Comments on Ministry of Energy's February 6 Draft "Rate Mitigation Plan Options"

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

OVERVIEW

- The largest impacts on rates and largest potential fiscal exposures are from the proposed deferred recovery of Global Adjustment costs (about $1.3 to $7.5 billion per fiscal year or more, depending on the option).
- Other Energy proposals involve placing or shifting costs or risks of rate mitigation measures from the rate base to the tax base. Based on CEFD analysis the fiscal exposure could range to about $0.7 to $0.9 billion per year, depending on the option selected.
- In addition, Energy raises a sub-option to a GA variant: increase the rebate from 8% to 15%.
- The above measures would be in addition to the existing fiscally-funded electricity price mitigation efforts that, over the past five years, have averaged about $1.5 billion and is already expected to increase to about $2 billion with the introduction of the Ontario Rebate for Electricity Consumers (OREC) in 2017-18.
- The government introduced OREC, which is providing a rebate equal to the 8% provincial portion of the Harmonized Sales Tax, 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

ENERGY'S BROAD POLICY THEMES / RATIONALES – BASED ON JAN 24th DECK (Subject to Updates)

- In recognition of the costs borne by ratepayers related to decarbonizing and modernizing the province's electricity sector, options for further rate mitigation include:
  1. Provide significant and immediate rate relief through cost deferral of the global adjustment (GA).
  2. Initiate delivery rate relief, which would allow a monthly cap on delivery charges for all residential customers across the province.
  3. Provide a greater focus on vulnerable consumers by expanding electricity support programs, such as the Ontario Electricity Support Program (OESP), and greater support for lower income conservation benefit and First Nations Rate program and funding them through the tax-base.

SUMMARY OF ENERGY PRICE MITIGATION OPTIONS

Energy Theme / Rationale / Savings	Key Staff Comments	Estimated Fiscal Cost
(Based on Feb 4th Deck) **1) Consider options to defer the pass-through to ratepayers of some generation supply costs by partially financing the cost of the global adjustment (GA).** *(Based on Feb 4th Deck)* **"February 4 - Option 1a"** GA paid lowered by $5B in 2017 and 2018 below the true cost of GA. Part of combination of initiatives to reduce residential bill by 25%. In out-years, incremental monthly cost about $40. **"February 4 - Option 1b"** GA paid lowered by $7B in 2017 and 2018 below the true cost of GA. Part of combination of initiatives to reduce residential bill by 33%. In out-years, incremental monthly cost rises to almost $90. **"February 4 - Option 1c"** GA paid lowered by $4B in 2017 below the true cost of GA. Part of combination of initiatives to reduce residential bill by 25%, including increasing the OREC rebate from the current 8% to 15% [Check].	• Incurring debt to pay the generators their contracted or regulated payments while deferring supply cost pass-through. • Accumulated debt and financing costs would be very high, particularly if third party financing is sought. • Energy's deck analyzes the system cost and ratepayer impacts of the option. ○ Larger the initial savings is also reflected as larger incremental costs in out years when annual GA recovery is greater than GA costs. • Based on preliminary discussions with KPMG, Energy has identified key steps for there not to be a fiscal impact: ▪ Have a non-consolidated entity hold the liability. **OR** ▪ Need to be able to create an asset. ○ Energy has proposed options for the GA financing recovery mechanisms such as a new GA Deferral Account or a new arms-length entity. ○ Energy is working with IESO, MOF, TBS and external accountants on accounting issues and legislative and regulatory requirements. ○ Likely requires legislation to implement. Should assess legal risks. • Scenarios provided in the February 4th deck indicate, on a preliminary basis [Energy has not provided detailed modelling figures], significant annual fiscal exposures (depending on accounting) and debt accumulation up to $62Bn for Option 1a, $99Bn for Option 1b and $31Bn for Option 1c. • Revised scenarios are significantly higher in potential annual fiscal impacts and increases in debt, $19Bn - $23Bn for Options 1a and 1b [January 24 scenarios], about $65 Bn for Option 4 [in February 1 deck] .	If consolidated: Risk of fiscal impact ranges (as per Feb 4th deck: • About$5Bn in 17-18 and 18-19 for Scenario 1a, • About $7Bn for 17-18 and 18-19 for Senario 1b • About $3-4Bn in 17-18 and 18-19 for Scenario 1c Scenarios in Jan 24th & Feb 1 decks: • "Moderate" scenarios of more than $1.1 to $3.4 billion in 2017-18 • $4.4 – 5 Bn in the "high" scenario.
(Updated for Feb 1 Deck) **2) RRRP Enhancement: Delivery Charge Relief for Hydro One Customers.** **R1 (mid-density)** **R2 (low-density)**	• Energy characterizes this enhanced relief as an acceleration toward the OEB initiative for LDCs to have fixed distribution delivery rates, based on average cost to serve. ○ Benefits higher volume users, who will pay less than currently. ○ Lower volume users will pay more than currently.	Cost of Enhancement: 2017-18: $64-90M decreasing to $26-36M in 2020-21.

Energy Theme / Rationale / Savings	Key Staff Comments	Estimated Fiscal Cost
• **Cap delivery rates for R1 customersto $55.70 per month and $64.64 per month for R2 customers.**	• Energy indicates that the cap will not be needed after 2022 when most distributors will have fixed delivery charges. • Energy does not clarify if the cap would increase every year to reflect increasing costs as the cap values are based on 2017 estimates of what Hydro One distribution rates would be under a fixed rate regime. • RRRP is not income tested. • Moving to fixed distribution rates will result in below-average volume consumers experiencing cost increases.	

(Updated for Feb 1 Deck)
 	
3) Electricity Support Programs Funded Through the Tax Base
 	
Provide greater support for lower income Ontarians by enhancing the OESP, expanding eligibility, and simplifying access to achieve 100% take-up.
• **Estimated to reduce average monthly residential bill by $0.83 based on current OESP charge.**
	• There may be a risk that changes to the design of the OESP may change the view of the federal government that it is not a taxable benefit. When OESP was created, TPD worked with Finance Canada and Energy to ensure that it was not considered a taxable benefit.
	• Feds may be unwilling or unable to administer OESP due to complexity and the significant restrictions that apply to using federal tax forms.
	
	• 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).
	  ○ 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.
		<u>OESP</u>
		• 2017: $162M
		
		• Increasing to $408M in 2022.

4) Low Income / Affordability
 	
Low Income Conservation Benefit Program
 	
LDC Affordability Fund
	• Existing low-income programs delivered by LDCs and IESO help qualified residential customers and social and/or assisted housing providers improve their energy efficiency. Programs include a Home Assistance Program and a Retrofit Program.
	• Energy is currently working with IESO to explore options to enhance and/or expand the existing Home Assistance Program for residential customers.
	  ○ Participants could receive incentives for improved weatherization measures, appliances and lighting controls (e.g., new or upgraded furnace and central AC; windows/doors; washer/dryers, heat pumps.
	
	• Energy is exploring the potential to establish an Affordability Fund.
	  ○ To allow for funds to flow in 2017/18, Energy would sign a Transfer Payment Agreement with a qualified third party/ies to administer the Fund.
		<u>Low Income Conservation Benefit</u>
		$12.5M in 2017-18 to $30M in 2018-19 and 2019-20, and $22.5M in 2020-21.
		
		<u>LDC Affordability Fund</u>
		TBD. Energy notes $200M as an

Energy Theme / Rationale / Savings	Key Staff Comments	Estimated Fiscal Cost
	○ LDCs would apply for funding and redistribute support to those customers that meet the targeted eligibility criteria. Energy states that establishing an Affordability Fund could provide a means to help struggling customers who do not qualify for low income programs and cannot upgrade their homes without financial assistance.	illustrative amount.

SUMMARY: FISCAL EXPOSURE ELECTRICITY PRICE MITIGATION – FEBRUARY 1 DECK

($M)	2016-17[1]	2017-18[1]	2018-19[1]	2019-20[1]	2020-21[1]
ENERGY'S Recommended Initiatives*					
1) Debt-Finance Global Adjustment Fiscal Exposure	TBD (see below)	TBD (see below)	TBD (see below)	TBD (see below)	TBD (see below)
2) a. Delivery Rate Relief RRRP Enhancement If Incl. Existing RRRP Cost to Tax Base	-	64-90 306-332	52-72 300-320	38-54 293-309	26-36 287-297
2) b. OESP Expansion	-	162	225	279	323
2) c. Low Income Conservation Program	-	12.5	30	30	22.5
3) c. LDC Affordability Fund		TBD	TBD	TBD	TBD
3) OEB – OEB Red-Tape Reduction / LDC Efficiencies and Rates	-	-	-	-	-
4) OPG – Operational Efficiencies	-	240	240	240	240
5) IESO – Market Renewal Initiatives	-	-	-	-	-
Fiscal Exposure Total (Before GA Options):		**747**	**815**	**858**	**883**
GLOBAL ADJUSTMENT DEFERRAL OPTIONS:					
($M)	2016-17	2017-18	2018-19	2019-20	2020-21
Proposed GA Fiscal Exposure, Scenarios 1a[2] January 24th Deck, 25, 30 yr financing	**795 - 851**	**3,107 – 3,335**	**2,805 - 3,049**	**2,697 - 2,958**	**2,774 - 3,052**
Proposed GA Fiscal Exposure, Scenarios 1b[3] January 24th Deck, 25, 30 yr financing	**292 – 362**	**1,317 – 1,597**	**1,901 – 2,175**	**2,670 – 2,940**	**3,390 – 3,661**
Proposed GA Fiscal Exposure, Scenario 1a February 4th Deck[4]	**1,250**	**5,000**	**4,750**	**4,250**	**4,750**
Proposed GA Fiscal Exposure, Scenario 1a February 4th Deck[4]	**1,750**	**7,000**	**7,000**	**7,250**	**7,500**
Proposed GA Fiscal Exposure, Scenario 1a February 4th Deck[4]	**1,000**	**3,750**	**3,000**	**3,250**	**3,500**

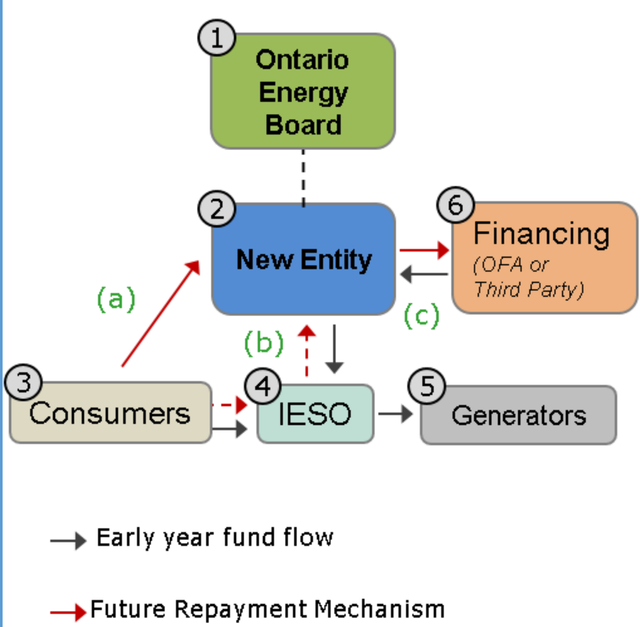
1. Based on estimated / forecasted numbers [May have some variations from the January 24 deck.]
2. Range based on fiscal exposure of Options 1a 25-year and 30-year financing periods, respectively from CEFD Analysis.
3. Range based on fiscal explosure of Options 1b 25-year and 30-year financing periods, respectively from CEFD analysis.
4. Estimates are based scenarios provided in the February 4th deck and preliminary [CEFD staff have not reviewed the modelling figures]

GA DEFERRAL IMPLEMENTATION OPTIONS

- The Ministry of Energy(Energy) indicates that it is continuing to consider options in terms of implementing the GA deferral mechanism.
- Objective includes accounting treatment that would not result in a fiscal impact.
- Two leading options currently under consideration are as follows:

    - Option A: Create a new special purpose entity, independent from the Province that would be dedicated to GA smoothing.
        - Objective would be that it not be a consolidated entity in Public Accounts.
        - Would need to be not controlled by the Province for accounting purposes.
        - Energy has introduced the OEB into this model, where the OEB could be empowered to approve the GA smoothing mechanism and oversee the operations of the entity on, e.g., compensation.

    - Option B: Make changes to IESO in order to enable it to assume responsibility for GA smoothing.
        - Objective would be for it to be able to not have the annual deferral of the GA amounts affect its bottom line, and not affect the Province on consolidation.
        - Energy discusses achieving Government Business Enetrprise (GBE) accounting treatment.
        - Would require legislative changes for the IESO.
        - Would need to enhance OEB's role in regulating the IESO and GA deferrals and recovery.



1. The OEB oversees the new entity, as well as the GA smoothing mechanism on an ongoing basis.
2. The New Entity funds part of the GA and (a) would have a legislative right to recover associated principle, interest and administrative costs from customers (settled via service agreement with IESO).
3. Electricity Consumers pay IESO a portion of the GA in early years. In the future, the New Entity recovers principle, interest and administrative costs fro consumers. Customers bill presentation remains unchanged (costs should diminish in early years).
4. The IESO pays generators (in early years), partially from consumers and partially financed by the New Entity. (b) The IESO provides collection services to New Entity under a service contract.
5. Generators continue to receive payments from IESO according to existing contract / regulatory structures.
6. The OFA or a 3rd party lender funds the GA shortfall in early years and receives payments from the New Entity as debt is repaid. (c) Debt is subject to a contract between the New Entity and the lender.

Control / Governance of a New GA Entity

- To achieve the desired accounting treatment, the entity would have to be structured as follows:
  - While the Province would choose the first board of directors or trustees, future directors or trustees would be selected in accordance with a mechanism created at the time the entity is created. The Province would have no ongoing role in appointments or in selection of key personnel, including the CEO.
  - The Province would not have a determining vote in the entity's business decisions.
  - The Province would have no recourse to the entity's assets and would not be responsible for the debt.
  - The Province could not dissolve the entity and having access to its assets and obligations.
  - The Province would not be able to change the mission or mandate of the entity, once it is created.
  - The Province would have no right to approve business plans or budgets or to require amendments to them.
  - The Province would not be able to alter the terms of the entity's debt arrangements.
  - The Province would not be able to affect the debt by controlling the entity's financial and operating policies.
  - The Province would not have input into the operational and financial policies of the entity, including accounting, personnel, compensation, collective bargaining or deployment of resources. For example, legislation like the *Broader Public Sector Executive Compensation Act, 2014* would not apply.
- As a result,
  - Staff would not be OPS employees.
  - Oversight would not be provided by Offices of the Legislature (AG, FAO etc.).
  - The *Freedom of Information and Protection of Privacy Act* would not apply.

GBE Status

- Energy notes that it would need to determine whether it is likely that IESO could be sufficiently transformed in order to meet the following accounting tests:
  - Government Business Enterprise (GBE) Treatment: consistent with OPG and Hydro One, this treatment would require consolidation of only net income and equity (as opposed to line-by-line consolidations currently applied to IESO). This test includes the following components:
    - Separate entity.
    - Delegated financial / operational authority to carry out a business.
    - Sells goods and services to individuals and organizations outside of the government reporting entity as its principal activity.
    - Can, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity.
    - Power to contract in own name.
    - Sue and be sued.

Comments:

- Without a favourable outcome on the discussions and implementation of the accounting treatment of the GA-related debt financing, the accumulated debt would potentially represent fiscal exposure to the Province.
  - In addition, the outcome may not be known until after the implementation of the proposal and at such a later stage as following the review of the Province's Public Accounts by the Auditor General.
- For Option A, the issue of control is a significant issue in determining whether the entity would need to be consolidated with the Province or not.

- For Option B, it remains to be seen if the IESO could be transformed sufficiently to be treated as a Government Business Enterprise (GBE), as in the case with Ontario Power Generation and Hydro One.
    - While not mentioned in the slides, an objective may be to have the IESO be able to have rate-regulated accounting so that it can have a regulatory asset for deferred recovery of the GA costs, as approved by the OEB.
- Both proposals will require significant legislative changes with no clear indication of success in achieving the desired accounting outcome.

Corporate and Electricity Finance Division / Ontario Financing Authority
February 5, 2017

APPENDIX

- As an alternative to the GA financing, in addition to the delivery rate relief and other electricity support programs funded through the tax-base, Energy had previously proposed that other mitigation measures could be pursued, including:

  Alt 1. Enhanced Tax-Based RPP Rebate (5%)

  Alt 2. Contract Renegotiations:
  - Contract Extensions – Wind and Solar;
  - Clean Energy Supply (CES) Contracts

    CEFD staff are of the view that contract renegotiations, such as contract extensions, could provide potentially beneficial outcome and warrant as much consideration as the Global Adjustment-related proposals. While contract renegotiations are thought to be difficult, implementation of GA-related proposals would expect to have its own significant challenges.

  Alt 3. Amortization of Conservation Expenses

Alternative Options if not proceeding with the GA proposal		
Energy Theme / Rationale / Savings	**Key Staff Comments**	**Estimated Fiscal Cost**
(Based on Jan 24th Deck) **Alt 1) Enhance Tax-base RPP Rebate by 5%, to 13% [or 15% in Scenario 1c in the Feb 4th version]** • **Estimated to reduce average monthly residential bill by $7.04 in 2017 to $7.83 in 2022**	• This proposal would increase the funding requirement of the newly established Ontario Rebate for Electricity Consumers (OREC) by about $700 million per fiscal year, to reduce an average residential bill by about $7 each month or $84 annually. • The current OREC provides average savings of about $11 each month or $130 annually. • Note OREC and RPP have slight variations in eligibility. ○ Hotels, motels and various other buildings are eligible for OREC while being ineligible to RPP.	• About $700M per year [when enhancing the rebate by 5%]
(Based on Jan 24th Deck) **Alt 2) Alternative to GA Financing – Contract Renegotiations** **Alt 2a) Wind and Solar Contract Extensions** **Alt 2b) Clean Energy Supply Contracts**	• This proposal involves renegotiating current IESO contracts with wind, solar, and natural gas providers in order to reduce rates in the near term. • Potential to defer costs into the future for the Global Adjustment without provincial borrowing for wind and solar contracts. ○ Estimated savings could be higher than $0.09 per month for the average bill for the first five years when rates are kept to a minimum. • For the Clean Energy Supply (CES) contracts, the outright purchase of natural gas assets in order to temporarily idle them could reduce monthly residential bills by an estimated $2.37 to $4.00 from 2017-2019.	• TBD • Impact from wind and solar contract extension depends on success of IESO negotiations. Generally will be funded by the ratebase. • Potential fiscal impact from reduction in OPG Net Income and

Alternative Options if not proceeding with the GA proposal		
Energy Theme / Rationale / Savings	**Key Staff Comments**	**Estimated Fiscal Cost**
	○ Provincial borrowing would be required to fund the asset purchase. ○ Suggested targets like Portland and Brighton Beach are currently valued at $324M on OPG's balance sheet for OPG's 50% ownership interest; would likely cost significantly more than $324M to acquire the remaining 50%. • For all contract negotiations, the potential rate mitigation depends on each individual contract/project as well as the success of the negotiation. • Risk that the strong bargaining position of counterparties to IESO contracts leads to additional value extracted from negotiations. • The additional costs to extend contracts and to lower near term costs may lead to larger rate increases in the future.	provincial borrowing required for gas asset purchases for the CES option
(Based on Jan 24th Deck) **Alt 3) Conservation Amortization** • **Pursuing this option would result in approximately $1/month in savings from 2017 to 2020.**	• Approximately $3 billion will be spent on conservation programs between 2015 and 2020, which is recovered through the GA. Alternatively, a certain portion of this amount could be amortized over 10-year or 15-year terms with the IESO borrowing from the OFA to fund these incentives. • This benefit would turn into a cost due to growing interest charges. • Interest charges (at 3%) would be approximately $712 million (10-year amortization or $1.3 million (15-year amortization) which would be recovered from ratepayers, subject to legislative changes or from the Consolidated Revenue Fund (i.e., taxpayer) • If this option is pursued, the Ministry of Energy would seek a formal opinion from the Ontario Provincial Controller whether certain costs can be amortized in accordance with rate-regulated accounting standards. Further legal analysis would also be required.	• Potential for interest costs to be recovered from Taxpayers • Alternatively, portion of the conservation program costs to be recovered from the tax base.

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