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

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

CONTEXT

- As outlined in Energy's deck, electricity costs have been increasing following investments to transform towards cleaner generation (i.e., meeting goals to decarbonize) and modernize the electricity infrastructure (e.g., more than $35 billion in cleaner generation and $15.5 billion investment by Hydro One alone in transmission and distribution systems).

- The government has taken action to lower electricity cost pressures to all consumers by taking actions, including deferring investments in generation (e.g., new build nuclear, LRP II), improving market efficiency and decreasing costs related to renewable procurement (e.g., GEIA renegotiation with Samsung consortium, decreasing FIT prices, etc.).

- The government introduced the Ontario Rebate for Electricity Consumers (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 program, saving eligible RRRP customers about $45 per month, when combined with OREC.

COMMENTS

- A significant number of Energy's proposals involve shifting costs or risks from the rate base to the tax base. The fiscal exposure could be well over $2 billion in 2017-18.
- The largest impacts on rates and largest potential fiscal exposures are from the deferred recovery of Global Adjustment costs ($2 bn per year or more) and an enhanced, tax-base-funded 5% rebate for Regulated Price Plan (RPP) customers (about $700 million per year).
    - Significant fiscal exposure comes from proposals not yet fully costed by Energy (e.g., the Global Adjustment, with Energy to benefit from consulting with OPCD and KPMG on accounting).
    - Energy also presents other proposals where costs and impacts are not shown or "TBD".
    - Energy does not show OPG efficiencies as a fiscal risk in its table on slide 8. It is estimated at a $240 million per year exposure on slide 33.
- Over the past five years, the existing fiscally-funded electricity price mitigation efforts have averaged about $1.5 billion and is already expected to increase to about $2 billion with the introduction of 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 etirement Charge
OREC – Ont. Rebate for Electricity Consumers
NOEC – Northern Ontario Energy Credit
OEPTC – Ont. Energy & Property Tax Credit

ENERGY'S BROAD POLICY THEMES / RATIONALES

- In recognition of the costs borne by ratepayers related to the to decarbonizing and modernizing the province's electricity sector:
    1. Provide significant and immediate rate relief through cost deferral of the global adjustment (GA).
    2. Provide a greater focus on vulnerable consumers by funding electricity support programs, such as the Ontario Electricity Support Program (OESP) and the Rural or Remote Electricity Rate Protection, (RRRP) through the tax-base. In addition, provide greater support for lower income Ontarians by enhancing the OESP, etc.
    3. Empower energy agencies to increase cost effectiveness and improve efficiency by having – Independent Electricity System Operator (IESO) modernize Ontario's electricity market through electricity market renewal initiatives, the Ontario Energy Board (OEB) identify opportunities for future LDC cost reductions/efficiencies and work with Ontario Power Generation (OPG) to find further efficiencies in operations and pass on savings to ratepayers.
    4. Enhance the existing 8% rebate that went into effect January 1, 2017.

Energy Theme / Rationale	Key Staff Comments	Estimated Fiscal Cost

Consider options to defer the pass-through to ratepayers of some generation supply costs by partially financing the cost of the global adjustment (GA)	• Incurring debt to pay the generators their contracted or regulated payments
	• Energy's deck analyzes the system cost and ratepayer impacts of the option, but does not fully address the fiscal impact/accounting treatment, or implementation
	  ○ Based on preliminary discussions with KPMG, Energy has identified key steps (presumably for there not to be a fiscal impact):
	    ▪ need to be able to create an asset
	    ▪ Need to identify an entity that could hold such an asset (e.g. OEFC, IESO or LDCs?)
	  ○ Energy is said to be working with LSB, IESO, MOF, TBS and external accountants on legislative, regulatory and accounting requirements
	  ○ Energy's deck clearly identify that under the current legal framework, the GA would not be able to recover interest costs of the deferral
	• Likely will lead to significant annual fiscal impact and increase in net debt (illustrated as $9 Bn on slide 9, or $23 Bn on slides 11 & 12 scenarios; previously estimated by Energy to be up to $65 Bn, depending on Energy's scenario) – Energy to consult with OPCD on accounting treatment
	• Likely requires legislation to implement.
		• Risk of fiscal impact of more than $2 billion in 2017-18 and ongoing during period GA costs are derferred.

Energy Theme / Rationale	Key Staff Comments	Estimated Fiscal Cost
	• Furthermore, likely entails significant legal / Constitutional Law risks	
Fund cost-shifting through Tax base. **Provide greater support for lower income Ontarians by enhancing the OESP or expanding eligibility.** • **Estimated to reduce average monthly residential bill by $0.83 based on current OESP charge.** **Provide further support for rural consumers by expanding the Rural or Remote Rate Protection (RRRP) program.** • **Estimated to reduce average monthly residential bill by ≈ $1.60 in 2017, increasing to ≈ $1.80 in 2022.**	• Would provide on-bill benefits. • Could contemplate phase-in to manage fiscal impact. • Could look at phasing out existing fiscal-funded programs also targeted to low income or identified groups (e.g., OEPTC, NOEC). ○ Not on the bill, so less direct and visible electricity cost mitigation. ○ Phase-out to reflect time to increase application based OESP reaching an increasing portion of eligible households. • There may be a risk that expanding OESP or RRRP 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. • RRRP expansion that subsidised high-cost distribution systems may create a disincentive effect on achieving efficiencies é cost reductions in those LDCs (or Toronto, as the benchmark). Energy and OEB would need to address this through the regulatory system or other measures such as eligibility conditions.	<u>OESP</u> • 2017-18: $162 M • Increasing to $323 M in 2020-21. <u>Conservation</u> • 2017-18: $457 M • Increasing to $493 M in 2020-21
Create a new low income conservation benefit program that would build on existing programs.	• Conservation programs provide electricity system benefits. Fiscal-funding would result in a cross-subsidisation from tax-base. • Accessing the cap & trade amount in the GGRA would crowd-out other GGRA programs, affecting overall GHG reductions and negatively affect the fiscal plan.	• $60 million per year.
OPG to Increase Cost Effectiveness and Improve Efficiency	• Provide expectation that OPG meet more aggressive cost targets, improving efficiency by ~$3/Megawatt hour (MWh), with OPG regulated rates set on this basis. • Dollar-for-dollar fiscal exposure if OPG is not able to meet the targeted lower cost targets.	• $240 million per year.
Enhance Tax-base RPP Rebat by 5%, to 13%	• 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.	• About $700 per year

DRAFT: COMMERCIALLY SENSITIVE AND CONFIDENTIAL ADVICE TO MINISTERS

DETAIL ON ENERGY PROPOSALS INCLUDED IN THE JANUARY 18th DECK

Energy has outlined the following rate mitigation proposals with significant bearing on the fiscal plan:

Debt Financing of the Global Adjustment Proposal :
In a draft Energy deck shared with the Ministry of Finance, Energy considers a number of electricity price mitigation options to defer the pass-through to ratepayers of some generation supply costs by partially financing the cost of the Global Adjustment (GA) and incurring debt to pay the generators their contracted or regulated payments. This will involve debt financing and recovering over a 25 to 30 year period.

While details of this proposal have not been developed, there is a risk of significant fiscal impacts, e.g., of up to $2 billion annually (under options 1a, 1b, and low GA Financing scenario), or more (e.g., about $5.5 bn in 2017 under high GA Financing scenario), as estimated by Energy, during the period that GA costs are deferred, depending on the scenario.

Under the high GA Financing scenario, now discussed in the Appendix of the latest deck, net debt could rise by $65 Bn over time, as estimated by Energy, and the cost pressure could be up to $51 per month by 2047. There would be significant interest rate exposure to the fiscal impact and accumulated debt estimates. The size of the deficit and debt impacts could affect the Province's credit rating and cost of debt.

Commented [GH1]: This option has been moved to the appendix section, not sure if need to be mentioned.

- Energy's deck analyzes the system cost and ratepayer impacts of the option, but does not address the fiscal impact/accounting treatment, or implementation. There are four options considered:
  - Option 1a: Moderate GA financing, paying $3.2 and $3.4 billion below the true cost of GA, with limits of no more than $2 billion above the true cost of GA
  - Option 1b: Moderate GA financing, paying $1.1 billion below the true cost of GA, with limits of no more than $2 billion above the true cost of GA
  - Option 3: Low / GA financing – paying $2.5 billion below the true cost of GA and increases in each subsequent year until the total amount of money borrowed is paid off, with limits of no more than $2 billion above the true cost of GA.
  - Option 4: High / GA financing – paying $4.4 and $5 billion below the true cost of GA and increases at 2% in each subsequent year until the total amount of money borrowed is paid off in 25 and 30 years respectively, with no limits above the true cost of GA.
- It should be noted that under any of these options the relief period is quite limited when compare to the period under where future ratepayers will have to pay the cost of the deferral. Chart 1a and 1b (slides 10 and 11) illustrate that the impact of the relief would not last beyond 2022 (1a) and 2024 (1b) whill the higher cost caused by the deferral would hit electricity bills until 2042 at the least.
- Impact of the Level of Financing on Large Industrial Electricity Consumers provided in the deck was based on previous scenarios. It should be updated using above scenarios.
- While the details of the proposal would need to be analyzed prior to a decision to proceed with further consideration of the proposal, the Office of the Provincial Controller Division's (OPCD) preliminary assessment is that this would lead to a negative fiscal impact [TBC].
- Preliminary discussions between CEFD and OPCD staff suggest that there are material fiscal and reporting risk associated with this proposal.

OESP & RRRP ($0.51-0.62 bn in 2017 to $0.80-0.92 bn in 2022):

Would shift the cost of the current and proposed expanded Ontario Electricity Support Program (OESP), and Rural or Remote Electricity Rate Program (RRRP), to the tax base. Lower range of fiscal impat estimate is based on current programs. *Note: that the fiscal exposure would increase if the OESP take up rate is larger, and faster than assumed.*

- The fiscal impact from shifting OESP and RRRP to the tax base may also be larger if future changes are made to the programs. Upper range of fiscal impact estimate includes the following changes to the programs.
  - Current RRRP mostly supports Hydro One rural consumers. RRRP could be expanded to mitigate delivery costs for not only Hydro One customers but other high-cost LDCs.
  - OESP program benefits could be increased across the board by 50 per cent, which would mean:
    - Single low income consumers would see an increase from $30 to $45/ month ($540/year); and
    - Families of four with electric heat could see an increase from $55 to $82.50/month ($990/year).
- Energy also notest that if moved to the tax base, OESP could be broadened to include all potential low-income households, despite whether they directly pay for electricity. Broadening OESP in this way could result in a further fiscal impact.
- The RRRP regulation provides a funding mechanism for transmission infrastructure required to grid connect remote First Nation communities. Considerations for how that funding will be supported by the tax base will need to be determined. [The current deck links Trillium Trust for remote electrification.]

Low Income Conservation Benefit Program

- A new low income conservation benefit program would build on existing programs.
  - Existing low income programs delivered by local distribution companies and IESO help qualified homeowners and social and/or assisted housing providers improve the energy efficiency of their homes.
  - With respect to a new program Energy notes that participants could receive incentives for conservation measures not currently covered, increased incentive amounts, and targeted education and awareness initiatives.

- Energy notes an illustrative budget of $60 million per year, but states that further analysis is required on costing and implementation details, including alignment with the existing conservation framework.

Energy Agencies' Cost Effectiveness and Efficiencies:

By empowering energy agencies to continue to move forward with various programs, the initiative is expected to lead to cost effectiveness and efficiencies that could be passed through to the benefit of the rate payers. These initiatives, other than the tax incentives for consolidations, are generally not considered to have fiscal impacts. [Check.]

- IESO's Market Renewal Initiatives – the current "two-schedule price setting system", which is used to settle and dispatch resources in the IESO- administered market, is under review by the IESO.
    - This review is part of a series of consultations launched by the IESO to consider the efficiency and effectiveness of various aspects of the electricity market, and will focus on the energy market pricing system.

  - As part of this review, potential design alternatives will be compared against the status quo with an overall objective of providing "an efficient dispatch and pricing process that produces transparent prices."
  - Moving to “technology-agnostic” procurements will provide new opportunities for innovation and modernization and ensure ratepayers receive the best prices possible.
  - IESO estimates that the total implementation cost – including a 15% contingency and net of avoided costs – will be $150 million. The bulk of the costs (capital) would only be recovered once the project has been implemented and as the benefits are being realized.
- LDC Efficiencies and Rates – reducing osts and having LDCs become more efficient could result in a reduction of Distribution costs on electricity bills, now accounting for about 20% of the total bill.
  - The OEB has a mandate to regulate the electricity distribution sector in the public interest, ensuring the financial viability of the sector while promoting reliable service to customers at just and reasonable rates.
  - Since 2012, the OEB has taken action – through the Renewed Regulatory Framework for Energy – to more closely link rate regulation with performance measures and outcomes.
  - In 2012, the government asked the Ontario Distribution Sector Review Panel to review the distribution sector and make recommendations about how it could become more efficient. While the Panel concluded that a $1.2 billion net present value in savings could be achieved by consolidating LDCs into 8-12 regional entities, the government response was to pursue voluntary consolidation and put in place tax incentives for consolidation.
- OPG Operational Efficiencies – provide expectation that OPG meet more aggressive cost targets, improving efficiency by about $3/Megawatt hour (MWh).
  - The Province could provide instructions to OPG to focus on its stretch target as part of the Minister’s Concurrence letter. This would be a public document that would likely be reviewed by OEB and, if adopted by OEB, would be incorporated as part of OPG’s current rate application.
  - If OPG is unable to meet more aggressive cost targets, this could affect its net income and payments-in-lieu of taxes to OEFC, and the Province’s fiscal plan (Energy estimates it at $240 million per year).

SUMMARY: TAXPAYER FUNDED ELECTRICITY PRICE MITIGATION –JANUARY 18 DECK

($M)	2016-17[1]	2017-18[1]	2018-19[1]	2019-20[1]	2020-21[1]
ENERGY’S Recommended Initiatives*					
Amortize and Debt-Finance Global Adjustment Costs	TBD	TBD	TBD	TBD	TBD
RRRP		457	469	479	493
OESP – Enhance Benefit		162	225	279	323
Low Income Conservation Program		60	60	60	60
First Nations Rate		18	18	18	18
Risk Exposure: OPG Operational Efficiencies	60	240	240	240	240
Enhanced RPP Rebate	169	699	679	732	724
Proposed Program Total:[3]	**229 + GA**	**1,636 + GA**	**1,691 + GA**	**1,808 + GA**	**1,858 + GA**

1. Based on estimated / forecasted numbers [May have some variations from the January 18 deck.]
2. OEPTC amounts in all years based on energy component of the rebate.

* Sourced from Energy PRRT submission

3. Total would be significantly larger with the TBDs crystalized.

Appendix: Options not currently recommended by Energy

Expand the scope of the "Trillium Trust" to make investments in energy infrastructure eligible for funding	• **Would require either squeezing out existing Moving Ontario Forward project funding from the Trillium Trust, requiring funding from another source; or additional funding from asset optimization, given that the government is committed to using the targeted $5.7 billion to fund across Moving Ontario Forward projects** • **Would have little near-term rate impact, even if TT funding displaces near-term, non-incremental projects coming onto service – amortised annual costs are small** • **May have no rate mitigation impact in some cases if, as indicated by Energy, investments are made in incremental projects that would not have been built due to cost barriers under the OEB's beneficiaries pay principle** • **Could lower utility value (share price) and affect fiscal contributions from the electricity sector (net income), including Hydro One, by removing projects, currently and prospectively, that they might have been able to add to their ratebase and earn a return** • **Could have an upfront fiscal impact if Province does not own the asset and is not able to amortize those projects [TBC with OPCD].** • **Energy has indicated that if these investments are provided from the OEB there would be a need to develop oversight mechanisms as is not the OEB's role to review cost prudence of tax-based mechanisms.**	• **Up to $390 million annually from 2017-18 to 2020-21.**
Dedicate the Departure Tax	• In connection with the 2015 IPO of Hydro One shares, Hydro One paid OEFC a $2.6 billion "departure tax". • The departure tax was not a fiscal windfall. It was net fiscally neutral -- while it represented revenue to OEFC, it was an expense to Hydro One and to the Province on consolidation into Public Accounts. • Repurposing the departure tax to provide rate mitigation would have a dollar-per dollar fiscal impact and could trigger an increase in OEFC's stranded debt. • The Province would remain exposed to a negative fiscal impact (lower share price and lower net income) if the OEB decides to allocate all or part of the deffered tax benefit recognized by Hydro One to ratepayers.	• $260 million annually from 2017-18 to 2020-21.
Amortize conservation program costs to smooth recovery of costs from ratepayer. Alternatively, rate smooth conservation costs through an IESO deferral account.	• Ministry of Energy is consulting OPCD on whether consevation costs can be amortized according to accounting standards. Without the ability under accounting standards to amortise the cost, there would be a fiscal impact. Energy states total remaining 2017-2020 electricity conservation program costs are expected to be approximately $2.1 billion.	• [If amortization is not permitted, 2017-18 fiscal impact of $450 M.] [TBC].

	• Energy notes that an alternative to amortizing conservation costs would be to fund these costs through tax base. o Conservation programs provide electricity system benefits. Fiscal-fundingwould result in a cross-subsidisation from tax-base • Accessing the cap & trade amount in the GGRA would crowd-out other GGRA programs, affecting overall GHG reductions and negatively affect the fiscal plan

Expanding the scope of the Trillium Trust to invest in energy infrastructure:

The Province is currently targeting $5.7 billion from asset optimization to dedicate to the Trillium Trust for investment in infrastructure under Moving Ontario Forward. The $5.7 billion target already includes all fiscal benefits expected from the sale of Hydro One common shares (this includes net gains from shares and the Provincial portion of the deferred tax benefit recognized by Hydro One in 2015).

- Expanding access to natural gas is already included under Moving Ontario Forward.
- Using the Trillium Trust for additional energy projects would require either
  - squeeze out existing Moving Ontario Forward project funding from the Trillium Trust, requiring funding from another source, or
  - additional funding from asset optimization, given that the government is committed to using the targeted $5.7 billion to fund across Moving Ontario Forward projects.
- In effect, in both cases above, incremental investments for energy infrastructure from the Trillium Trust would have negative fiscal impacts once the assets are in-service and amortized.
  - Inclusion of investments in First Nation communities that are not in provincial lands would trigger an upfront fiscal impact as the Province may not be able to amortize these projects (TBC with OPCD).
- Investments through the Trillium Trust instead of through other electricity sector entities (Hydro One, OPG, LDCs) could have additional negative fiscal impacts as these entities could see reduced ratebase growth, lowering the revenues that the Province realizes from these entities (e.g., consolidated net income, payments-in-lieu of taxes, etc.).
  - May also negatively impact Hydro One share price if the measure is perceived by the market as reducing Hydro One's potential ratebase growth.
  - This could also question the government's policy rationale for selling Hydro One shares when it would be effectively investing back into the electricity sector through a different vehicle.
- Unless applied to existing projects, to displace ratepayer-supported costs, this measure would have little or no near-term rate impact.
- Energy also suggests that investments could be made into projects that are currently not preceding due to cost barriers under the OEB's beneficiary pays principle.

Departure Tax:

As a result of the IPO, Hydro One paid a "departure tax" payment in lieu of tax (PIL) of $2.6 billion, as a final true-up of its PILs tax obligation. Energy lists using some or all of this departure tax for price mitigation.

- This would have a dollar-for-dolar fiscal impact.
- This was paid to the Ontario Electricity Financial Corporation (OEFC). The departure tax payment was fiscally neutral to the Province on consolidation, as the income (revenue) to the OEFC was fully offset

by a reduction in the Province's revenue from net income of Hydro One (dollar-for-dollar lower due to the departure tax expense).

- The payment was also cash neutral, the $2.6 billion were funded from a capital contribution made by the Province into Hydro One and received back by the Province in OEFC as the departure tax payment was made in cash.
- Using some or all of it for price mitigation would require restating the net stranded debt paydown by OEFC related to the IPO. It would be the first time since 2004 that stranded debt would increase.
- Having OEFC help implement this measure may require introducing changes to OEFC's objects.
- This would be a one-time measure, potentially spread out over a few years, as the departure tax was one-time.

<u>Amortize Conservation Program Costs</u>:

Certain conservation costs are proposed to be amortized over the lifetime of the benefits resulting from the funded conservation measures. Energy proposes that this would involve IESO borrowing funds from the Ontario Financing Authority (OFA) on an annual basis to fund program incentives (non-administrative costs). Energy estimates this would produce a benefit for electricity ratepayers in excess of $1/month from 2017 to 2020.

- Energy would seek an opinion from IESO's external auditor and from the Ontario Provincial Controller Division (OPCD) to determine whether conservation costs could be amortized according to rate-regulated accounting standards.
  - Under Public Sector Accounting Board (PSAB) accounting standards, used by both the Province and IESO, only certain assets can be amortized. Conservation costs would not meet this criteria. Rate-regulated accounting was developed to recognize the unique nature of regulated entities (e.g., electricity generators, LDCs). Under rate-regulated accounting certain costs can be treated as amortizable assets that would not normally be considered assets under accounting principles.
  - Over the past several years, the Auditor General (AG) has expressed concerns about the appropriateness of recognizing rate-regulated assets in the Province's consolidated financial statements.
  - Rate-regulated accounting is currently under review by international accounting standard setting bodies and is currently permitted only on an interim basis, so its future is unclear at present.

- If amortization accounting of conservation costs is not permitted, a fiscal impact would result from this proposal. Energy also notes directly funding conservation costs from the tax base as an alternative option.

- Alternatively, Energy proposes that a regulatory amendment could allow IESO to establish a deferral account for conservation costs.
  - Energy notes that this option would not require approval of the Provincial Controller. However, choosing this option as an alternative to amortization may open Energy to criticism by the Controller and/or Auditor General since the rate impact is the same.

Corporate and Electricity Finance Division / Ontario Financing Authority
January 19, 2017