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Q&A: Ontario Power Generation (OPG) – Ontario's Fair Hydro Trust Debt Offering Tech Briefing
Ministry of Energy
Questions and Answers
Date: February 6, 2018

Q. Why did the government introduce Ontario's Fair Hydro Plan?

We've been making important investments in a cleaner and more reliable electricity system, but these investments have led to higher bills. 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.

Ontario's Fair Hydro Plan is delivering the single-largest reduction in electricity rates in the province's history. Our plan lowered electricity bills by 25 per cent on average for all residential consumers and will hold any increases to the rate of inflation for four years. As many as half a million small businesses and farms are also benefitting.

To address the impact of our electricity system investments on consumers, Ontario's Fair Hydro Plan includes:

- Refinancing the Global Adjustment (GA) over a longer term period for Regulated Price Plan (RPP) eligible consumers, including families, small businesses and farms.

- Helping vulnerable electricity consumers by enhancing electricity support programs and shifting costs off the electricity bill. Eligible consumers will receive additional funding through assistance programs including:

    - Establishing a new Affordability Fund which will support Ontarians who are not eligible for the Home Assistance Program and who have difficulty paying their electricity bills.
    - Broadening Rural or Remote Rate Protection (RRRP) to provide distribution charge relief for the customers of the local distribution companies (LDC's) with the highest distribution charges.
    - Expanding the Ontario Electricity Support Program (OESP) to increase participation and provide further assistance to eligible participants.
    - Establishing a new On-Reserve First Nations Delivery Rate.

- Improving sector efficiency and modernizing Ontario's electricity market, working in collaboration with the Independent Electricity System Operator (IESO) and the Ontario Energy Board (OEB).

- Any rate increases over the next four years will be held to the rate of inflation.

Rate relief programs such as the OESP and RRRP have social value and benefit vulnerable people across Ontario and so, the province has shifted these programs from being paid for through electricity bills to being paid for through government funding.

This will reduce bills for everyone, and ensure these programs continue to serve those in need.

As well, a portion of Global Adjustment (GA) costs is being refinanced to reduce pressure on today's electricity consumers. In later years, the cost of financing will be recovered from consumers.

In developing the policy to refinance the Global Adjustment (GA), we considered a range of implementation options and consulted with legal, accounting, financial and energy sector third-party experts to provide advice and ensure due diligence was completed.

GA refinancing is designed so that the spread out costs are borne by the rate-base, as the beneficiaries of the electricity system, and not the tax-base.

Our plan operates under a financial and accounting framework that is appropriate for the intended purpose and in accordance with Public Sector Accounting Standards (PSAS) and ensures that the fairness goals underlying the program are achieved in a cost-effective manner.

Q. What is Global Adjustment (GA)?

Global Adjustment (GA) is a mechanism that recovers certain electricity system costs, such as capital costs incurred by generators. GA is calculated by the Independent Electricity System Operator (IESO) based on the difference between the market price for electricity, which represents the marginal cost of electricity production, and rates paid to regulated and contracted generators to ensure they can recover their fixed costs. It also recovers costs associated with running conservation programs in the province.

GA has been an important factor in providing stable prices while ensuring that sufficient generating capacity is in place to deliver a reliable supply of electricity.

GA pays for the bulk of the recent investments in the electricity system. The majority of the province's electricity generators operate under 20-year contracts. Third-party experts have confirmed that many of these generators will be able to continue to operate beyond the end of their contract. This means that generating assets are expected to have ongoing useful life and benefit future ratepayers by reducing the need to finance the development of new generating assets.

Refinancing the GA is providing significant and immediate rate relief by spreading the cost of electricity investments over the expected lifecycle of the infrastructure that has been built. This more fairly shares the cost of our investments across the generations of electricity ratepayers who will benefit from them.

Q. Has the Ministry of Energy's estimate for "peak debt" related to Ontario's Fair Hydro Plan changed? How much is the program expected to cost?

Ontario Power Generation (OPG) has begun the process of raising funds to finance the deferred costs, and while total borrowing costs will not be known until the program is complete, accumulated interest is projected to be considerably less than original estimates.

Current government estimates forecast that the peak debt over the thirty year life of Ontario's Fair Hydro Plan will be approximately $20 billion. The preliminary estimate from March 2017 was about $28 billion.

A number of variables, including interest rates, electricity demand and electricity costs, will vary over the thirty-year life of the plan and cost estimates will continue to be revised to reflect these changing conditions.

If pressed on the details of the revised peak debt number:

Peak debt for the Fair Hydro Plan has been revised down substantially from March 2017, from about $28 billion to approximately $20 billion. These estimates are consistent with Ontario's 2017 Long-Term Energy Plan (LTEP) projections, including fees charged by OPG in its role as financial service manager (FSM) and assume a 5 per cent interest rate.

Q. Why is the government using Ontario Power Generation (OPG) as a borrowing agent for Ontario's Fair Hydro Plan? Would it be easier to use a traditional government borrowing agent like the Ontario Financing Authority (OFA)?

Ontario Power Generation (OPG) has the necessary financing and commercial expertise to assist with refinancing the Global Adjustment (GA).

OPG currently manages approximately $20 billion in segregated nuclear funds to manage nuclear liabilities, and, is an electricity sector entity regulated by the Ontario Energy Board (OEB) with extensive experience with regulatory deferral and variance accounts.

OPG also has the breadth and demonstrated track record in the financial markets with its Corporate Debt platform, private placement of insurance linked bonds, participation in securitization programs and highly successful project debt issuances tied to new hydroelectric developments. These financing initiatives have been well received by investors at a reasonable cost to OPG. The innovative, cost saving and precedent setting aspects of these structures have resulted in international recognition.

OPG has developed solid investor relationships and has a large investor base in the structured finance space that would be the target market for financing Ontario's Fair Hydro Plan initiative. For example, Lower Mattagami project financing attracted a broad investor base of ~80 institutional investors[1], including major investors in the Canadian power and utility bonds market.

In terms of administration, OPG is currently managing its own Corporate public debt program and three project financing programs totalling more than $2 billion and two commercial paper programs.

Finally, OPG's Treasury functions are well positioned given their management of existing multiple debt programs.

Q. How much was spent by OPG to complete this transaction? Will these costs be borne by ratepayers?

OPG was identified as the Financial Services Manager that will manage the debt obligations. OPG has the necessary financing and commercial expertise to assist with refinancing the GA and will ensure that it is done in an efficient and cost-effective manner.

Under the *Ontario Fair Hydro Plan Act, 2017* (the "Act") and associated regulations, OPG is permitted to charge fees as financial services manager, which are calculated based on OPG's performance in managing the debt obligations and allow OPG to recover costs incurred in relation to the establishment, management and administration of the financing entity and/or the investment asset. In accordance with the structure of Ontario's Fair Hydro Plan, these amounts will be recovered from ratepayers.

Ontario's Fair Hydro Plan is designed to fairly allocate costs across the generations of electricity ratepayers. Current ratepayers are paying less now, and future ratepayers will in turn help to pay for their fair share of the significant investments that we've made to build a clean and reliable electricity system.

Further questions on OPG costs should be directed to OPG.

Q. Some say you are unfairly placing the burden of debt on future generations through things like Ontario's Fair Hydro Plan, how do you respond?

Future generations will be paying their fair share for a system they will be benefiting from. Not only will they benefit from a reliable electricity system, but also from cleaner air resulting from the elimination of coal-fired generation.

Ontario's Fair Hydro Plan acts much like taking out a new mortgage – providing much-needed relief now by spreading costs across the life of our assets. Current ratepayers are paying less now, and future ratepayers will in turn help to pay for their fair share of the significant investments that we've made to build a clean and reliable electricity system. This more fairly shares the cost of our investments across the generations of electricity ratepayers who will benefit from them.

Moving forward, *Delivering Fairness and Choice,* Ontario's 2017 Long-Term Energy Plan (2017 LTEP) focuses on continuing to put downward pressure on electricity bills over the long term. Our robust electricity supply puts us in a good position to improve efficiency, increase transparency and enhance opportunities for innovation and competition to further reduce system costs. That is why Ontario's Fair Hydro Plan includes a commitment to improving sector efficiency and modernizing Ontario's electricity market, building on the collaboration of the Independent Electricity System Operator (IESO) and the Ontario Energy Board (OEB).

For example, IESO's Market Renewal initiative will result in a more efficient marketplace with competitive and transparent mechanisms that meet future system needs at the lowest cost. The initiative is expected to save up to $5.2 billion over a 10-year period and forms a key component of Ontario's plan to ensure the affordability of electricity in the longer term.

Q. When will the next tranche of debt be sold?

OPG was identified as the Financial Services Manager that will manage the debt obligations. OPG has the necessary financing and commercial expertise to assist with refinancing the GA and will ensure that it is done in an efficient and cost-effective manner.

OPG is expected to purchase IESO's regulatory asset monthly, and to issue longer term debt in the capital markets on a periodic basis.

Q. There is an election in 17 weeks. Can Ontario's Fair Hydro Plan be undone? What will that mean for the refinancing of the GA and Ontario ratepayers?

Ontario's Fair Hydro Plan is governed by legislation and regulations, and its implementation is ongoing. GA Refinancing is implemented through ongoing financings that OPG, as the Financial Services Manager, takes to market.

The *Ontario Fair Hydro Plan Act, 2017* and associated regulations provide the legislative framework for the GA refinancing program and its policy goals, allowing certain electricity system costs to be fairly allocated across generations of electricity ratepayers. Current ratepayers are paying less now, and future ratepayers will in turn help to pay for their fair share of the significant investments that we've made to build a clean and reliable electricity system.In accordance with the legislation and associated regulations, Ontario's Fair Hydro Plan has lowered electricity bills by 25 per cent on average across the province for all residential customers. As many as half a million small businesses and farms are also benefitting. Any increases will be held to the rate of inflation for four years.

Q. Who was involved in the policy and implementation process to meet the mandate?

Senior officials and staff from several departments and agencies, led by the Ministry of Energy, collaborated to plan a structure, identify risks, make decisions and take other actions to meet the mandate.

The senior officials and staff were from:
- Ministry of Energy;
- Ministry of Finance;
- Treasury Board Secretariat;
- Office of the Provincial Controller;
- Cabinet Office;
- Ontario Financing Authority (OFA);
- Independent Electricity System Operator (IESO); and
- Ontario Power Generation Inc. (OPG).

In development and implementation of Global Adjustment (GA) refinancing, the government considered a range of implementation options and consulted with legal, accounting, financial and energy sector third-party experts to provide advice and ensure due diligence was completed.

Auditor General and Financial Accountability Office reports

Q. The Auditor General and the Financial Accountability Office both suggest that the cost of borrowing will be more expensive than traditional government borrowing? Is this true?

In the development of Ontario's Fair Hydro Plan, the government made the policy decision that deferred electricity system costs should be borne by the rate-base and not the tax-base.

Based on this policy decision, it was decided that the debt obligation would be recognized as a regulatory asset that would be sold and securitized. This design appropriately aligns the costs and benefits within the group of eligible consumers.

Ontario Power Generation (OPG) was identified as the Financial Services Manager responsible for the financing plans and the financing entity (i.e., Fair Hydro Trust) that will manage the debt obligations. OPG has the necessary financing and commercial expertise to assist with refinancing the Global Adjustment (GA) and will ensure that it is done in an efficient and cost-effective manner.

OPG has a demonstrated track record in the financial markets with its Corporate Debt platform, private placement of insurance linked bonds, participation in securitization programs and highly successful project debt issuances tied to new hydroelectric developments. The innovative, cost saving and precedent setting aspects of these structures have resulted in international recognition.

Total borrowing estimates over the thirty year life of the Fair Hydro Plan have been revised down substantially by the government since the FAO released its report in May 2017, and borrowing costs are now forecast to be substantially lower than original estimates.

The preliminary estimate from March 2017 was about $28 billion. Current government estimates forecast that the peak debt over the thirty year life of OFHP will be approximately $20 billion. With respect to the $4 billion figure referenced by the Financial Accountability Office (FAO) in its May 2017 report, it should be noted that the FAO's report was based on initial Ministry of Energy estimates from March 2017. Subsequent analysis conducted by the Ministry of Energy refined a number of variables, including the cost of borrowing and electricity system cost forecasts.

A number of variables, including interest rates, electricity demand and electricity costs, will vary over the thirty year life of the Fair Hydro Plan 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.

If pressed on the details of the revised peak debt number:

Peak debt for OFHP has been revised down substantially from March 2017, from about $28 billion to approximately $20 billion. The higher March 2017 estimate was used by the FAO in its May 2017 report.

Updated estimates are consistent with 2017 Long-Term Energy Plan (LTEP) projections, include fees charged by OPG in its role as financial service manage (FSM) and assume a 5 per cent interest rate.

If pressed on interest costs:

The government estimates of total interest cost also decreased from $25 billion[2] to less than $19 billion.

Q. Has the Ministry of Energy's estimate for "peak debt" related to Ontario's Fair Hydro Plan (OFHP) changed? I understand that the Office of the Audit General (OAG) has asked what are the factors that resulted in the changes in estimates from March 1 to August 31?

With respect to the $4 billion[3] figure referenced by the Financial Accountability Office (FAO) in its May 2017 report, it should be noted that the FAO's report was based on initial Ministry of Energy estimates from March 2017. Subsequent analysis conducted by the Ministry of Energy refined a number of variables, including the cost of borrowing and electricity system cost forecasts.

Total borrowing estimates over the thirty year life of OFHP have been revised down substantially by the government since the FAO released its report in May 2017, and borrowing costs are forecast to be substantially lower than original estimates. Current government estimates forecast that the peak debt over the thirty year life of OFHP will be approximately $20 billion[4]. The preliminary estimate from March 2017 was about $28 billion[5].

The revised estimates are the result of a number of factors, including updated long-term cost projections for the electricity system and residential bills provided by the Independent Electricity System Operator (IESO).

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.

If pressed on the details of the revised peak debt number:

Peak debt for OFHP has been revised down substantially from March 2017, from about $28 billion[6] to approximately $20 billion. The higher March 2017 estimate was used by the FAO in its May 2017 report.

Updated estimates are consistent with 2017 Long-Term Energy Plan (LTEP) projections, include fees charged by OPG in its role as financial service manage (FSM) and assume a 5 per cent interest rate.

If pressed on interest costs:

The government estimates of total interest cost also decreased from $25 billion[7] to less than $19 billion[8].

Q. In the development of Ontario's Fair Hydro Plan, did the government set up the financing structure intentionally to keep it off government books?

No. GA refinancing is designed so that deferred costs are borne by the rate-base, as the beneficiaries of the electricity system, and not the tax-base.

GA refinancing operates under a financial and accounting framework that is appropriate for the intended purpose and in accordance with Public Sector Accounting Standards (PSAS) and ensures that the fairness goals underlying the program are achieved in a cost-effective manner.

Q. How do you respond to the Financial Accountability Office's (FAO) suggestion from May 2017 that using Ontario Power Generation as the borrowing agent will cost $4 billion more? Why not have the Province borrow for the OFHP?

The policy objective of the Fair Hydro Plan is to more fairly allocate the cost to ratepayers over the useful life, not the contractual term, of the electricity generating assets. Therefore, it was a primary policy objective to ensure that the costs are borne by the beneficiaries of the electricity system – the rate-base – not the tax-base.

We believe it is appropriate for ratepayers to pay for the financing of electricity assets. The rate-base has a different risk profile than the tax-base, which would be reflected in different interest costs. Having the rate-base pay is not a new policy, for example Hydro One has borrowed in the capital markets since the early 2000s.

The $4 billion figure was an estimate made by the Financial Accountability Office (FAO) based on initial Ministry of Energy estimates from March 2017. Subsequent analysis conducted by the Ministry of Energy refined a number of variables, including the cost of borrowing and electricity system cost forecasts.

Total borrowing estimates over the thirty year life of OFHP have been revised down substantially by the government since the FAO released its report in May 2017, and borrowing costs are now forecast to be substantially lower than original estimates. Current government estimates forecast that the peak debt over the thirty year life of the Fair Hydro Plan will be approximately $20 billion. The preliminary estimate from March 2017 was about $28 billion.

The FAO report itself concludes by saying "the FAO's estimates are subject to many assumptions and uncertainties (…) Fiscal impact may differ significantly from the FAO's estimates."

If pressed on the details of the revised peak debt number:

Peak debt for OFHP has been revised down substantially from March 2017, from about $28 billion[9]to approximately $20 billion. The higher March 2017 estimate was used by the FAO in its May 2017 report.

Updated estimates are consistent with 2017 Long-Term Energy Plan (LTEP) projections, include fees charged by OPG in its role as financial service manager (FSM) and assume a 5 per cent interest rate.

If pressed on interest costs:

The government estimates of total interest cost also decreased from $25 billion to less than $19 billion.

Q. Do you disagree with the FAO on financial costs?

With respect to the $4 billion figure referenced by the Financial Accountability Office (FAO) in its May 2017, it should be noted that the FAO's report was based on initial Ministry of Energy estimates from March 2017. Subsequent analysis conducted by the Ministry of Energy refined a number of variables, including the cost of borrowing and electricity system cost forecasts.

Total borrowing estimates over the thirty-year life of OFHP have been revised down substantially by the government since the FAO released its report in May 2017, and borrowing costs are now forecast to be substantially lower than original estimates. Current government estimates forecast that the peak debt over the thirty year life of the Fair Hydro Plan will be approximately $20 billion. The preliminary estimate from March 2017 was about $28 billion.

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.

If pressed on the details of the revised peak debt number:

Peak debt for the Fair Hydro Plan has been revised down substantially from March 2017, from about $28 billion to approximately $20 billion. The higher March 2017 estimate was used by the FAO in its May 2017 report.

Updated estimates are consistent with 2017 Long-Term Energy Plan (LTEP) projections, include fees charged by OPG in its role as financial service manager (FSM) and assume a 5 per cent interest rate.

If pressed on interest costs:

The Ministry estimates of total interest cost also decreased from $25 billion to less than $19 billion.

Reasoning for Accounting Approach

Q. How do you respond to the Auditor General's claim that the government ignored warnings regarding a potential adverse audit opinion of Ontario's public accounts?

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 in 2017-18 and in future years.

In regards to rate-regulated accounting, PSAS are 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.

Many entities in Canada, including OPG and Hydro One use rate-regulated accounting:

- The OAG can refer to the CPA Canada research study that was shared.
- Rate-regulated accounting is well understood in the electricity sector.
- The recognition of regulatory assets brings IESO in line with 6 other independent system operators in North America, including AESO, ISO New England, NYISO, MISO, PJM and ERCOT.

The IESO management, IESO's Audit Committee, IESO's Board of Directors, IESO's external auditor and the Office of the Provincial Controller all support the use of rate-regulated accounting by IESO.

In the development of Ontario's Fair Hydro Plan, the government consulted with several third party advisors in the application of accounting standards. This is normal course of business governments take for complex transactions.