capital Expense					
Vote 2901 - Ministry Administration Program	14.1	15.1	15.1	15.1	15.1
Vote 2902 - Energy Development and Management	257.2	24.5	47.8	24.5	24.5
Vote 2905 - Electricity Price Mitigation	346.3	1,464.0	1,606.8	1,737.0	1,813.0
Vote 2906 - Strategic Asset Management	42.9	280.0	35.0	-	-
Total Ministry Operating and Capital Allocation	**660.5**	**1,783.6**	**1,704.7**	**1,776.6**	**1,852.6**
Consolidation and Other Adjustments					
Independent Electricity System Operator	220.7	218.4	227.1	225.7	225.8
Ontario Energy Board	38.5	45.7	46.3	46.0	45.5
GGRA Adjustment - EV Overnight Charging Rebate Program	-	2.2	2.2	1.9	2.5
Total Consolidation and Other Adjustments	**259.2**	**266.3**	**275.6**	**273.6**	**273.7**
Total Operating and Capital Expense (including Consolidation and Other Adjustments)	**919.7**	**2,049.9**	**1,990.5**	**2,050.2**	**2,126.3**
Ministry Operating Asset					
Vote 2905 - Electricity Price Mitigation	-	1,100.0	1,100.00	-	-
Total Operating Asset	**-**	**1,100.0**	**1,100.00**	**-**	**-**

Electricity price mitigation programs found in Ministry of Energy program budget. These include:

1. OREC
2. OESP
3. RRRP
4. Northern Ontario energy credit
5. HST Rebate
6. First Nations Delivery Credit

OEPTC is not included under Energy, as it is a tax expenditure.

NIER is included under MNDM.

To fund purchase of equity in OPG to help finance the Fair Hydro Plan

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Agency Consolidation

- The Ministry is responsible for two not-for-profit agencies: the Ontario Energy Board (OEB) and the Independent Electricity System Operator (IESO).
- These agencies are funded through the charges paid for by electricity ratepayers; they receive no funding from the tax-base and do not impact the fiscal plan.
  - OEB: Annual budget approved by the Minister through its business plan. Costs are assessed to regulated entities and included in the rates charged to customers; typically in the “delivery” line of the electricity bill.
  - IESO: Annual budget approved by the Minister through its business plan. IESO fees are set by the OEB through a public hearing process and included in the “regulatory” line of the electricity bill.
- While fiscally neutral, these agencies have their financial statements consolidated with the Ministry’s financials for the purposes of Public Accounts.
- 2017-18 fiscal year:
  - OEB: $46M – 2% of the ministry’s financial allocation.
  - IESO: $222.9M – 11% of the ministry’s financial allocation.