Independent Electricity System Operator
1600-120 Adelaide Street West
Toronto, ON M5H 1T1
t 416.967.7474
www.ieso.ca

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# Memorandum

To: THE BOARD OF DIRECTORS
of the Independent Electricity System Operator

From: Kim Marshall
CFO & Vice President, Corporate Services

Date: May 17, 2017

Re: IESO Risks – Ontario Fair Hydro Act

The government of Ontario has introduced legislation, the Fair Hydro Act that if passed, would lower electricity bills by 25 per cent on average for all residential customers to provide significant rate relief and ensure greater fairness. The proposed legislation will see the deferred global adjustment costs transferred to a trust to be created by Ontario Power Generation ("OPG"). In later years, the cost of refinancing will be recovered through adjustments to consumer hydro bills called a Clean Energy Adjustment. Under the proposed legislation, the Independent Electricity System Operator ('IESO'), as an agent of the Trust, will collect the Clean Energy Adjustment from consumers and LDCs and remit it to the Trust.

Given the IESO`s role in the administration of the Fair Hydro Act, the IESO will be potentially subject to reputational, financial, solvency, credit, regulatory and legal risks. Through discussions held with the CEO, CFO, General Counsel and representatives from Legal and Finance within the IESO, potential risks were identified. The 9 risks identified culminate into a single key risk "The structure proposed for the Ontario Fair Hydro Plan is abandoned or fails, either in whole or in part" that represents the overall risk to the IESO. **Appendix A** presents the 9 identified risks, their assessed impact and likelihood, and the IESO actions towards mitigation.

An assessment was performed on each of the identified risks. The results of the assessment are included in the heat map presented in **Appendix B**. The IESO has taken action towards mitigating the aspects of the risks that are within its control, defined in **Appendix A**, which supported a reduction in the likelihood of the risks. Assuming all of the anticipated assurances and actions unfold as planned, the overall combined assessment of the nine risks is considered within an acceptable range. However, residual risk remains that is beyond the IESO's control including any future changes in government policy or the OPG`s inability to purchase the regulatory asset from the IESO in whole or in part.

It should be noted, to avoid contempt of the legislature, certain implementation activities will not be done prior to passage of the legislation. Therefore, Government indemnities which require action on the part of the Ministry of Finance cannot be finalized until after passage. Attached is a letter from the Deputy Minister of Energy acknowledging the CEO's request for assurance.

The IESO will continue to take the appropriate actions to support the management of the risks and continue to assess the impact that future developments, including legislation, regulations and agreements, will have on the risks. Although, initial risks have been identified, risks will continue to evolve and change over time as we move from the design to the implementation of the Ontario Fair Hydro Act. The IESO will continue to monitor and identify new risks as they arise, assess their impact and determine the appropriate mitigation plans required.

An update on the Ontario Fair Hydro Act risks will be reported to the Audit Committee at each meeting for the immediate future as the IESO continues to manage the risks.

## Appendix A – IESO Risks Related to the Ontario Fair Hydro Act

| Key IESO Risk | The structure proposed for the Ontario Fair Hydro Plan is abandoned or fails, either in whole or in part | | | | |
|---|---|---|---|---|---|
| *Risk Register* | | | | | |
| **#** | **IESO Risk** | **Impact Assessment** | **Likelihood Assessment** | **Identified Impacts** | **IESO Actions Towards Mitigation** |
| 1 | OPG financing entity does not purchase regulatory asset in whole or in part from IESO | Significant | Unlikely | - diminished IESO liquidity due to limited credit facilities<br>- if situation continues too long, IESO solvency risk<br>- IESO credit rating being downgraded<br>- adverse impact on sector / IESO reputation | IESO has sought formal commitment from Province of its financial support if this scenario occurs.<br><br>IESO seeking higher credit limit with OFA<br><br>IESO to seek commercial arrangement with OPG whereby OPG must provide sufficient advance notice that it will not purchase asset<br><br>Continue to advocate for legislation and regulations that provide the best support for asset creation, transfer and collection and financing of asset for OPG |

| **Key IESO Risk** | **The structure proposed for the Ontario Fair Hydro Plan is abandoned or fails, either in whole or in part** | | | | |
|---|---|---|---|---|---|
| | | | *Risk Register* | | |
| **#** | **IESO Risk** | **Impact Assessment** | **Likelihood Assessment** | **Identified Impacts** | **IESO Actions Towards Mitigation** |
| 2 | A change in government policy changes some or all of the terms of the Ontario Fair Hydro Plan | Moderate | Somewhat Likely | - unknown - depends on terms of changes | Provide advice on consequences of any action taken to change terms of Fair Hydro Plan |
| 3 | IESO is unable to provide the standard representations and warranties and legal opinions (valid sale, all necessary approvals, etc.) due to nature of asset and underlying legislation - i.e. opinion, and representations and warranties are qualified | Moderate | Somewhat Likely | - may result in higher cost for the overall plan due to higher financing costs with consequent concern to government | We are proactively communicating concerns with legal issues that may result in qualified opinions, and representations and warranties<br><br>Continue to ensure that legislation, regulations and agreements provide the best support for asset creation and transfer, and ability to provide sufficient representations, warranties and opinions<br><br>Legal due diligence continuing which is informing comments on legislation, regulations and agreements |

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| 4 | Ontario Financing Authority (OFA) and Ontario Electricity Financing Corporation (OEFC) are unwilling or unable to expand the IESO's credit limit or to enhance credit facilities to clarify continuity of funding | Moderate | Unlikely | - IESO solvency<br>- IESO needs to secure funding arrangements to satisfy its payment obligations<br>- IESO credit rating being downgraded | IESO has requested changes to OFA and OEFC credit agreements to increase credit limits and to require continued advancements if the IESO cannot sell a Fair Hydro regulatory asset; and to provide more flexible repayment terms. IESO has sought support for these changes from Ministry of Energy |
| 5 | Inability to achieve appropriate terms for the Master Sales Agreement and Service Level Agreement between IESO and OPG | Negligible | Somewhat Likely | - legal and financial risk | IESO is seeking indemnification from government. Legal mitigation is managed through contract clauses |
| 6 | Ontario Securities Commission (OSC) rescinds transmission rights (TR) exemption due to IESO's role under the | Negligible | Unlikely | - requires the IESO and participants in the TR market to meet onerous OSC filing requirements | Working with external legal counsel to avoid linking the management of the regulatory asset with other programs within the IESO |

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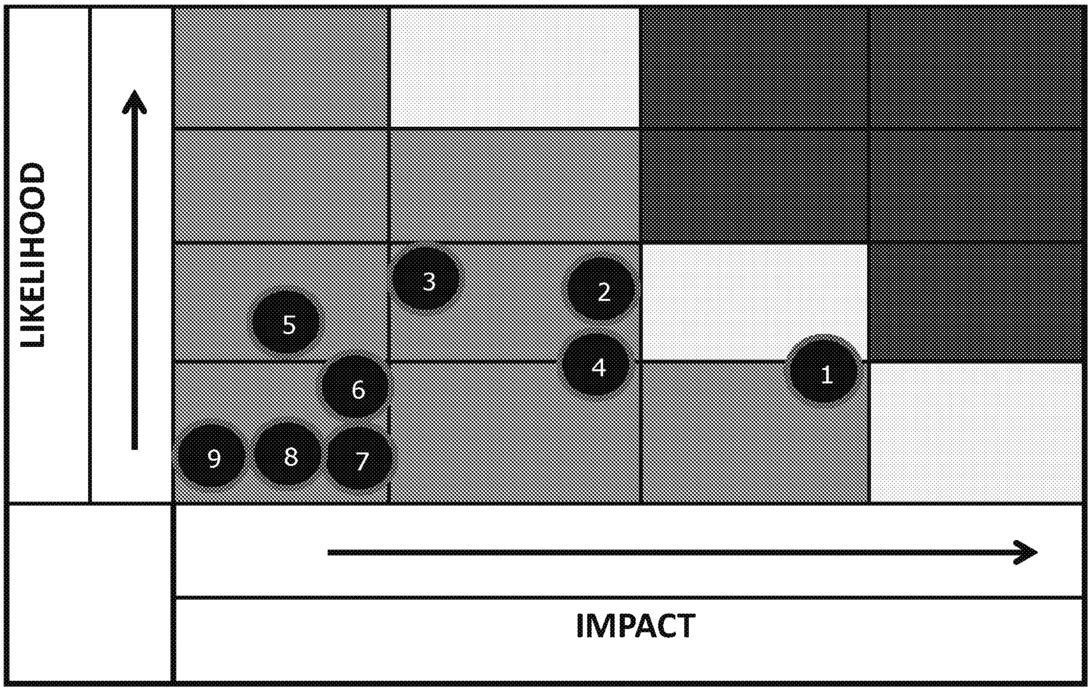
|---|---|---|---|---|---|
| *Risk Register* | | | | | |
| **#** | **IESO Risk** | **Impact Assessment** | **Likelihood Assessment** | **Identified Impacts** | **IESO Actions Towards Mitigation** |
| | Ontario Fair Hydro Plan | | | | administered markets |
| 7 | The IESO is named a party of the US prospectus due to the IESO being the regulatory asset originator | Negligible | Unlikely | - financial risk<br>- legal risk<br>- reputational risk | IESO has requested enhanced government indemnities for IESO Corporate, directors, officers and employees |
| 8 | Legislation and regulations require the regulatory asset structure to use additional processes and systems, making implementation more challenging and less efficient | Negligible | Unlikely | - financial statement audit risk<br>- increased workload in an environment where it is difficult to increase resources<br>- increased operational cost | We are proactively advocating using existing systems and processes and not layering additional processes<br><br>We are advocating leaving details of implementation to regulations<br><br>Need to see draft legislation and regulations to properly understand how implementation will occur |
| 9 | IESO is bound to hold the regulatory asset or equity in OPG financing entity | Negligible | Unlikely | - risk/reward is not transferred fully or partially and is considered an IESO liability, not a regulatory asset | KPMG has provided opinion that the accounting treatment is appropriate |

## Appendix B – Heat Map of IESO Risks Related to the Ontario Fair Hydro Act




Name Kim Marshall

Initials KM

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Cc: IESO Records