THE $6.2 BILLION SLEIGHT-OF-HAND

Parker Gallant is a retired banker who has done tremendous service to the people of Ontario by reporting publicly on the Ontario government's mismanagement of the province's electrical energy system. In an analysis he posted on April 11, 2014, Mr. Gallant applied his knowledge of financial management and accounting to reveal the damaging and possibly illegal actions of the Liberal government with respect to the Debt Retirement Charge included in the monthly electricity bills of Ontario residents. The analysis can be found online here:

http://ep.probeinternational.org/2014/04/11/parker-gallant-the-debt-retirement-charge-premier-wynnes-6-2-billion-revenue-tool-5/#more-12245

This note offers my explanation, in layperson's terms, of what Mr. Gallant revealed.

Background

In 1998 the Ontario government launched a major restructuring of the province's publicly-owned electricity industry. One aspect of this restructuring was the breakup of Ontario Hydro into five successor companies on April 1, 1999.

The Ontario Ministry of Finance determined that, on April 1, 1999, Ontario Hydro's total debt and other liabilities stood at $38.1 billion, which greatly exceeded the estimated $17.2 billion market value of the assets being transferred to the new entities. The resulting shortfall of $20.9 billion was determined to be "stranded debt", representing the total debt and other liabilities of Ontario Hydro that the Ministry judged could not be serviced in "a competitive electricity environment". This total was subsequently reduced to $19.4 billion when it was adjusted for $1.5 billion of additional assets transferred to OEFC. Responsibility for servicing and managing the "legacy" debt of Ontario Hydro, which includes the stranded debt, was given to the Ontario Electricity Financial Corporation (OEFC), whose opening balance sheet reflected a stranded debt, or unfunded liability, of $19.4 billion. This was the difference between the $18.7 billion value of assets assumed by the OEFC and the $38.1 billion of Ontario Hydro legacy debt.

To retire the debt, the government established a long-term plan wherein the burden of debt repayment would be borne partly through dedicated revenues from the electricity sector companies – Ontario Power Generation (OPG), Hydro One, and Municipal Electrical Utilities – and partly by electricity consumers directly. (Bear in mind that all the revenues from the electricity sector companies come from electricity consumers, so electricity consumers pay all the costs, one way or the other.). The electricity companies would make "payments in lieu of taxes" to the OEFC (this is, in theory, the equivalent of corporate income taxes). It was projected that future revenues from OPG and Hydro One and municipal electricity distributors would generate $11.6 billion over the next eight to nine years.

To recap:

Total Stranded Debt:	$20.9 billion
Less: Additional Assets	$1.5 billion
Net Stranded Debt	$19.4 billion
Less: Future earnings & IPL	$11.6 billion
Residual Stranded Debt	$7.8 billion

The charge on electricity ratepayers was called the Debt Retirement Charge (DRC), as authorized by the *Electricity Act, 1998*. This was to be paid by electricity consumers until the residual stranded debt was retired. The debt retirement charge has been collected from ratepayers since May 1, 2002. The rate of the charge was established at 0.7 cents per kWh of electricity and remains the same today. Currently, the OEFC collects more than $900 million a year in DRC revenues from ratepayers.

In announcing the DRC in 2000, the then Minister of Energy made the following statement:

"All revenues from the DRC will go directly to the Ontario Electricity Financial Corporation to be used exclusively to service the residual stranded debt. Once the residual stranded debt has been retired, the DRC will end."

The 2011 report of the provincial Auditor General noted that, despite the fact that significant funds had already been collected via the DRC, the province gave no indication of when the residual stranded debt would be paid off and when the DRC would end. The Auditor General's report stated:

"*Our view is that the Minister should make a formal determination of the outstanding amount of the residual stranded debt in the near future and make this determination public."*

The Ontario Minister of Finance had included a report in the 2012 Ontario Economic Outlook and the 2013 Budget on the residual stranded debt. The Budget report revealed that the debt was $4.5 billion at March 31, 2012. The report gave no explanation or commitment as to when the debt would be fully paid and the DRC charge removed.

<u>Parker Gallant's Findings</u>

Parker Gallant's research found that the action taken by the Ontario Treasury Minister in response to the Auditor Genera's 2011 audit was to arbitrarily backdate and revise the revenue streams resulting from payments from OPG, Hydro One and municipal utilities, reducing them by $4.4 billion for the year ended March 31, 2004 and $1.8 billion for the year ended March 31, 2011. This had the effect of increasing the residual stranded debt by $6.2 billion, from $7.8 billion to $15.0 billion, and extending the period the DRC would remain on ratepayers' bills. Those adjustments were made in Finance Minister Dwight Duncan's 2012 budget, effectively rewriting the Province's financial history!

In fact, how much has been collected by the province so far to address the residual stranded debt? According to the 2012 Budget, since March 31, 1999, "future earnings and IPL" have generated "excess revenue" of $10.9 billion. The $10.9 billion is "excess" to the $520 million in annual interest ($6.8 billion in interest since 2000) costs on the $8.9 billion that the province owes OEFC for the price of acquisition of OPG and Hydro One. OEFC annual reports show that, up to March 31, 2012, it had collected $12.8 billion as a result of the debt retirement charge. The total collected to the end of March, 2012, was thus ($10.9 billion plus $12.8 billion) $23.7 billion.

In Finance Minister Sousa's 2013 fall Update, the Minister acknowledged that the "future earnings and IPL" and DRC revenues together had generated revenues of $24.7 billion, yet had only reduced the residual stranded debt to $11.3 billion.

In other words, to the fall of 2013, $24.7 billion had been collected to repay the original stranded debt of $19.4 billion, yet $11.3 billion remains to be paid!

<u>What's Going On?</u>

It would probably take a full review by the Auditor General and/or an investigation by a legislative committee to fully explain what happened that led to the present situation.

Parker Gallant had done an admirable job of examining some of the details in his analysis. One element of the drama, however, is that the Ontario government appears to have acted contrary to the requirements of the *Electricity Act, 1998*, which, under part 62, "Use of revenues", states:

"Despite the Financial Administration Act, the revenues received by the Financial Corporation (OEFC) do not form part of the Consolidated Revenue Fund and shall be used by the Corporation for the purpose of carrying out its objects."

They were not. Parker Gallant cites two examples. Since 2008, the province has delayed in paying $500 million per year in "excess revenue". The total excess revenue owing was $2.8 billion by the end of March, 2012. Both the revenue and the interest costs on it should have been paid to the OEFC by the Ministry of Finance instead of by the ratepayers. In addition, Hydro One has paid $1.2 billion in dividends to the province since 2008 but it would appear that, instead of passing those funds to the OEFC, the Ministry of Finance simply used them as part of the Consolidated Revenue Fund. Why has the Finance Ministry ignored the Act?

Considerable mystery surrounds the $6.2 billion in adjustments to the residual stranded debt made retroactively by the government. What caused this? Some potential explanations are that these were extra costs imposed upon OPG through Liberal government policy decisions, including:

- Directives to OPG to build “Big Becky”, the hydro project at Niagara Falls ($1.5 billion), convert the Atikokan coal plant to biomass ($170 million), and proceed with the $2.6 billion Mattagami project
- Directives consistent with the *Green Energy and Economy Act* forcing OPG to close coal plants (negative impact $473 million) and to contract for billions of dollars of wind and solar energy, at a time when the province already has surplus generating capacity
- Giving renewable energy sources “first rights to the grid” in preference to the power generation sources owned by OPG, thus forcing OPG to spill hydro and curtail production from other plants without compensation

As the result of policy directives, it is arguable that these initiatives should have been funded by taxpayers rather than being transferred to electricity ratepayers through the “back door” of transferring costs to OPG and thus reducing the funds available to pay off the residual stranded debt. Increasing electricity bills is far more regressive than raising income taxes, as the costs fall far more heavily on those with low or fixed incomes who must pay heating costs.

Finally, the residual stranded debt, however mysteriously calculated, still stands at $11.3 billion. It may take many more years before electricity ratepayers are finally freed from an expense originally rationalized by the sale of Ontario Hydro, but now driven by an opaque policy agenda.