

Ontario's "Fair Hydro Plan" changes provincial electricity pricing and expands opportunities for behind-the-fence generation

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In this Update

- On March 2, 2017, the Government of Ontario released highlights of its "Fair Hydro Plan" (the Plan), significantly reducing the price of electricity for many groups in Ontario and expanding opportunities for the development of behind-the-fence generation.
- The most significant element of the Plan is a 25% reduction in electricity bills for households, small businesses and farms, to be achieved through an effective refinancing of the Global Adjustment charge, as well as effectively removing the 8% provincial portion of the HST from electricity bills.
- As part of the Plan, it has also been reported that the eligibility threshold for the Industrial Conservation Initiative (ICI), which allows certain non-residential users that conserve or self-generate during peak hours to significantly reduce their electricity costs, has been lowered from a minimum peak load requirement of 1 MW to 0.5 MW for many industries.
- The Plan presents new opportunities for participation in ICI based on its expanded eligibility, both for newly eligible customers and third-party developers partnering with these customers.
- The Plan is also mostly good news for existing ICI participants, as it preserves the value of capital investments made by participants in behind-the-fence generation and other conservation initiatives, although expanded participation in ICI may make it more difficult for participants to forecast peak hours.

On March 2, 2017, the Government of Ontario released highlights of its "Fair Hydro Plan" (the Plan), significantly reducing the price of electricity for many groups in Ontario and expanding opportunities for the development of behind-the-fence generation. The most significant element of the Plan is a 25% reduction in electricity bills for households, small businesses and farms. This reduction is essentially fixed for a period of four years, subject to inflation. As part of the Plan, it has also been reported that the eligibility threshold for certain non-residential electricity customers to participate in the Industrial Conservation Initiative (ICI) has been lowered from a minimum peak load requirement of 1 MW to 0.5 MW for many industries. The ICI program allows industrial customers that meet the eligibility requirements to substantially reduce their electricity bills if they are not consuming power from the grid during peak hours of the year by reducing their share of the Global Adjustment charge. The Plan is mostly good news for existing ICI participants, and presents new opportunities for

participation in the program, either by newly eligible loads or third-party developers partnering with these customers.

The Plan contains a number of other elements, including enhancements to the Ontario Electricity Support Program, which discount electricity bills for low-income electricity consumers as well as Indigenous customers; removal of the delivery charge for on-reserve First Nations residential customers; a new tax credit for low-to-moderate income families and seniors; a northern Ontario energy credit; and increased funding for the saveONenergy Home Assistance Program.

As it relates to residential, small business and farm electricity consumers, the Plan also features an effective refinancing of the Independent Electricity System Operator's long-term contractual payment obligations resulting from electricity resource procurements, conservation initiatives and other electricity sector programs and costs. These "non-commodity" costs, known as the "Global Adjustment" (GA), make up an increasingly large portion of the ultimate consumer rate for electricity in Ontario. While intended to provide immediate relief to consumers affected by increases in electricity rates, this refinancing (by way of a debt or variance account funding mechanism supported by the government-owned Ontario Power Generation, the details of which are yet to be fully set out) will extend the duration and ultimate total cost of the long-term financial obligations that are determining electricity rates as of today.

The Plan will be further detailed in implementing legislation and regulation that the Government of Ontario has stated is to be in place for the summer of 2017.

Near-term rate reduction for regulated price plan participants

The Plan includes a series of new support measures directed at the reduction of residential electricity costs and which are to be funded directly by the provincial treasury, rather than by electricity ratepayers through rates. These measures include:

- a new "Affordability Fund," which will provide certain customers who cannot qualify for other programs with financial assistance to undertake energy-efficiency improvements;
- enhancements to the Ontario Electricity Support Program (which provides rebates for low-income electricity customers);
- expansion of the Rural or Remote Rate Protection (RRRP) program (reducing the delivery charge for customers of specified local distribution companies with the highest delivery costs); and
- a First Nations On-Reserve Delivery Credit (eliminating the delivery charge for all on-reserve First Nations households).

Importantly, programs such as these have until now been included in the GA and borne by electricity ratepayers. The Plan indicates that the costs of all of these initiatives, representing an estimated \$2.5 billion over three years, are to be funded by the provincial treasury rather than by Ontario electricity users.

In addition to enhancing and provincially funding the support mechanisms described above, the Plan describes a "refinancing" of the portion of the GA borne by residential, small business and farm customers. This is to be accomplished by effectively shifting electricity ratepayer impact of power sector contractual obligations over a longer period of time, on the basis of an assumed longer useful life of the assets that are the subject of these obligations, relative to the remaining terms of their contracts. This will be implemented by financing a

portion of these costs with funds being made available by the province. The financing costs for this “smoothing” or refinancing will ultimately be incorporated in the GA in the future. The Government of Ontario estimates this mechanism can result in a GA reduction of \$2.5 billion per year on average over the first 10 years, with annual interest costs not exceeding \$1.4 billion. In addition to this mechanism, effective January 1, 2017, the 8% provincial portion of the harmonized sales tax has been effectively removed from electricity bills for residential, small business and farm customers in Ontario, through the introduction of a new off-setting credit.

Expanded opportunities for behind-the-fence generation

ICI overview

While most consumers pay GA on a volumetric basis (i.e., based on the number of kilowatt-hours they consume), participants in ICI pay GA based on their percentage contribution to the five peak Ontario demand hours over a 12-month period. By reducing their demand or by self-generating using behind-the-fence generation during peak hours, ICI participants can significantly reduce their electricity bills. If they manage to avoid drawing any power from the grid during the peak hours, they are effectively exempt from paying GA for the next year. Given that GA makes up the majority component of many industrial users’ electricity bills, this presents a very significant opportunity to reduce electricity costs.

While it is impossible to know for certain when the peak hours will occur, it is possible to make an educated guess based on the time of year (typically summer, but occasionally winter), day of the week, and the time of day when demand has historically peaked (usually mid-to-late afternoon). By combining this information with weather forecasts, which are good indicators of expected heating or cooling electrical load, it is possible to forecast the peak days with reasonable accuracy. While many industrial consumers have a limited ability to conserve or shift demand during forecasted peaks without affecting their production, they can significantly reduce or eliminate their draw of electricity from the grid on peak days through the use of behind-the-fence generation. This creates a significant reduction or elimination of their GA expense for the following year.

Opportunities for new participants

When ICI was first introduced in 2010, it applied to consumers with a peak demand greater than 5 MW. It was then lowered to 3 MW, and before the March 2 announcement, the eligibility threshold was to be lowered to 1 MW. Now, the new lower eligibility of 0.5 MW greatly expands the number of eligible participants, although we understand that participants in the 0.5 – 1 MW range are required to be in certain industries identified by their North American Industry Classification System (NAICS) code. We expect the eligible industries to be refrigerated warehousing, mining, quarrying, oil and gas extraction, manufacturing, data processing, data hosting, greenhouses, nurseries and floriculture production.

Implications for existing participants

Existing participants in ICI who invested capital in behind-the-fence generation or other conservation initiatives and have multi-year payback periods have taken on the regulatory risk associated with the ICI program. Two of the key risks to existing participants is a change to ICI eligibility that makes them no longer eligible, and a fundamental change to the cost structure of electricity (such as GA) that either significantly reduces the value of the ICI program or renders it irrelevant. For months, political pressure has been building on the

government to take action on rising electricity bills. Given that the majority of the bill increases are being driven by the increased GA, there was a concern that a major policy change could significantly undermine the value of ICI. For those participants who had invested capital to participate in ICI, this created a risk of stranded assets. The government has now taken a clear policy direction on electricity pricing, and the good news for existing ICI participants is that it has not undermined the value of their investment. While there are never any guarantees of policy stability, least of all in the Ontario electricity sector, now that ICI has survived this policy shift, there may be some period of stability in electricity pricing that should facilitate further investments in reliance on the now expanded ICI program. Even though Ontario is scheduled for a general election in spring 2018, the policy direction taken by the current government will be difficult, although not impossible, for a successive government to unwind.

It is not all good news for existing participants. The expanded eligibility for ICI means there will be more industrial customers “chasing the peaks.” This means when a day looks like it might contain a peak hour, there will be an increased number of customers firing up their behind-the-fence generators and taking other conservation initiatives, which will flatten out the load on that day. In some cases, as a result of this conservation and behind-the-fence generation, the day will not turn out to have a peak hour. While this is one of the objectives of the ICI program, to shave peaks, as more and more participants react to potential peaks, the peaks will get harder to forecast. Participants in ICI will need to run their behind-the-fence generators more often and chase more potential peak days, in order to ensure they capture the five peak demand hours in the province.