Message

From: Emanuel Movchovitch [/O=IMO/OU=EXCHANGE ADMINISTRATIVE GROUP (FYDIBOHF23SPDLT)/CN=RECIPIENTS/CN=EMANUEL MOVCHOVITCH139]
Sent: 2017-01-25 11:00:59 AM
To: Jordan Penic [/O=IMO/OU=EXCHANGE ADMINISTRATIVE GROUP (FYDIBOHF23SPDLT)/CN=RECIPIENTS/CN=Penicj]; Michael Killeavy [/O=IMO/OU=EXCHANGE ADMINISTRATIVE GROUP (FYDIBOHF23SPDLT)/CN=RECIPIENTS/CN=Michael Killeavycc3]; Barbara Ellard [/O=IMO/OU=EXCHANGE ADMINISTRATIVE GROUP (FYDIBOHF23SPDLT)/CN=RECIPIENTS/CN=Ellardb]; JoAnne Butler [/O=IMO/OU=EXCHANGE ADMINISTRATIVE GROUP (FYDIBOHF23SPDLT)/CN=RECIPIENTS/CN=JoAnne Butlercd3]
CC: Tom Chapman [/O=IMO/OU=EXCHANGE ADMINISTRATIVE GROUP (FYDIBOHF23SPDLT)/CN=RECIPIENTS/CN=Chapmant]
Subject: RE: Messaging for meeting with Alan H
Attachments: Considerations Around Contract Extensions_January 25 2016 EM.docx

Attached are my changes.

Emanuel

From: Jordan Penic
Sent: January 24, 2017 11:50 PM
To: Michael Killeavy; Emanuel Movchovitch; Barbara Ellard; JoAnne Butler
Cc: Tom Chapman
Subject: RE: Messaging for meeting with Alan H

Good evening,

As discussed late today, please find attached for your consideration a draft note that could be passed along to the Ministry and Alan H at tomorrow's briefing. I have attempted to include the information that each of you have provided throughout the day.

See you at 9:00.

Cheers,

Jordan

From: Michael Killeavy
Sent: January 24, 2017 7:03 PM
To: Emanuel Movchovitch; Barbara Ellard; Jordan Penic; JoAnne Butler
Cc: Tom Chapman
Subject: Re: Messaging for meeting with Alan H

I think this makes sense.

Sent from my BlackBerry 10 smartphone on the Rogers network.

From: Emanuel Movchovitch
Sent: Tuesday, January 24, 2017 6:48 PM
To: Barbara Ellard; Michael Killeavy; Jordan Penic; JoAnne Butler
Cc: Tom Chapman
Subject: Re: Messaging for meeting with Alan H

See my comments in red below. I think we should start off stating that we are talking about crumbs here even if we only look at the financial perspective. The risk considerations and the opportunity loss to create significant future savings lead us to suggest that this is not a good idea.

From: Barbara Ellard
Sent: Tuesday, January 24, 2017 5:20 PM
To: Michael Killeavy; Jordan Penic; JoAnne Butler; Emanuel Movchovitch
Cc: Tom Chapman
Subject: RE: Messaging for meeting with Alan H

My edits in blue on top of MK's version.

Jordan, should we address their gas proposal too and how that could cause operability and reliability issues?

Barbara

From: Michael Killeavy
Sent: January 24, 2017 4:59 PM
To: Jordan Penic; JoAnne Butler; Emanuel Movchovitch; Barbara Ellard
Subject: RE: Messaging for meeting with Alan H

Here's my mark up, in blackline, below.

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From: Jordan Penic
Sent: January 24, 2017 11:04 AM
To: JoAnne Butler; Emanuel Movchovitch; George Pessione; Michael Killeavy
Subject: Messaging for meeting with Alan H

Hi,

Here is a first draft. I have to run out for a meeting, but can revise again later this afternoon with further input form the group. It may be helpful to identify who on the IESO team will respond to questions on particular topics. For example, Barb re Market Renewal, etc.)

-Jordan

Approach:

- IESO to bring in material for discussion and provide content, as required throughout discussion
- Discussion about option of extending contracts to be positioned as a consideration that IESO has had in the past, seemed to make sense on first blush. But as details were considered around negotiations and impact on broader sector, IESO found that the drawback outweighed the benefits.

Key Messages:

- Extending contracts was an idea considered by the IESO as we evaluated rate mitigation options recently. After evaluating the impacts of extending contracts we ultimately came to the conclusion that ~~there were better options to mitigate rates. [NTD: what are those options?]~~ the benefits (cost reductions) are small, while the risks and opportunity future opportunity losses are significant.

- As an example, a simple extension of a 20 year fit wind contract by 10 yeas, while keeping all assumptions the same and only varying the price to get a proponent to the same IRR, leads to a 5% reduction in price
- However, our negotiating experience tells us that this is an unlikely scenario and suppliers would be estimating increased maintenance and capital costs in the additional 10 years, reduced equipment reliability and increased IRR expectation to cover additional risks. Therefore our estimates show that the likely decrease in price would be less than 1 to 2% and therefore likely immaterial (to put things in perspective, all of wind generation in 2016 amounted to 9TWh and cost approximately $1Billion. The savings even at 5% would be $50 million per year)
- This does not include the IESO costs of renegotiating agreements or costs for suppliers to renegotiate their agreements, including secured lender agreements, therefore most likely wiping out any savings from this plan
- The risks however are significant, including lost opportunities to create future savings for ratepayers, as further explained below

- We determined that contract extensions were problematic for a number of reasons, including:
    - **It will take longer than expected:** Negotiations will likely be lengthy given their complex nature and numbers of parties involved and our experience to date with renegotiating contracts suggests that we're looking at about a year and a half to two years before the discussions are complete (i.e. renewable integration). Additional staff, technical consultants, and legal counsel will need to be marshalled to undertake such an effort ~~[There are a number of points we could include here, but I have picked a couple that seemed to resonate the most – adjust as required. I expect we'll get into more detail as the conversation progresses]~~
    - Negotiations will be multi-party since there are secured lenders with a security interest in the contracts and any secured lender needs to agree to any such amendment. Credit agreements will need to be opened up and renegotiated, too, which results in a multiplicity of contract negotiations that will need to take place
    - Negotiations could very likely result in the ratepayer taking on more risk as counterparties will attempt to improve their position by transferring as much risk as they can get away with
    - Negotiations will likely result in a checkerboard of different amendments, i.e., one size will not fit all, changing the fundamental nature of the standard offer FIT program, which will increase contract administration costs
    - Significant reputational risk for the IESO in having to open up so many contracts, which could impact its ability to administer and enforce its other contracts
    - Potential weakening of investor confidence, which will spill over into other infrastructure sectors
    - We would be locking in technological obsolescence by extending the contracts and foregoing innovation

    - **Risk of additional costs:** The contract counterparties are business people and will naturally attempt to extract additional benefits or value.
        - IESO will have a very weak bargaining position. This position could be further weakened if there are public commitments made to this course of action;
        - Counterparties will demand to be kept whole. Extending the operational life will likely mean increased CAPEX. OPEX will necessarily increase as facilities age. Counterparties will need to recoup incremental CAPEX and OPEX through the price and earn a return on any new investments;

        - ~~The opportunity for reduction is limited as counterparties have costs to service and a reduction is only possible with respect to their profit margin [NTD: Tom, Emanuel, I am trying to pick up the points from our conversation, not sure I got the terminology right] In the end, this means that the opportunity for savings may not be as significant as first expected~~

    - ~~[As above - there are several points we could include here, but I have picked a couple that seemed to resonate the most – adjust as required. I expect we'll get into more detail as the conversation progresses]~~
    - The resource requirements of such an initiative will be quite significant – additional staff, technical consultants, and legal counsel will need to be marshalled to undertake such an effort

- Ratepayers would be on the hook for any refinancing costs including the legal and technical costs associated with renegotiation of financing deals
- **Opportunity Cost:** One of the main reasons that IESO went in a different direction was because there are better options available to ratepayers and the sector that will help address the fundamental issues that drive consumer costs – in particular, the *Market Renewal* project seeks to address these issues. If contracts are extended, the potential ratepayers benefits of this project would decrease.

- **Market Renewal:**
  - The objective of the *Market Renewal Project* is to achieve material efficiencies in the near and longer term and introduce competitive mechanisms to meet system needs to achieve cost savings for the ratepayer.
  - Preliminary estimates suggest that the Market Renewal project could find efficiencies greater than $3.5 billion, with a significant portion of those savings coming from re-committing existing assets at lower costs through a competitive transparent auction process.
  - One of the three main initiatives of the project would be to implement a capacity auction to acquire Ontario's future capacity needs. The IESO recently implemented a similar mechanism for DR that has helped to reduce the cost of DR by about 20-30 percent compared to the original contracts – and we've seen new technologies and entrants into the sector as a result. We expect a comparable level of cost savings and innovative solutions from a broader capacity auction. Extending contracts would negate any potential benefits from an auction process.
  - By extending contracts, these benefits and reforms would be lost for Ontario ratepayers. We would be locking in resources and technologies that may not be needed in the future and we will be foregoing for innovation to drive the costs down in the future

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