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: Alexander De Angelis
Manager, Enterprise Risk & Corporate Performance

Date: November 22, 2017

Re: Fair Hydro Plan – Risk Update

The government of Ontario passed legislation - the Ontario Fair Hydro Plan Act, 2017 ("Ontario Fair Hydro Plan"), - that lowers electricity bills by 25 per cent on average for all residential customers and other specified consumers. The Ontario Fair Hydro Plan 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 Ontario Fair Hydro Plan, the IESO is potentially subject to reputational, financial, resourcing, financial reporting and legal risks. In May 2017, risks were identified through an internal process, culminating into a single enterprise level 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. Risk updates were provided to the Audit Committee in May 2017 and Board of Directors in July 2017 respectively.

Appendix A presents an update to the identified risks, their assessed impact and likelihood, including the IESO actions towards mitigation that have evolved since the last risk update in July 2017. The results of both the November and July 2017 assessments are included in the heat maps presented in **Appendix B** to demonstrate any movement in the risks since the last risk update.

The movement in risks is caused by the movement from the design to the implementation of the Ontario Fair Hydro Plan. Notable changes include closing the risks related to the IESO's ability to achieve appropriate terms for the Master Transfer and Servicing Agreement and the OSC rescinding the IESO's transmission rights exemption. However, five new risks were identified (please refer to risks 11 to 15 in **Appendix A**) due to the IESO entering into the agreements necessary to enable the transfer of the IESO's regulatory asset to the financing entity.

The IESO has taken action towards mitigating the aspects of the risks that are within its control which support a reduction in the likelihood of the risks, however, residual risk remains that is beyond the IESO's control.

As noted in the November 22 heat map in **Appendix B**, 3 risks have a higher level of residual risk and merit discussion with the board:

1. Accounting treatment for Ontario Fair Hydro Plan is disputed
2. A change in government policy changes some or all of the terms of the Ontario Fair Hydro Plan
3. LDCs have challenges meeting the requirements under the OFHP program (legislation, regulation, MTSA) requiring the IESO to provide more guidance than originally anticipated

The IESO will continue to take the appropriate actions to support the management of the risks. The IESO will continue to monitor and identify new risks if they arise, assess their impact, determine the appropriate mitigation plans required and report risk updates to the Board of Directors.

Appendix A – IESO Risks Related to the Ontario Fair Hydro Plan

<table>
<tr><td colspan="6"><u>Enterprise Risk</u>: The structure proposed for the Ontario Fair Hydro Plan is abandoned or fails, either in whole or in part</td></tr>
<tr><td colspan="6">Risk Register</td></tr>
<tr><th>#</th><th>IESO Risk</th><th>Impact</th><th>Likelihood</th><th>Identified Impacts</th><th>IESO Actions Towards Mitigation</th></tr>
<tr><td>1</td><td>OPG financing entity does not purchase regulatory asset in whole or in part from IESO</td><td>Significant</td><td>Unlikely</td><td>- 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</td><td>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 is working with the Ministry of Energy to obtain an agreement to fund the IESO if required to permit the IESO to pay its liabilities as they become due.</td></tr>
<tr><td>2</td><td>A change in government policy changes some or all of the terms of the Ontario Fair Hydro Plan</td><td>Significant</td><td>Somewhat Likely</td><td>- unknown - depends on terms of changes</td><td>Proactively provide advice on consequences of any action taken to change terms of Fair Hydro Plan.
IESO has an indemnity agreement from the Province if liability is incurred relating to implementation of Fair Hydro.</td></tr>
<tr><td>3</td><td>IESO is unable to provide the standard representations and warranties and legal opinions (valid sale, all necessary</td><td>Low</td><td>Somewhat Likely</td><td>- may result in higher cost for the overall plan due to higher financing costs with consequent concern to</td><td>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</td></tr>
</table>

Enterprise 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**	**Likelihood**	**Identified Impacts**	**IESO Actions Towards Mitigation**
	approvals, etc.) due to nature of asset and underlying legislation - i.e. opinion, and representations and warranties are qualified			government	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				**Closed July 2017**
5	Inability to achieve appropriate terms for the Master Transfer and Servicing Agreement between IESO and financing entity				**Closed November 2017**
6	Ontario Securities Commission (OSC) rescinds transmission rights (TR) exemption due to IESO's role under the Ontario Fair Hydro Plan				**Closed November 2017**
7	The IESO is named a party of the US prospectus or required to be a signatory to underwriting agreement due to the IESO being the regulatory asset originator	Low	Likely	- financial risk - legal risk - reputational risk	IESO has received government indemnities for IESO Corporate, directors, officers and employees. Electricity Act, section 19 also 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	Negligible	Unlikely	- financial statement audit risk - increased workload in an environment where it is	The IESO has advocated using existing systems and processes and not layering additional processes. The financing entity has agreed to fund IESO's incremental direct costs for

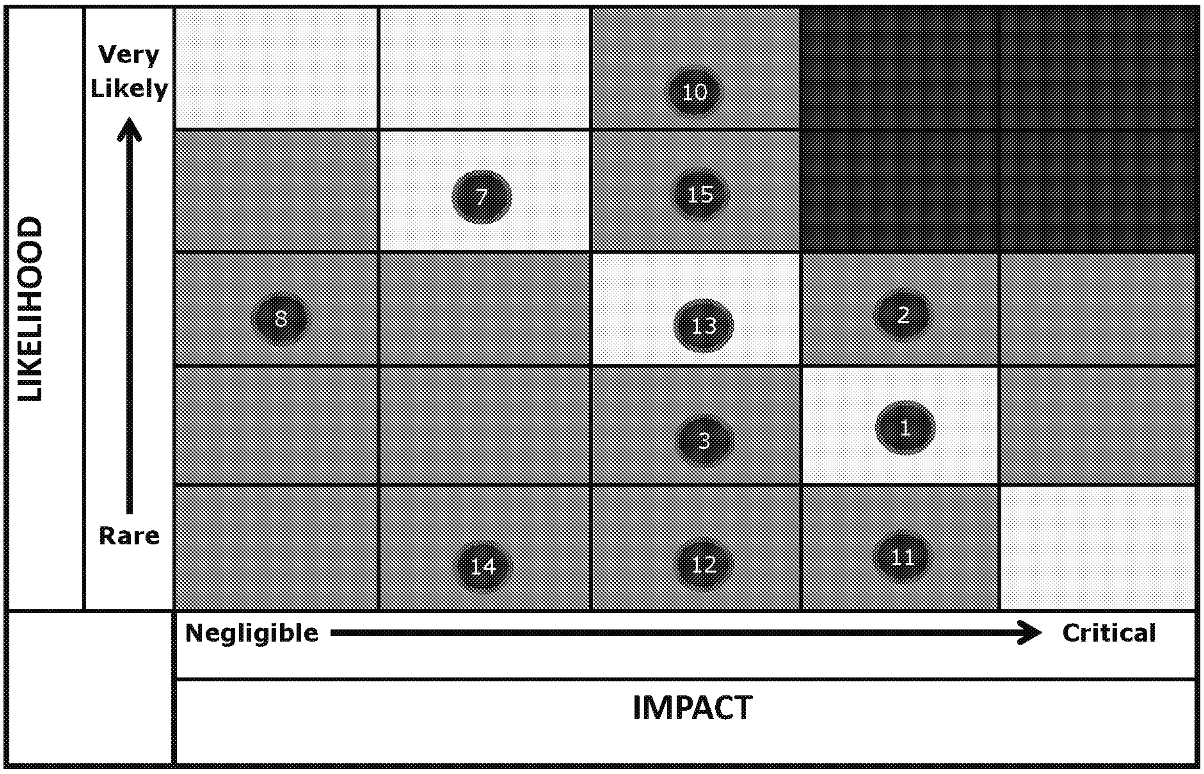
<u>Enterprise Risk</u>: The structure proposed for the Ontario Fair Hydro Plan is abandoned or fails, either in whole or in part					
Risk Register					
#	**IESO Risk**	**Impact**	**Likelihood**	**Identified Impacts**	**IESO Actions Towards Mitigation**
				difficult to increase resources - increased operational cost	providing the services under the Master Transfer and Servicing Agreement.
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>Closed July 2017</u>**
10	Accounting treatment for Ontario Fair Hydro Plan is disputed	Moderate	Very Likely	- use of rate - regulated accounting continues to be a point of contention - increased demands on IESO resources - negative reputational impact on the IESO	Legislation and regulations are completed. The accounting for the creation of the regulatory asset is consistent with current accounting practices and is supported by the opinions of KPMG. IESO's Board of Directors provided a response to the Auditor General's office.
11	The IESO provides security to the financing entity that it has priority over IESO receivables	Significant	Rare	- negative reputational impact on the IESO - Increased workload and operational cost	Continued support by Ontario Financing Authority for credit; and IESO's provincial indemnity/support letter IESO's ability to provide the security is supported by legal advice of internal and external counsel.
12	IESO is non-compliant with the terms of the Master Transfer	Moderate	Rare	- legal risk - reputational risk	IESO will implement processes and controls to manage this risk. IESO can hire contractors to provide

<u>Enterprise Risk</u>: The structure proposed for the Ontario Fair Hydro Plan is abandoned or fails, either in whole or in part					
Risk Register					
#	**IESO Risk**	**Impact**	**Likelihood**	**Identified Impacts**	**IESO Actions Towards Mitigation**
	Servicing Agreement				IESO support. IESO has an indemnity agreement from the Province if liability is incurred relating to the implementation of Fair Hydro.
13	IESO's role under the OFHP Act is misunderstood by affected parties (Financing entity, dealers, rating agencies, investors, LDCs etc.)	Moderate	Somewhat Likely	- legal risk - reputational risk	We consistently expressed in discussions and negotiations, and have reflected in agreements, the roles and responsibilities of the IESO as it pertains to OFHP Act to ensure they are well understood by all parties.
14	Lending facilities for corporate and IESO administered markets are unwilling to update lending agreement due to security priority and Master Transfer and Service Agreement with the Financing Entity	Low	Rare	- reputational risk - increased costs - potential credit downgrade	Substitute lending facilities with OFA/OEFC or other commercial bank lender. Incur higher fees and interest costs until 2021 to compensate bank for IESO risk.
15	LDCs have challenges meeting the	Moderate	Likely	- Increased workload and operational	IESO is proactively addressing the requirement challenges through

<u>Enterprise Risk</u>: The structure proposed for the Ontario Fair Hydro Plan is abandoned or fails, either in whole or in part					
Risk Register					
#	**IESO Risk**	**Impact**	**Likelihood**	**Identified Impacts**	**IESO Actions Towards Mitigation**
	requirements under the OFHP program (legislation, regulation, MTSA) requiring the IESO to provide more guidance than originally anticipated			cost - reputational risk	communicating with the Ministry, OEB and LDCs well in advance of the CEA remittance to address invoicing, submissions and reporting challenges providing guidance and support as required.

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

Heat Map as of November 22, 2017



Heat Map as of July 25, 2017