ieso
Connecting Today.
Powering Tomorrow.

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

Memorandum

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

From: Kim Marshall
CFO & Vice President, Corporate Services

Date: July 25, 2017

Re: Fair Hydro Plan – Risk Update

Subsequent to the IESO's Board update call regarding this item in May, the government of Ontario passed legislation - the Ontario Fair Hydro Plan Act, 2017 ("Fair Hydro Act"), - that lowers electricity bills by 25 per cent on average for all residential customers and other specified consumers. The Fair Hydro Act provides for the deferred global adjustment costs to be a regulatory asset of the IESO, recoverable from future consumers. The legislation further provides that this regulatory asset may be transferred to a financing entity created by Ontario Power Generation ("OPG"). When transferred to the financing entity, the asset becomes an investment asset, the costs of which will in part be financed by way of securities offerings. In later years, the financing entity's cost of financing related to the investment asset will be recovered through adjustments to consumer hydro bills called a Clean Energy Adjustment. The IESO, as an agent of the financing entity, will receive the Clean Energy Adjustment from LDCs (and any specified consumers invoiced directly by the IESO) and remit it to the financing entity.

Given the IESO`s role in the administration of the Fair Hydro Act, the IESO is potentially subject to reputational, financial, regulatory and legal risks. In early May, 9 potential risks were identified through an internal process, culminating 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 an update to the identified risks, their assessed impact and likelihood, including an update to the IESO actions towards mitigation that have evolved since May.

There are three notable changes since May. The risk related to the IESO's ability to expand or enhance its credit facilities, and IESO holding a regulatory asset or equity in the Financing Entity have been closed. An additional risk was identified relating to the reputational impact the IESO may experience if the accounting treatment for the Ontario Fair Hydro Plan is disputed.

An assessment was performed on each of the identified risks in May and an updated assessment was performed in July. The results of both assessments are included in the heat maps presented in **Appendix B** to demonstrate any movement in the risks since the initial assessment. The IESO has taken action towards mitigating the aspects of the risks that are within its control, defined in **Appendix A**, which support 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 updated 8 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 financing entity`s inability to purchase the regulatory asset from the IESO in whole or in part.

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 if they arise, assess their impact and determine the appropriate mitigation plans required.

To address IESO's Board interest in quantifying the impact of the Fair Hydro Plan risk it should be noted that the IESO has obtained a $2 billion dollar line of credit from the OFA to support the IESO's role in the implementing the Fair Hydro Act. It is estimated that the credit facility will allow the IESO to meet its obligations for a period of 6 – 10 months. The IESO expects that if the $2 billion line becomes insufficient (i.e. the financing entity stops its purchases of the regulatory asset from the IESO) that the government will continue to support the IESO to avoid any material financial risk that may impact the IESO, for example by an increase to the $2 billion credit limit or by seeking taxpayer base support.

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 - if situation continues too long, IESO solvency risk - IESO credit rating being downgraded - adverse impact on sector / IESO reputation	IESO has a new formal commitment of a $2 billion line of credit from Province to support if this scenario occurs. This facility is expected to provide sufficient time (6 to 10 months) to modify/change the Fair Hydro Plan without impeding the IESO's solvency. IESO to seek commercial arrangement with financing entity whereby financing entity will provide sufficient advance notice that it will not purchase regulatory asset.

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	Proactively 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. Legal due diligence was applied to inform comments on legislation, regulations and agreements.
4	OFA and OEFC are unwilling or unable to expand the IESO's credit limit or to enhance credit facilities to clarify continuity of funding				**<u>Risk Has Been Closed</u>** IESO has a new formal commitment of a $2 billion line of credit from Province to expand its credit facility. Facility is currently in progress of being finalized.

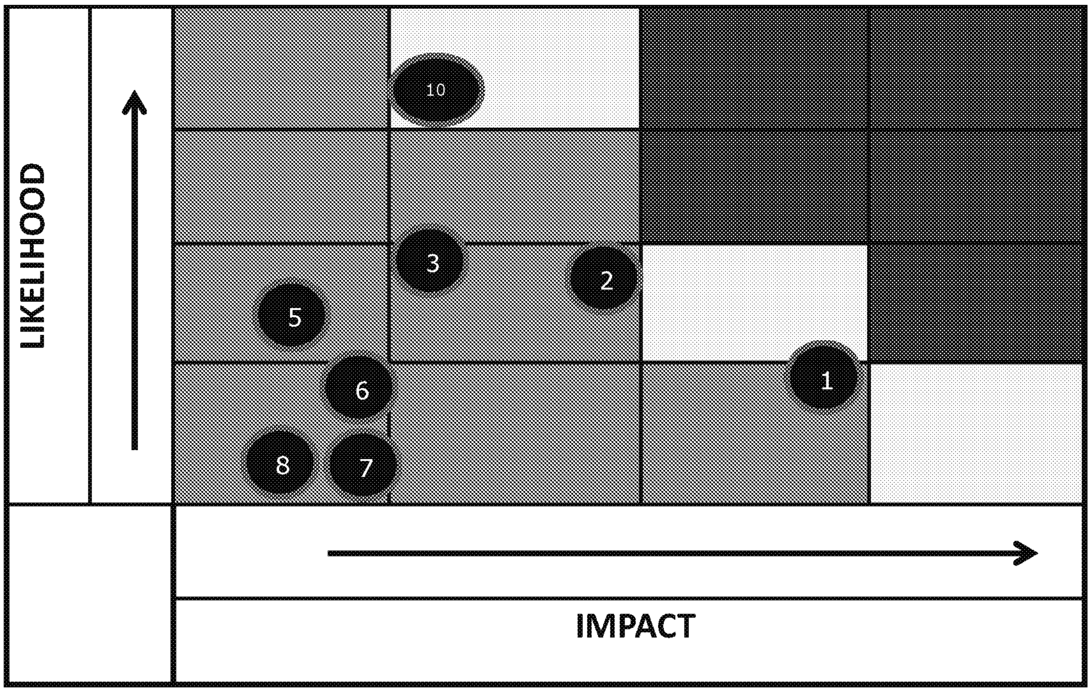
Key IESO Risk	**The structure proposed for the Ontario Fair Hydro Plan is abandoned or fails, either in whole or in part**				
Risk Register					
#	**IESO Risk**	**Impact Assessment**	**Likelihood Assessment**	**Identified Impacts**	**IESO Actions Towards Mitigation**
5	Inability to achieve appropriate terms for the Master Transfer and Servicing Agreement between IESO and financing entity	Negligible	Somewhat Likely	- legal, accounting, and financial risk	IESO is negotiating the agreement to best represent its interests while maintaining the integrity of what is set out in the legislation. IESO has received indemnification from government. Legal mitigation is managed through commercial contract clauses.
6	Ontario Securities Commission (OSC) rescinds transmission rights (TR) exemption due to IESO's role under the Ontario Fair Hydro Plan	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 administered markets.
7	The IESO is named a party of the US prospectus or required to be a signatory to underwriting agreement due	Negligible	Unlikely	- financial risk - legal risk - reputational risk	IESO has received government indemnities for IESO Corporate, directors, officers and employees. Electricity Act, section 19 also

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**
	to the IESO being the regulatory asset originator				provides protection for actions of directors, officers and employees of IESO for performance in good faith of powers or duties.
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 - increased workload in an environment where it is difficult to increase resources - increased operational cost	We are proactively advocating using existing systems and processes and not layering additional processes. We have successfully advocated leaving details of implementation to regulations, and/or commercial agreements.
9	IESO is found to hold the investment asset or equity in financing entity; or other aspects of the transaction require recognition of liability by IESO				**<u>Risk Has Been Closed</u>** Through further discussion, the determination was made that this risk did not impact the IESO. Risk has been replaced with risk 10 below.

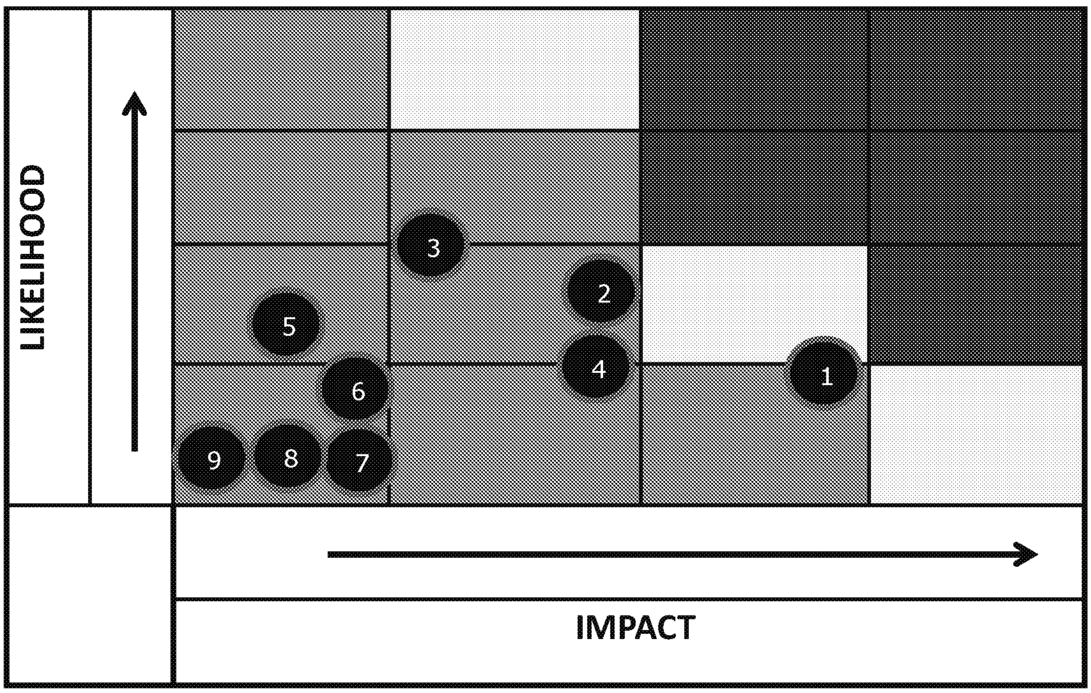
Key IESO Risk	**The structure proposed for the Ontario Fair Hydro Plan is abandoned or fails, either in whole or in part**				
Risk Register					
#	**IESO Risk**	**Impact Assessment**	**Likelihood Assessment**	**Identified Impacts**	**IESO Actions Towards Mitigation**
10	Accounting treatment for Ontario Fair Hydro Plan is disputed with negative reputational impact on the IESO	Moderate	Very Likely	- use of rate - regulated accounting continues to be a point of contention - increased demands on IESO resources	Legislation and regulations are completed. The accounting for the creation of the regulatory asset is consistent with current accounting practices. IESO's Board of Directors to provide a response to the Auditor General's office.

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

Heat Map As of July 25, 2017



Heat Map As of May 17, 2017



Kim Marshall