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

Memorandum

To: Tim O'Neill, Chair
Carole Workman, Audit Committee Chair
Peter Gregg, President and CEO

From: Michael Boll, Associate General Counsel

Date: December 17, 2017

Re: Ontario Fair Hydro Plan - Agreements

The purpose of this memorandum is to summarize changes that have been made to the Fair Hydro Program agreements following the December 5 update we provided to you, and to seek your approval for such changes.

The changes summarized below result from rating agency comments and requirements.

IESO Approvals Background

At the special IESO Board meeting on November 22, 2017, the IESO Board authorized and approved the IESO entering into and performing its obligations under the following agreements:

a) a Master Transfer and Servicing Agreement between the Corporation and Fair Hydro Trust;
b) a Security Agreement between the Corporation and Fair Hydro Trust; and
c) an Acknowledgement and Indemnity Agreement between the Corporation and BNY Trust Company of Canada, in its capacity as Indenture Trustee of Fair Hydro Trust.

The Board delegated authority to the Chief Executive Officer, Board Chair and Audit Committee Chair to approve any additions, deletions or changes to the form of the agreements that had been presented to the Board on November 22. Any such approved amendments are required to be reported to the Board promptly and no later than the Board's next regularly scheduled meeting. The Chief Executive Officer and one of the Board Chair and Audit Committee Chair were authorized to execute the agreements.

An update was provided to you by memorandum dated December 5 summarizing the changes to the agreements following the November 22 Board meeting, which you approved.

<u>Master Transfer and Servicing Agreement</u>

A blackline of the Master Transfer and Servicing Agreement (MTSA) is attached showing the changes to the version provided with the December 5 update.

The substantive changes are described below:

(1) Definition of Monthly Servicer Report – this is a report the IESO is required to provide monthly once clean energy adjustments are collected from specified consumers. The rating agencies were not comfortable that details of the report were being left for a later date. Therefore the contents of the report have been added and other related reporting provisions have been modified. We do not consider these changes to be material.

(2) Section 3.15 – IESO Security for CEA Remittances. This section requires the IESO to post a letter of credit as security for non-remittance by non- credit rated electricity vendors of clean energy adjustment amounts collected. For clarity, this is not the security over IESO receivables for which we provided a separate memorandum to the Board.

In the prior draft of the MTSA, there had been a $100 million cap on the amount of security that would be required. The rating agencies were concerned that there may be changes that may make that cap too low, such as LDCs choosing to no longer obtain a credit rating. In addition, the definition of a non-credit rated electricity vendor was changed so only electricity vendors that have an investment grade rating from both Moody's and DBRS would qualify. As a result of this change, only Hydro One would meet the definition. Therefore this security will secure the obligations of all other LDCs. The formula to determine the amount of security was also amended to increase the assumed percentage of default from 45% to 50%.

- The impact of these changes is to increase the amount of security the IESO must provide when clean energy adjustments begin to be charged to consumers. This will increase the cost of the security (if it is a letter of credit) that the IESO will recover from specified consumers.

- We do not believe it materially changes the likelihood of the security being called.
- KPMG has confirmed these changes do not change the accounting treatment.
- The Ministry has been informed of the change.
- We were advised by OPG that this was a material issue for the rating agencies and without these changes a rating would not have been provided this year, which would have prevented the first transfer of the regulatory asset this December from occurring.
- IESO and OPG will work together to attempt to convince the rating agencies of the low risk presented by LDCs in Ontario in an effort to reduce the quantum of security required, and also to explore forms of security that will result in lower costs to consumers.

Acknowledgement and Indemnity Agreement

A blackline of the Acknowledgement and Indemnity Agreement is attached showing changes to the form provided with the December 5 update.

There is one change that we do not believe is material. Near the end of section 4 there is a clarification that the indemnity applies with respect to a representation, warranty or covenant of the IESO (acting as servicer under the MTSA) that survives termination of the MTSA.

Security Agreement

There have been no substantive changes to the security agreement.

A blackline of the Security Agreement is attached showing changes to the form provided with the December 5 update.

MJB

Encl.