



ONTARIO ENERGY BOARD

FILE NO.: EB-2010-0046

VOLUME: 1

DATE: April 25, 2011

BEFORE:	Karen Taylor	Presiding Member
	Marika Hare	Member

THE ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B);

AND IN THE MATTER OF the Independent Electricity System Operator Fiscal 2011 Fees Submission for Review.

Hearing held at 2300 Yonge Street,
25th Floor, Toronto, Ontario,
on Monday, April 25th, 2011,
commencing at 10:04 a.m.

VOLUME 1

BEFORE:

KAREN TAYLOR	Presiding Member
MARIKA HARE	Member

A P P E A R A N C E S

KRISTI SEBALJ	Board Counsel
ROBERT CAPUTO	Board Staff
LEILA AZAIEZ	
DAVID RICHMOND	
GLENN ZACHER	Independent Electricity System
PATRICK DUFFY	Operator (IESO)
MICHAEL BUONAGURO	Vulnerable Energy Consumers
	Coalition (VECC)
SHELLEY GRICE	Association of Major Power
	Consumers of Ontario (AMPCO)
VINCE DeROSE	Canadian Manufacturers & Exporters
	(CME)
DAVID BARR	Ontario Power Generation (OPA)
ALSO PRESENT:	
SUSAN NICHOLSON	Independent Electricity System
BRIAN RIVARD	Operator (IESO)
TERRY YOUNG	
BIJU GOPI	

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NO UNDERTAKINGS WERE FILED IN THIS PROCEEDING

1 Monday, April 25, 2011

2 --- On commencing at 10:04 a.m.

3 MS. TAYLOR: Please be seated.

4 Good morning. My name is Karen Taylor, and sitting
5 with me today is Marika Hare. The Board has convened today
6 on the matter of an application filed on November 2nd, 2010
7 by the Independent Electricity System Operator, the IESO,
8 for review by the Board pursuant to sections 18 and 19 of
9 the Electricity Act with respect to the IESO's fiscal 2011
10 fees. The Board has assigned docket EB-2010-0046 to this
11 review.

12 The Board issued a notice of application on December
13 3rd, 2010 and issued Procedural Order No. 1 on January
14 18th, 2011, which included a draft issues list.

15 On February 11th, 2011, the Board issued a decision
16 and order that included a Board-approved issues list, and a
17 technical conference relating to the application was held
18 on February 18th.

19 A settlement conference was held on March 8th, and on
20 March 16th, 2011 the IESO filed a settlement proposal based
21 on the agreements reached at the settlement conference.

22 The parties to the settlement proposal are the IESO,
23 the Association of Major Power Consumers in Ontario, or
24 AMPCO, Energy Probe Research Foundation or Energy Probe,
25 the Canadian Manufacturers & Exporters, or CME, and the
26 Vulnerable Energy Consumers Coalition, or VECC.

27 The settlement proposal indicates that parties have
28 agreed to a settlement on all issues, with the exception of

1 issue 3.3 which reads:

2 "Is the IESO's proposal for the treatment of its
3 2010 accumulated operating surplus appropriate
4 and reasonable?"

5 The Board issued a procedural order on April 5th
6 setting down today as the date on which the Board would
7 hear parties present the settlement proposal, with a
8 specific focus on issue 5.3 and to hear submissions from
9 parties regarding issue 3.3.

10 With respect to the logistics of this hearing, we will
11 first hear parties present on the settlement proposal and
12 answer the questions on the settlement proposal the Panel
13 may have.

14 We will then take a short break, during which the
15 Panel will consider whether or not to accept the settlement
16 proposal.

17 We will then return to hear any settled issues of
18 concern to the Board, and hear submissions from parties on
19 issue 3.3.

20 Please be aware that depending on the nature of
21 submissions, the Panel may choose to render an oral
22 decision on issue 3.3 after an appropriate break today.

23 May I have appearances, please?

24 **APPEARANCES:**

25 MR. ZACHER: Good morning, Madam Chair, Ms. Hare. My
26 name is Glenn Zacher and I am appearing as counsel for the
27 IESO. With me is my colleague Patrick Duffy, and as well
28 from the IESO to my left is Susan Nicholson, who is the

1 IESO's corporate controller, and to the right of Mr. Duffy
2 is Brian Rivard, who is the IESO's manager of regulatory
3 affairs.

4 I should just note, as well, that behind me is Terry
5 Young. Mr. Young is the IESO's VP of corporate relations,
6 along with Biju Gopi, who is a senior regulatory analyst.
7 Thank you.

8 MS. SEBALJ: Good morning, Panel. Kristi Sebalj for
9 Board Staff, and with me is the Board Staff team, which is
10 made up of Robert Caputo, Laila Azaiez and David Richmond.

11 MS. TAYLOR: Thank you.

12 MR. DeROSE: Good morning, Panel. Vince DeRose on
13 behalf of CME.

14 MR. BUONAGURO: Good morning. Michael Buonaguro for
15 VECC.

16 MS. GRICE: Good morning. Shelley Grice for AMPCO.

17 MS. TAYLOR: Ms. Grice.

18 MR. BARR: Good morning. David Barr with Ontario
19 Power Generation.

20 MS. TAYLOR: Okay. I think we have covered the bases.
21 Are there any preliminary matters? If not, then, Mr.
22 Zacher, would you like to begin?

23 **PRESENTATION OF SETTLEMENT AGREEMENT**

24 **SUBMISSIONS BY MR. ZACHER:**

25 MR. ZACHER: Thank you, Madam Chair.

26 So as I understand it, you would like us to walk
27 through the settlement proposal first, deal with that.

28 Let me first off say I will walk through some of the

1 background with regards to the settlement proposal. My
2 colleague, Mr. Duffy, has acted for the IESO with respect
3 to smart metering issues with respect to the recent licence
4 application and so I am not trying to duck any tough
5 questions, but he will be more adept at answering any
6 questions you have on that.

7 MS. TAYLOR: Okay.

8 MR. ZACHER: So by way of background, Madam Chair,
9 there was of course the Board's initial procedural order in
10 January. That established an issues list. That issues
11 list was then the subject matter of a technical conference,
12 which occurred in February.

13 At the technical conference, all of the intervenors, I
14 think, save for Ontario Power Generation, appeared. In
15 advance of that technical conference, a number of the
16 intervenors submitted questions on the issues list to the
17 IESO. Those questions were addressed at the technical
18 conference, in addition to other follow-up questions and
19 other inquiries that parties had about the issues.

20 The IESO had several panels of witnesses. In addition
21 to Ms. Nicholson and Mr. Rivard, there was also Mark
22 Wilson, who is the IESO's director of corporate planning;
23 Darren Finkbeiner, the IESO's manager of market
24 development; Bill Van Veghel, the IESO's manager of
25 compensation and benefits; and Rhonda Wright Hilbig, who is
26 the IESO's manager and responsible for the enhanced day-
27 ahead commitment project.

28 Following that technical conference that took the

1 better part of half a day, there was then a settlement
2 conference which occurred on March 8. Again, most of the
3 intervenors were present at that settlement conference.
4 The facilitator was Gail Morrison, and with Ms. Morrison's
5 assistance the parties succeeded in coming to a resolution
6 on all of the issues, with the exception of issue 3.3,
7 concerning the IESO's proposed treatment of the operating
8 surplus.

9 So the settlement was then documented in the
10 settlement proposal which was filed with the Board. That
11 is appended as Exhibit A -- or appendix A, rather, to the
12 written submissions we filed this past Thursday.

13 In my submission, it accords with the usual
14 requirements required of a settlement proposal, in that it
15 identifies all of the issues that the parties reached a
16 settlement on, and it provides a reference in the evidence
17 either to the IESO's business plan or to evidence from the
18 technical conference that supports the settlement of that
19 issue.

20 So I believe the IESO speaks for all of the
21 intervenors here in asking that the Board approve that
22 partial settlement proposal, subject to any questions you
23 may have on any parts of it, in particular the issue of
24 smart metering expenditures, which I understand you may
25 have some questions with respect to.

26 MS. TAYLOR: So why don't we proceed to looking at
27 issue 5.3 in the settlement as it relates to that issue?

28 MR. ZACHER: Okay. As I indicated, I will turn that

1 over to my colleague, Mr. Duffy.

2 **SUBMISSIONS BY MR. DUFFY:**

3 MR. DUFFY: Good morning, Panel. I understand you
4 have before you some materials that we filed in the SME
5 licence application. I know, Ms. Taylor, you presided at
6 that application, and so we wanted to give you a little bit
7 more background on what is happening with the SME.

8 And really it comes down to three points that I think
9 are of importance, the first one being that the SME costs
10 are tracked separately, and the time spent on SME matters
11 are tracked separately from IESO costs. So, therefore,
12 none of the expenditures that are at issue in this
13 proceeding relate to the SME.

14 The second is that the SME-related costs will be
15 recovered at a future date through a separate regulatory
16 charge, and its preliminary nickname at this point is the
17 smart metering charge, or SMC.

18 There has been some discussion, I know, in past IESO
19 fees cases about when the IESO will be seeking recovery of
20 those costs. It is important to understand that the IESO's
21 role as an SME is transitional in nature and that there
22 have been discussions over the past couple of years about
23 what the long-term governance of the SME role will look
24 like.

25 And in the past year, there has been an agreement that
26 eventually that role will transition to LDC control through
27 the EDA, and we expect that that transition will take place
28 when the IESO's role, which is effectively setting up the

1 MDM/R and bringing LDCs on to the MDM/R, is substantially
2 complete, which is expected to occur sometime around the
3 end of 2011.

4 Then at that point, about four million of the
5 4.6 million customers will eventually have smart meters,
6 will be enrolled and receiving service from the MDM/R.

7 And the third point is that the operations of the
8 MDM/R and the operations of the SME have been underway and
9 have been continuing separate from the governance
10 discussions over the past few years. And at this point, as
11 I mentioned, they are expecting to have four million of the
12 4.6 million customers on line by the end of the year.

13 And the SME is filing regular monthly reports with the
14 Board, detailing progress on getting to time-of-use rates
15 and getting -- I mean, an essential part of that is getting
16 LDCs on to the MDM/R.

17 So if there are any questions on any of that, I am
18 happy to take them. I have been involved, as I mentioned,
19 on council for the SME for the last few years, so I have
20 some -- I have kind of lived it through the years.

21 MS. TAYLOR: I believe Ms. Hare has questions.

22 MS. HARE: I think our concern in asking about this is
23 to ensure that there are adequate resources being devoted
24 to the SME, so that we don't later find out that if there
25 are any issues with the functionality and ability to meet
26 obligations, that it isn't because additional funds weren't
27 put in.

28 But if these costs are tracked separately, then it

1 would appear to me this may not be the case to actually
2 review that.

3 Is that -- I see lots of heads agreeing.

4 MR. DUFFY: Yes. That would be the -- the basic point
5 being that there will be a future proceeding at some date
6 down the road.

7 MS. HARE: But wouldn't that be after the fact?

8 MR. DUFFY: That's true. I mean, that will be -- we
9 anticipate that that will be, like I said, sometime around
10 the end of this year when the IESO's role is substantially
11 complete, and the IESO's cost, that it has incurred,
12 getting the MDM/R up and running and getting LDCs on board
13 will form part of that, and then there will be a rate going
14 forward as well.

15 In respect to your question about adequacy, at this
16 time the IESO feels it has adequate resources.

17 What you are seeing is -- I know there are a number of
18 exemption applications from time-of-use rates coming
19 forward before the Board. Each one of those -- you have 80
20 different LDCs -- each one is kind of an individual
21 circumstance, but at this time the IESO feels it has
22 adequate resources.

23 They anticipate that they will be able to deal with
24 the coming enrolment in the next few months, and they don't
25 anticipate having to turn anybody away. So if an LDC is
26 ready to come on board the MDM/R, at this time the IESO has
27 the resources and is ready to accommodate them.

28 MS. HARE: Thank you. That is the assurance that at

1 least I was looking for.

2 MS. TAYLOR: My question, I think, was a little bit
3 different.

4 You said the IESO feels that it has adequate
5 resources, and I see there are certain references in the
6 settlement agreement to transcript and pieces of the
7 business plan.

8 Does that substantially form the basis of the
9 settlement? And precisely what did the parties settle on
10 that, that the IESO, in its belief it has adequate
11 resources, as opposed to -- is that what parties settled?

12 It wasn't immediately clear to me when I read the
13 settlement agreement what the parties had actually agreed
14 as to that point.

15 MR. DUFFY: Well, if you read the issue, the issue is
16 linked to the IESO's expenditures, and as my first point
17 was, the fees being spent in this case have no relationship
18 to the SME.

19 So I think that is probably how I would read the first
20 point, which is that the parties have settled on the
21 understanding -- I don't want to speak for the other
22 parties, but on the understanding that none of the fees
23 that are the subject of this proceeding relate to the SME.

24 I mean, I would add to that that I am not sure that in
25 this proceeding we have the appropriate parties at the
26 table who would even be in a position to know whether or
27 not the SME is operating effectively, and those would
28 primarily be the LDCs. And that at the moment, as I

1 mentioned, there is an oversight mechanism for that; that
2 is a regular monthly reporting that is happening. The SME
3 reports to that. And then the Board obviously produces its
4 own report coming out of that, as well.

5 MS. TAYLOR: Do you have any further questions?

6 So I think at this point the Panel will break, if
7 there is no other questions from any other party.

8 I have no further questions, and we will decide on the
9 settlement agreement.

10 So we will reconvene in 15 minutes.

11 --- Recess taken at 10:19 a.m.

12 --- On resuming at 10:34 a.m.

13 **DECISION:**

14 MS. TAYLOR: Please be seated.

15 The Panel has determined that it will accept the
16 proposed settlement agreement as filed. The additional
17 context provided by counsel for the IESO has been useful to
18 the Board with respect to the settlement of issue 5.3.

19 Although parties had agreed that we would only hear
20 submissions on the remaining issue, which is issue 3.3, the
21 Panel does have a couple of questions that we would like to
22 ask, so it is appropriate at this time that we would swear
23 Ms. Nicholson in so that we can ask the questions under
24 oath.

25 **INDEPENDENT ELECTRICITY SYSTEM OPERATOR - PANEL**

26 **Susan Nicholson, Sworn.**

27 MR. ZACHER: Madam Chair, is it all right for Ms.
28 Nicholson to stay here?

1 MS. TAYLOR: Yes.

2 MR. ZACHER: Okay.

3 **QUESTIONS BY THE BOARD:**

4 MS. TAYLOR: We only have two questions.

5 The Panel, in looking at the material that was filed
6 and the submissions that have been filed, really just has
7 two questions, the first of which is why the 5 million is
8 not sufficient for 2011.

9 MS. NICHOLSON: At the time we prepared our business
10 plan, we put together a three-year business plan and we
11 looked out over the three years and looked at the
12 implications to the business over that three-year period.

13 The 5 million would be sufficient for 2011, but when
14 we look out over the entire planning period, we are looking
15 at increasing costs and decreasing demand in 2012 and 2013.

16 At the time of the business plan, the IESO had
17 projected an operating surplus for 2010 of \$8.1 million,
18 which, when we use that over the three-year planning
19 period, helped to rate-stabilize over the three-year
20 period.

21 So the increase of the 8.1 million to the 5 million is
22 not an impact for 2011. It is really for rate
23 stabilization in 2012 and 2013.

24 Our actual costs in 2010 were lower than what we had
25 projected in the business plan, leaving us with an
26 additional operating surplus of 10.2 million, and that we
27 are proposing to rebate to market participants as part of
28 this rate case application.

1 MS. TAYLOR: The second question that the Panel has -
2 and you have addressed it somewhat in the answer here - is
3 you will be returning to the Board and you will be filing a
4 new budget with the Minister in 2012 for 2012 fees.

5 Why is it not appropriate to consider the monies
6 retained in the context of the overall cost structure as it
7 relates to that overall filing?

8 MS. NICHOLSON: It is correct we do come back every
9 year with an annual rate submission, both to yourself and
10 to the Minister. But the planning period is over three
11 years, and we thought it was financially prudent to use the
12 money over the planning period as opposed to having rate
13 stable in 2011 and see dramatic rate increases in the
14 future years.

15 Without the use of the surplus, we are looking at a
16 12 percent increase by 2013 to our rates, but by using the
17 8.1 million that was the accumulated surplus for 2010, as
18 in the business plan, we're actually able to maintain our
19 rates at an increase of only 2 percent in 2011 and -- or,
20 sorry, 2012 and 2013, and to keep the rate flat in 2011
21 from the 2010 fee.

22 MS. HARE: Just one question. If in 2012 when you
23 come forward you see a significant increase, wouldn't
24 another solution be to decrease your budget for 2012?

25 MS. NICHOLSON: Yes. We've looked through our budget.
26 We think we are very financially prudent in our budgeting.
27 With the annual submission in front of the Board, the IESO
28 has a history of not spending out what its budget is. If

1 we don't spend the money, the money gets rebated to market
2 participants. If there were any changes in our 2012
3 application, we would be back again next year to present
4 those changes to the Board, either in the form of a rebate
5 or other deficit.

6 MS. HARE: Thank you.

7 MS. TAYLOR: The Panel has no further questions.

8 So at this point, I think we would like to hear
9 submissions from parties regarding issue 3.3, beginning
10 with the IESO.

11 The Panel has received a written version of the IESO's
12 submission dated April 21 of 2011, pages 6 through 10, and
13 I am assuming, Mr. Zacher, you would like to walk us
14 through that submission?

15 MR. ZACHER: If I might, thank you.

16 MS. TAYLOR: Proceed.

17 **CLOSING ARGUMENT BY MR. ZACHER:**

18 MR. ZACHER: So if I might structure my submissions
19 to, first off, just address and be clear exactly what the
20 IESO is seeking.

21 Second, Panel Members, I would like to just put in
22 historical context exactly what's being sought here, and,
23 third, address why, in my submission, the proposal before
24 you is a reasonable and appropriate one.

25 So as Ms. Nicholson indicated, what the IESO is
26 seeking to do is to retain a portion of its operating
27 surplus from 2010, coupled with \$5 million remaining as its
28 accumulated surplus from the previous year, and to apply

1 that, if necessary, over the three-year planning horizon.

2 So it is a total of \$13.1 million which the IESO is
3 seeking to retain, 8.1 million from 2010, \$5 million which
4 was the accumulated surplus from the previous year.

5 And the one clarification or the one change that was
6 made to the IESO's submission - again, I just want to be
7 clear about this - is that initially when the IESO filed
8 its business plan in its application in the fall, it was
9 projecting a 2010 operating surplus of \$8.1 million, and so
10 it was seeking to hang on to that entire amount as a
11 surplus to apply for rate stabilization purposes.

12 Since that time, the IESO has projected a larger
13 surplus, and so the IESO amended its notice of application.
14 That was filed I believe in February, before the technical
15 conference, and what that makes clear is that
16 notwithstanding that the 2010 surplus is higher, the IESO
17 is still only seeking to retain \$8.1 million of that.

18 So the balance, \$10.2 million, the IESO is proposing
19 to rebate to market participants based on last year's
20 consumption.

21 So subject to your approval, the IESO would be
22 proposing to do that immediately.

23 MS. TAYLOR: So just to be clear with the numbers,
24 then, Mr. Zacher, so the surplus for this year is \$18.3.
25 Add that to the additional surplus from last year of five,
26 which gives me 23.3, deduct 10.2, leaves a net retained
27 surplus for 2010 or 2011 of 13.1; is that correct?

28 MR. ZACHER: That's correct. That's correct.

1 MS. TAYLOR: Okay.

2 MR. ZACHER: So that is what the IESO is proposing to
3 do, and the reasons, which I will touch on in a little bit
4 more detail, are to counteract what the IESO forecasts are
5 increased costs over the planning period, and, as well, a
6 reduction in demand, which has the effect of reducing usage
7 fee revenue.

8 To just put this in historical context, because I want
9 to be clear that what the IESO is proposing to do this year
10 is not different than what it has proposed to do in the
11 past; rather, what the IESO is asking is simply to retain a
12 slightly higher portion of the surplus than it has in the
13 past.

14 Initially, the IESO filed an initial rate application
15 in 2000 following the deregulation. At that time, it was
16 recognized that the IESO was a slightly different animal
17 than other utilities. It does not have a rate -- rather, a
18 shareholder to absorb deficits or surpluses.

19 But on the other hand, there invariably will be
20 forecasts -- or, rather, variances from forecast that will
21 be reflected as deficits or surpluses.

22 And so the Board approved in that inaugural fees case
23 the establishment of a deferral account to record those
24 amounts, and the intention was that the IESO would come
25 forward at each of its annual fees cases, explain the
26 reason for the deficit or the surplus, and then propose how
27 that account, deferral account, was to be disposed of
28 through rates or what have you.

1 So what -- at the same time as the IESO has filed its
2 annual fees cases, it's espoused as a very important
3 objective of its business that it maintain fee stability
4 for its customers.

5 And so what the IESO has proposed in appropriate cases
6 where there have been surpluses is that those surpluses be
7 applied in a way to maintain fee stability, or in some
8 cases to reduce, incrementally reduce the usage fee.

9 So in the written submissions that we filed this past
10 week, I gave at least a couple of examples. If you look at
11 paragraph 17, there is referenced the IESO's 2002 fee
12 submission, where the Board approved the use of an
13 \$8.8 million surplus, including \$1.2 million carried over
14 from the previous year to apply against the 2002 revenue
15 requirement.

16 In the 2004 proceeding, the Board approved similar
17 treatment. And there, what I would suggest is important to
18 note is that the Board approved the use of the surplus to
19 offset the revenue requirement over not just the ensuing
20 year, but over the planning period. Okay? So not just --
21 even though the IESO, of course, comes before this Board
22 every year to have its revenue requirement approved and to
23 have its fee approved, it does use a three-year planning
24 horizon.

25 Since 2005, what the IESO has adopted almost every
26 year is that -- and this was subject to agreement amongst
27 intervenors in that case, again, approved by the Board --
28 was that the IESO would hold on to \$5 million of any

1 surplus, and any amount in addition to that would be
2 rebated to market participants.

3 That has been the treatment since 2005. But on no
4 occasion since then has the IESO faced a fee increase.

5 In fact, what the IESO has -- is proud to have
6 achieved over the past six or eight years is that in every
7 year the IESO's fee has been flat, or declined, or
8 increased by a very, very marginal amount.

9 So the objective of maintaining fee stability for its
10 customers has been something the IESO's been able to
11 achieve through prudent management of its business,
12 including the way in which the IESO has proposed that any
13 surplus be treated, and that the Board has approved.

14 And the difference this year is that the IESO is
15 forecasting or is projecting a relatively significant
16 increase in costs and reduction in demand, due largely to
17 Green Energy impact initiatives, and as well, in part, due
18 to the -- still the effects of the 2008 recession.

19 So the IESO is forecasting a reduction, a reduction in
20 demand. It's forecasting an increase in conservation and
21 embedded generation, which has a downward effect on
22 revenues. And it is also forecasting a relatively
23 significant increase in costs over the planning period,
24 largely in order to increase staffing and other resources
25 in order to implement Green Energy Act work.

26 If I might just -- if you have the IESO's application
27 record in front of you, if I could just -- there is one
28 exhibit that helps to illustrate this.

1 If you turn to -- it is Exhibit B, tab 3, schedule 1,
2 which is the methodology for calculating the usage fee.

3 If you turn over to page 2 of 3, you will see a couple
4 of tables. In the top table, which is identified as
5 "Revenue requirement calculation for IESO usage fee," you
6 will see there that from 2011 through 2013, that there is a
7 relatively significant increase in costs; so from
8 128.3 million to 139.5 million.

9 And then if you go to the second table below, you will
10 see a chart which references market demand over the
11 planning period. In the far-right column, you will see
12 that there is a reduction in market demand of -- from 153.3
13 terawatt-hours to 145.6 terawatt-hours.

14 So it is the revenue requirement divided by the market
15 demand that gives you the usage fee, and if you turn over
16 on to the next page, you will see how the usage fee is
17 calculated.

18 So what the IESO calculates is that the usage fee in
19 2011 will stay at 0.822 cents, and that even applying the
20 surplus in the manner recommended, the fee will still
21 increase by two percent in each year, to 0.838 in 2012 and
22 to 0.855 in 2013.

23 And the impact of not applying the surplus in that
24 manner would be a 12 percent increase over that period.

25 So the reason, Madam Chair and Ms. Hare, that the IESO
26 is recommending this is that, first off, it believes it is
27 incumbent on it in the circumstances to come forward with
28 this sort of plan.

1 The IESO has over the past 10 years had a fee that has
2 declined or remained relatively flat. It has declined
3 14 percent since 2002 or 2003, and what the IESO is
4 forecasting is an increase of 12 percent over a couple of
5 years.

6 And that, coupled with the increase in electricity
7 costs generally, is in the IESO's view cause to come
8 forward and to propose some sort of plan that mitigates or
9 softens the impact of that rate increase.

10 The other important point is that this is not
11 something that is set in stone. So while the IESO is
12 proposing that the surplus be retained so that it can be
13 used to offset any rate increases in subsequent years, the
14 IESO does have to come back before this Board next year.
15 And if circumstances were to change, so if at that point in
16 time, there was a revised forecast and the IESO projected
17 that costs would not be increasing as substantially, or
18 that demand would not be dropping as much, there is the
19 opportunity to adjust and true up for that in the next --
20 in next year's fees case.

21 The danger is that if the money is all rebated now,
22 then it is gone. And so if the IESO's projections do come
23 to fruition and there is this increase, forecast increase
24 in costs, there is this forecast reduction in demand, that
25 money will not be there in order to soften that impact.

26 And then the option is to phase in the rate increase.

27 Lastly, I want to just address the issue of any
28 concerns about intergenerational inequity, which are always

1 something that has to be considered whenever any kind of
2 rate deferral plan is being proposed.

3 And really, the potential impacts in this case are
4 marginal. The rate deferral plan is not a plan that is
5 being proposed over five, six or seven years. It is over a
6 very short period of time. So three years at most, with
7 the opportunity, as I said, to make adjustments annually,
8 and there is very little turnover in the IESO's effective
9 rate base.

10 So the market participants that pay for -- pay the
11 IESO's fees, it is just the load side. And the evidence in
12 the technical conference is that there is very marginal
13 turnover in those loads.

14 So those sorts of concerns that might prevail in other
15 cases are not, I submit, as significant in this case.

16 So, in short, my submission is the IESO is proposing
17 to do something which strikes a very, very reasonable
18 balance. It rebates to market participants now a little
19 over \$10 million of the surplus, but it proposes to
20 prudently hang on to the balance of the surplus in order to
21 mitigate the impacts of rate increases which are forecast
22 over the planning period.

23 Subject to any questions you may have, those are my
24 submissions.

25 MS. HARE: I do have a question. You have provided
26 transcript references where -- sorry, technical conference
27 transcript references where some of this was discussed.

28 But I didn't see, in the technical conference

1 materials - but maybe you could take me to that - where the
2 costs for 2012 and the decreased load was examined for 2012
3 and 2013.

4 MR. ZACHER: Ms. Hare, it might be easier to look at
5 the actual business plan.

6 So if I could ask you to turn up the IESO's business
7 plan, which is marked as Exhibit B, tab 1, schedule 1, and
8 to go to page 9 of that, which is marked as the financial
9 outlook, there is the IESO's evidence with regards to the
10 forecast increase in costs over the planning period.

11 On the subsequent pages, some of those costs are
12 broken out with regards to OM&A program costs, staffing,
13 pension expense, but the -- in the table at the top, under
14 -- three-quarters of the way down the table, there is the
15 line "Total Costs", and you will see that projected at
16 \$119.4 million for 2010, which I think the actuals are --
17 the actuals are a little less than that. Then the
18 projected increases over the planning period are
19 identified.

20 MS. HARE: I did see that in your evidence. What I
21 was really wondering was: Was there very much testing of
22 that evidence at the technical conference, or was it
23 accepted as filed?

24 MS. SEBALJ: I think if it assists, I have in my
25 technical conference transcript -- I am not sure, Mr.
26 Zacher, if you will agree with me, but around pages 79 and
27 80, there was a discussion about your table at that same
28 exhibit, page 14, which is appendix 1, IESO usage fee

1 financial statements.

2 I did ask some questions of Ms. Nicholson about what
3 happens over the planning period. There were some answers,
4 starting at about line 19 of page 80, about eating through
5 the surplus until you end up at a deficit of -- I think it
6 was \$700,000. So it is page 80, and then the top of
7 page 81.

8 I don't know if that is what you are looking for.

9 MS. HARE: Yes, it is, Ms. Sebalj. Thank you.

10 MR. ZACHER: Also at roughly page 22 to 40 in the
11 technical conference transcript, there are questions about
12 staff compensation, staff increases, about the amortization
13 expense.

14 MS. TAYLOR: The question that I would have following
15 the discussion in the transcript and the financial outlook
16 - and you can point me to this - the largest expense growth
17 on page 9 of your financial outlook is depreciation, which
18 goes from 14.3 million in 2011 to 18.7.

19 Your total revenue line increases modestly in '12
20 versus 2011, and basically flat 2013 versus '12. The other
21 cost lines are, you know, largely flat, with a very slight
22 -- so the largest growth in your expense is, per this
23 table, depreciation, which is non-cash.

24 So based on this, one would expect to see an increase
25 in your overall net cash position, and I didn't see a cash
26 flow statement for those years, as well, which would govern
27 the growth of the cash balance, unless there is one and I
28 just missed it.

1 MR. ZACHER: Ms. Taylor, at page 25 of the business
2 plan is an actual pro forma statement of cash flows.

3 MS. TAYLOR: So your cash from operations increases
4 from 5 million in the 2011 budget to 34.1 million by the
5 end of 2013.

6 It is partially offset by increases in investing
7 activities, and you are in fact, by 2013, retiring a
8 substantial portion of your outstanding debt, 13.8 million.

9 So how does that tie back into, then, the requirement
10 to have a higher cash balance on hand to offset -- so this
11 speaks to an improved liquidity position over the forecast
12 period as opposed to a notional decline in, arguably
13 speaking, net income, which again is being driven by non-
14 cash expenses.

15 So if you could just reconcile the two for me, please?

16 MR. ZACHER: Ms. Nicholson will address this.

17 MS. NICHOLSON: The financial planning of the IESO is
18 not done on a cash basis with the accumulated surplus kept
19 in cash.

20 Our position is that we maintain the least amount of
21 debt as possible and, therefore, that reduces the amount of
22 interest expense that goes through our books.

23 So as you can see from that cash flow statement, we
24 actually plan to hold no more than \$2 million of cash at
25 any given time, and the offset is always in terms of
26 retirement of debt.

27 MS. TAYLOR: Thank you. Do you have any additional
28 questions?

1 MS. HARE: No.

2 MS. TAYLOR: I understand that there is an order and
3 that we will hear from Mr. DeRose, then Mr. Buonaguro, and
4 we will follow up with Staff, Ms. Sebalj.

5 **CLOSING ARGUMENT BY MR. DEROSE:**

6 MR. DeROSE: Thank you, Madam Chair, Ms. Hare.

7 First of all, let me thank the IESO for their written
8 submissions on Thursday. I know that they weren't required
9 by the procedural order, but I think setting out the facts
10 on this issue has been helpful I hope to the Board. It
11 certainly was helpful to us, because, from our perspective,
12 this issue is really not one that is fact driven. It is an
13 issue of principle to be decided by this Board.

14 I would -- I have tried to simplify the issue in my
15 own mind, and this is what I have - what I would present to
16 you. The issue to be decided by the Board is: When should
17 the operating surplus from years prior to 2011 be credited
18 to market participants?

19 The IESO's position is that it should be entitled to
20 retain 13.1 million to mitigate rates, if necessary, in
21 future years beyond 2011.

22 Keep in mind that 2011 is the only year that you are
23 deciding -- that is the only year that is subject to this
24 application. And so as Mr. Zacher pointed out this
25 morning, it will be applied in 2012 and 2013, if necessary.
26 It may not be applied for 2012, 2013.

27 CME's position - which is contrary to the IESO - is
28 that the entire operating surplus should be cleared to

1 market participants, either in 2011 or alternatively in the
2 same manner as the Board has done in other utilities, where
3 you actually pick a time period. It is like the clearing
4 of a deferral account, where you will set out over a one-
5 year or a two-year period that it will be cleared, if you
6 feel that it should go beyond 2011.

7 Now, I have divided my submissions into two sections.
8 First of all, I just want to provide some context on a
9 couple of discrete points. It won't take long.

10 Then secondly, I would propose four principles that I
11 would urge you to consider when making your determination
12 of this issue.

13 So turning to the context, as, Madam Chair, you
14 pointed out this morning, just to get the numbers
15 straight -- because I think it is important, when we look
16 at -- the operating surplus from 2010 was 18.3 million.
17 The accumulated surplus is 23.3 million, because 5 million
18 is retained from prior to 2010. So you actually have --
19 part of the accumulated surplus is already going back over
20 24 months. We are going back to 2009.

21 When we -- I recognize that in the world of
22 electricity rates, 18.3 million and 23.3 million might not
23 seem like that much. If we were in an OPG case or a Hydro
24 One case, those are on the smaller side of many of the
25 numbers.

26 But I think you need to keep in mind that the 2011
27 revenue requirement that the IESO has -- well, that all of
28 the parties have asked that you approve through the

1 settlement agreement is 126 million. So the accumulated
2 surplus of 23.3 million represents 18 and a half percent of
3 their total revenue requirement.

4 The IESO's proposal to retain 13.1 million represents
5 over 10 percent of their entire revenue requirement; on my
6 math it is 10.4 percent.

7 And so when we relate it to their revenue requirement
8 for 2011, this is, by percentage, a very large portion of
9 funds to be retained.

10 Now, in determining how to clear the surplus, there
11 are a couple of additional facts I would like to just
12 reiterate to you.

13 First of all, the 13.1 million will not be used to
14 mitigate fees in 2011. For a reference to that, it is
15 technical conference, page 96.

16 So the decision on this operating surplus, I submit to
17 you, has no impact on the 2011 fees which you are being
18 asked to approve in this case.

19 Rather, the proposal is to use the 13.1 million, if
20 necessary, to mitigate fee increases in 2012 and 2013.
21 Those two years are not subject to this fees application.
22 They're included in the financial outlook, they provide
23 context, but you are not approving any fees for those two
24 years.

25 So when, Ms. Hare, you asked whether the 2012 and 2013
26 years were scrutinized in the technical conference, I
27 submit they weren't, and it is because they aren't subject
28 to this application.

1 The evidence -- with the exception of the business
2 plan -- the evidence is focussed on 2011, because those are
3 the issues set out in the issues list. Because you are
4 being asked to approve fees for 2011; you are not being
5 asked to approve fees for 2012 or 2013.

6 Now, in terms of the assessment of 2012 and 2013,
7 there were some additional questions, and they were more, I
8 think -- they were not scrutinizing 2012 and 2013 in the
9 context that, Ms. Hare, you were asking, but one of the
10 issues that we did ask about was whether any analysis has
11 been undertaken to assess whether the 6 percent increase in
12 2012 and 2013 that's projected, or the 12 percent by 2013,
13 has any analysis been undertaken to determine whether that
14 would create rate shock.

15 And the answer was no. For reference, that is
16 technical conference, page 93.

17 And again, keep -- I think you need to keep in mind
18 that the projected increases for 2012 and 2013, they might
19 be higher; they might be lower than what is being projected
20 now. And that will be subject to an application,
21 presumably next year.

22 The other technical conference -- the last piece of
23 evidence from the technical conference I just want to bring
24 your attention to, and it was at page 93. Again, I don't
25 think you need to turn it up, but it was consistent with
26 what was presented to you this morning by the IESO, and it
27 was confirmation that the IESO's strategy has been to try
28 and make sure that its costs escalate at rate of inflation.

1 This is consistent with the submissions of my friend
2 from the IESO, that has pointed out that over the past
3 decade, rates have generally been stable or minor declines.

4 Now, as you will both be aware, CME, I think, has
5 consistently applauded those market participants or
6 utilities whose goal is to ensure that its costs escalate
7 at the rate of inflation. If everyone's rates increased at
8 the rate of inflation because of cost controls, that would
9 be, I think, a positive outcome, particularly in the
10 current environment.

11 But our submission is that it should not be achieved
12 by retaining operating surpluses from prior years, because
13 that is not achieving it through cost control. That is
14 being achieved by asking market participants to pay more in
15 prior years than it actually cost to serve them, and rather
16 than crediting it, using it in the future to mitigate
17 rates.

18 So we would submit that when you look over the past
19 decade at the IESO's fees, and the fact that they've
20 declined or remained flat, it leads to the question: Why?

21 And in part, I think it is because of their effective
22 management and their cost containment. But in part, it is
23 also because they have used an operating surplus. They
24 have used and maintained. They have charged more in prior
25 years and kept the operating surplus to help in later
26 years.

27 So let me turn to the question that set out the
28 principles that I would submit, and just to reiterate the

1 issue as we see it.

2 Should the IESO be entitled to retain 13.1 million,
3 which represents over ten percent of its 2011 revenue
4 requirement, which was collected in 2010 and 2009 for the
5 purpose of reducing rates, if necessary, in future years,
6 beyond 2011?

7 CME submits that when you look at the four principles,
8 the answer is no.

9 Principle number one, operating surpluses, in
10 particular, but even more generally, deferral accounts
11 where credits are owing to ratepayers should be reimbursed
12 sooner rather than later.

13 In our submission, when over-collection occurs, the
14 credit should be applied against the revenue requirement or
15 reimbursed in a form of a rider in the next rate year.
16 That is principle number one.

17 Principle number two, the Board should not approve the
18 creation of what I refer to as a rainy-day fund. Surpluses
19 should not be retained to be used, if necessary, to
20 mitigate fees in future years that are not subject to the
21 application, if and when necessary.

22 This is, in effect, asking to -- in our submission, if
23 approved -- the IESO will be entitled to keep this
24 13.1 million as a cushion, and if and when in the future
25 rates start to increase, they can fall back on that cushion
26 to reduce the fees.

27 And it is, in our submission, not proper to simply
28 allow this to go into the future to be dealt with in future

1 applications, if and when necessary.

2 And I think we also need to separate this. I am aware
3 that both of you would be familiar with deferral account
4 clearances in traditional utilities, and there are times
5 that the Board has found that it is appropriate to clear a
6 deferral account over a period outside of the application
7 year that they're dealing with. It might be 12 months, 16
8 months, 24 months.

9 And at times, the Board has found that an extended
10 period of time to clear a deferral account is appropriate
11 because it does, in fact, mitigate costs. But the point is
12 the Board starts the clearance process in the very year
13 that it is dealing with it.

14 So to apply that to this context, you would order that
15 the amount be cleared -- rather than over 2011 and over a
16 12-month period, you would order that it be cleared over,
17 for instance, a 24-month period or whatever you feel is an
18 appropriate amount of time.

19 That is very different than this situation that we are
20 facing where the IESO -- the IESO is not even telling you
21 that it shall apply it in 2012 and 2013. It is saying, We
22 want to retain it to have the option to apply it, if we
23 feel it is necessary, in 2012 and 2013.

24 So that is a very different situation than what we
25 have seen in other cases.

26 Principle number 3 is that the Board should avoid
27 intergenerational inequity. And I take Mr. Zacher's
28 submissions this morning that the IESO is -- when it comes

1 to intergenerational subsidies or inequities, it is a
2 different beast than your traditional utility that would
3 have ratepayers coming and going.

4 That said, even though it may be minimal, I think you
5 need to take into consideration that the gap in the number
6 of years is getting larger. The accumulated surplus that
7 is going to be retained, if you approve what they're asking
8 for, starts in 2009, and it might be applied in 2012 or
9 2013.

10 So if it were to be applied -- and let's just assume
11 it is applied in 2013. Some of that was collected in 2009.
12 You have a four-year gap. And, in our submission, the
13 larger the gap, the greater the chances of
14 intergenerational subsidies, even in a pool of market
15 participants that the IESO deals with.

16 Finally, we submit that the Board should continue to
17 promote transparency of actual costs. Now, the IESO's
18 strategy is to ensure that its costs escalate at the rate
19 of inflation. And if you just look at the way that it's
20 being phrased to you today, its fees have remained stable
21 or declined over the past decade.

22 I have no doubt that if the operating surplus -- if
23 you allow the operating surplus to be retained, and if 2012
24 and 2013 do unfold exactly as it is set out in the
25 financial outlook and so the fees increase by, let's say,
26 2 percent a year, the perception of most market
27 participants, specifically, and ratepayers more broadly in
28 Ontario, will be that the IESO's fees have only increased

1 by 2 percent per year.

2 There will not be the appreciation that it increased
3 by 2 percent per year, because amounts that were overpaid
4 in 2009 and 2010 were retained to mitigate those fees and
5 ensure that they stay at 2 percent.

6 Now, I suspect the question may come up that: Is
7 2 percent preferable to a 6 percent increase in 2012 and
8 2013? Isn't a 12 percent increase unwanted? Two percent
9 would be preferred, absolutely. Two percent is -- a
10 2 percent increase is better than 6 percent.

11 But, in our submission, it is important that there be
12 transparency of what the actual costs are. And the
13 inclusion of the operating surplus does have the risk of
14 masking what the IESO's actual cost increases are.

15 And if the IESO's rates increase by 6 percent or more
16 in 2012 or 2013, we submit that they would have to justify
17 those increases in a future application. And if the
18 increases are of such significance that they create rate
19 shock, it would be at that time that the Board and the IESO
20 would have to address whether they require a mitigation
21 strategy or not.

22 The time to assess rate shock and mitigation
23 strategies, if required, are when the actual costs are
24 known and the Board is approving the fees. This is the way
25 it's been done in other utilities. And by example Hydro
26 One Distribution, when they were moving down from just over
27 90 rate classes to a limited set of rate classes, some of
28 those rate classes were facing rate increases of 25, 30,

1 40, 50 percent. I believe there was one over 100.

2 And it was at that time that rate shock was assessed
3 and there was a time period, a phase-in, that allowed for a
4 mitigation strategy. That is always available to the IESO,
5 but that can be done with all of the information before the
6 Board in a well-thought-out and transparent manner, because
7 it would be done through the use of deferral accounts,
8 which would include interest -- and there is a cost of
9 that, and the cost is borne by the ratepayers or by the
10 market participants ultimately over time.

11 So in conclusion, it is our submission that the Board
12 should not maintain the illusion of costs increasing at the
13 rate of inflation by allowing the use of prior year
14 surpluses to be used to mitigate the actual costs in future
15 years, if necessary.

16 Subject to any questions, those are our submissions on
17 this issue.

18 MS. TAYLOR: Mr. DeRose, I do have one question.

19 The Board's mandate with respect to the IESO fee is
20 more of a review function, and, in fact, the budget is in
21 fact submitted and potentially approved by the Minister
22 prior to the receipt by the Board, and then the process
23 that we're now going through.

24 How does that get reflected in what you have said,
25 because most -- a large portion of what you said seems to
26 track a conventional utility model where the Board, in
27 fact, will review the costs.

28 Does any of your -- or would any of your principles

1 change, if you backed up a second and said the Board's
2 function here is to review something that has already
3 notionally at least been approved?

4 MR. DeROSE: I don't think it would, and it is for
5 this reason. The fees that you are being asked to approve,
6 which the Ministry has already approved, will not change
7 regardless of what your decision is on the operating
8 surplus.

9 The issue of the operating surplus will have an effect
10 on future years that have not yet been approved by the
11 Ministry. The operating surplus will have absolutely --
12 your decision on this issue will have no issue on the 2011
13 fees. The IESO has made that crystal clear at the
14 technical conference and in their testimony today.

15 It will only have an impact on 2012 and 2013, if
16 necessary, and those years have not yet been approved by
17 the Ministry, and, quite frankly, you aren't approving
18 those years today.

19 So this issue is really -- I submit is something that
20 is fully within your mandate and will not have any negative
21 impact on the IESO's ability to operate in 2011.

22 MS. HARE: Just so I understand, if, in fact, this
23 Board decides to return all of the surplus, what you're
24 saying is the fee for 2011 remains as filed for and as
25 agreed to, and that the surplus would be returned by way of
26 a rider or some other mechanism, but -- so what the market
27 pays is actually lower, but the fee is still the same? Is
28 that what you're saying?

1 MR. DeROSE: Correct.

2 MS. HARE: Thank you.

3 MR. DeROSE: Just on that point, the IESO already has
4 a mechanism in place to return the 10.2 million, I believe,
5 all of the amount above the 13.1.

6 So the 10.2, the mechanism is already there. It is
7 just a question of how much it should be.

8 MS. HARE: Thank you.

9 MS. TAYLOR: The Panel has no other questions.

10 So Mr. Buonaguro?

11 **CLOSING ARGUMENT BY MR. BUONAGURO:**

12 MR. BUONAGURO: Thank you. I generally agree with the
13 concerns raised by Mr. DeRose in terms of the
14 appropriateness of the proposal by the IESO.

15 I think where we may differ slightly is in the concept
16 of any kind of appropriateness for a rate stability
17 mechanism, like retaining excess revenue and going forward
18 to provide some rate stability.

19 I can tell you that -- my understanding of Mr.
20 DeRose's arguments on behalf of CME is that the entire
21 amount of the excess revenue should be returned, either on
22 a schedule or immediately as a rebate, whereas as a
23 participant in the previous years' settlements, VECC has
24 endorsed, as part of an overall settlement agreement, the
25 idea of an amount of retention by the IESO in the order of
26 \$5 million, in order to allow them to provide some rate
27 stability going forward.

28 The issue, I think, in this case, from our perspective

1 is: Is that what is going on here, in this proposal? Or
2 is something different happening?

3 I think I would suggest that something different is
4 happening. To illustrate the point, I would take you to
5 the 2008 business plan, which actually sets out in one
6 paragraph sort of the justification for the retention of
7 the funds going forward at that time, which is one of the
8 settlement agreements that we agreed to, the proposal in
9 that case.

10 So this is from the IESO 2008 fees business plan, 2008
11 to 2010, dated September 27th, 2007, and it is from page 10
12 of the business plan. I am just going to read the one
13 paragraph, which in a nutshell, explains why at that time
14 this particular fund was being proposed.

15 "It is important to note that forecasts, by their
16 nature, rarely reflect actual results. Certain
17 factors that contribute to the IESO's forecasted
18 revenues and costs are beyond management's
19 control. For example, fluctuations in long-term
20 interest rates and equity market returns can
21 either positively or negatively impact IESO
22 revenues and costs. Similarly, deviations in
23 actual energy demand from forecasted energy
24 demand has a direct impact on IESO revenues. To
25 better manage these fluctuations, the IESO
26 maintains a surplus account of up to \$5 million,
27 refunding any excess to ratepayers in the form of
28 a market rebate. The surplus account allows the

1 IESO to provide customers with a higher degree of
2 rate stability".

3 Now, our understanding of that paragraph as
4 justification for this type of fund and the use of that
5 fund in future years is as a tool to react in a modest way
6 to these fluctuations that are beyond the IESO's control.
7 And the quote referred to long-term interest rate changes,
8 equity market changes, and deviations in actual energy
9 demand from forecasted energy demand.

10 I think what is happening here, though, in terms of
11 increasing the request beyond a \$5 million amount to almost
12 triple that amount, has to do with their actual forecast
13 demand going forward and their actual forecast cost
14 increases going forward, which is very different, I think,
15 than accounting for what you might almost call Z-factor-
16 type changes in the future, and the ability to react to
17 maintain rate stability in the face of those types of
18 changes in the future.

19 If rates are actually -- sorry, if costs are forecast
20 to go up in the future and demand is forecast to go down in
21 the future, that should to some extent be reflected in
22 rates, which I think is the thrust of at least part of Mr.
23 DeRose's argument.

24 We are not talking about blips in rates or -- in
25 interest rates, or blips in differences between actual
26 demands versus the forecast demand that the rates are based
27 on; we're talking about an actual forecast of increased
28 costs over the next three years, culminating in a

1 12 percent increase over -- by 2013.

2 That is different, I would suggest, than the type of
3 mitigation or rate stability that was contemplated by some
4 of the parties, and certainly VECC, when the original
5 \$5 million amount -- based on their relative revenue
6 requirement -- was agreed to over and over again in the
7 settlement agreements.

8 So I would put that to the Board as a consideration,
9 in terms of whether or not something like the \$5 million
10 amount, which has historical backing with respect to the
11 IESO, should be retained, versus the new proposal - I would
12 call it - which seeks to actually take forecast significant
13 material increases in the revenue requirement versus
14 demand -- versus the revenues going forward as being
15 something -- being a different animal in this case.

16 The last thing I would point out - and I think it was
17 implicit in what Mr. DeRose was saying, and following along
18 with the IESO's logic - if allowed to do the mitigation in
19 precisely the way they're asking, assuming everything
20 progresses in the future as they're suggesting it would
21 progress, you are looking at a perceived 2 percent increase
22 per year for 2012 and 2013.

23 But then that begs the question of what happens in
24 2014, when actual costs and actual demand, if their
25 forecasts are correct, have -- would have resulted in a
26 12 percent increase over those two years, which hasn't
27 actually been realized. Assuming that trend continues into
28 2014, what you are looking at, I would expect, is a massive

1 jump in rates in excess of 12 percent relative to what has
2 actually been experienced by consumers, or experienced by
3 market participants, over the interim.

4 So it may have an effect of mitigating the increases
5 over the next two years, but then it could have a very
6 unintended effect in 2014.

7 I would suggest those as considerations the Board
8 might have in terms of evaluating the relief.

9 I think in the end it is a judgment call. I think
10 everybody agrees the money is there, and it is going to go
11 to market participants either in a rebate or over a number
12 of years, or paid out at the discretion of the Board
13 depending on what happens in the next two years or so.

14 But I think it would be nice to do so on a principled
15 basis, and for that reason, we tend to support maintaining
16 some kind of fund in the order of the \$5 million, to allow
17 for a reaction to these real fluctuations or what I would
18 almost call Z-factor-type changes over the years, but shy
19 away from allowing this sort of contingency fund to exist
20 to offset actual planned forecast increases in the future.

21 Subject to any questions, those are our submissions.
22 Thank you.

23 MS. TAYLOR: Thank you. We have no questions.

24 Ms. Sebalj?

25 **CLOSING ARGUMENT BY MS. SEBALJ:**

26 MS. SEBALJ: Thank you. Our submissions don't
27 completely echo what Mr. DeRose has said, but they're in
28 that general direction, as well.

1 Board Staff went through the transcript from the
2 technical conference to pull out the reasons that were
3 cited by the IESO for retaining the surplus, both the
4 accumulated surplus, the 5 million, and the additional
5 surplus, the 8.1 that they're asking to retain.

6 And the three reasons that I was able to pull out were
7 just to assist in rate stabilization, to address the
8 higher-than-normal risk that energy volumes will be lower
9 than assumed, and to apply it to contingencies and future
10 revenue requirements over the three-year planning period.

11 And really, I think all of those, except perhaps the
12 contingencies and future revenue requirements, amount to
13 rate stabilization. And so this goes to the point that I
14 think both of my colleagues have made with respect to rate
15 stabilization, and whether it is and when is it
16 appropriate.

17 Board Staff agrees that it is a matter of principle,
18 but of course, Mr. Zacher has pointed you to the fact that
19 as a matter of principle, this Board has allowed the
20 retention of at least \$5 million in surplus on previous
21 occasions.

22 I will talk about that in a little bit more detail.

23 So Board Staff has three general points related to
24 rate stabilization. Who should bear the risk of the types
25 of events that the IESO is forecasting, and then of course
26 this concept of we are in a 2011 fees case and really this
27 surplus is being projected to be used over a period that
28 this fees case does not -- has not examined.

1 In general, this Board, in Board Staff's submission,
2 supports the concept of rate smoothing and rate mitigation.
3 I think everyone in this room has seen several examples of
4 this in the context of utility rate-setting, and we
5 certainly have a statement -- this Board has a statement
6 about it in its Electricity Distributor Deferral and
7 Variance Account Review report, which is commonly known as
8 the EDDVAR report.

9 Board Staff is of the view, however, that it is not
10 appropriate to stabilize rates unless there is a compelling
11 reason to do so.

12 In general, in electricity rate-setting contexts for
13 utilities, the concept of mitigation is usually only
14 allowed when the impact of rate changes approach or are
15 greater than about 10 percent on the total bill.

16 And as the parties have pointed out, there hasn't been
17 a thorough examination of whether the increases that the
18 IESO is projecting for 2012 and 2013 would constitute rate
19 shock or somewhere in the range of 10 percent on the total
20 bill.

21 I think intuitively, because we all know that the
22 IESO's fees are part of the wholesale market service charge
23 and that the wholesale market service charge is a
24 percentage of the total bill - and probably in the range of
25 12 percent - that it is unlikely that a 12 percent increase
26 over a two-year period would cause rate shock or require
27 rate mitigation in the traditional sense that the Board
28 uses that tool.

1 In the absence of rate shock, the principle of true
2 cost pricing or rate transparency that Mr. DeRose referred
3 to should, in Board Staff's view, prevail. In other words,
4 fee increases is not inherently bad to the extent that it
5 reflects increased costs.

6 Board Staff takes this view as it considers that part
7 of the Board's objective to protect the interests of
8 consumers with respect to prices and the adequacy,
9 reliability and quality of electricity service requires
10 that the Board set just and reasonable rates, which, in
11 turn, requires the Board, to the extent possible, and
12 without creating rate shock, to set rates that reflect the
13 costs to provide the service.

14 In this case, the IESO can do this, in Board Staff's
15 submission, without having to rate mitigate. So, in Board
16 Staff's view, it should do so.

17 The biggest mitigating factor for Board Staff, of
18 course, is that the IESO is a not-for-profit, and so it
19 doesn't have a shareholder from whom to borrow funds when
20 operating deficiencies occur.

21 As Mr. Zacher has indicated, the Board has approved
22 the retention of surpluses, and even though these have
23 largely been approved by the Board in the context of
24 settlement proposals, the general gist of those, in Board
25 Staff's opinion, was to deal with contingencies.

26 The evidence in this case, from a rate mitigation
27 perspective, however, is that the IESO could simply seek to
28 recover the deficiencies in the funds required in the next

1 fee's case.

2 Our second point is this concept of the risk of lower
3 demand and increased costs in future years. Board Staff is
4 of the view that while the IESO is clearly best positioned
5 to forecast these risks, the question becomes whether and
6 to what extent market participants should be funding a
7 contingency account which may or may not be needed, or
8 whether those consumers should get the benefit of these
9 funds now and be asked on ex post basis to fund past
10 revenue shortfalls by way of a subsequent fee increase.

11 Said in another way: To what extent should market
12 participants be bearing the risk premium on an upfront
13 basis by funding a contingency account that may or may not
14 be needed in future years, depending on whether the risks
15 identified by the IESO materialize?

16 In approving settlement proposals where the parties
17 agree that the IESO would retain \$5 million of any realized
18 surplus revenues, the Board has accepted on multiple
19 occasions the proposition that it is appropriate for the
20 IESO to retain a \$5 million surplus to fund these
21 contingencies.

22 Mr. Buonaguro has aptly pointed you to the fact that,
23 at least in Board Staff's perception, the types of
24 contingencies we thought that this 5 million was meant to
25 address were a, quote/unquote, "different animal"; not
26 forward-looking rate stability, but, rather, contingencies
27 of the sort that frankly the IESO has used it for. One
28 example is the \$4.3 million that is in evidence that was

1 used when there was a loss as a result of the losses on
2 asset-backed commercial paper.

3 Board Staff is of the view that it is appropriate to
4 continue this practice, meaning the approximately
5 \$5 million surplus, as it achieves a balance between
6 providing the IESO with the funds it needs to address
7 contingencies that may arise, against the need for market
8 participants to have some indication of the actual costs
9 that are associated with the operations of the IESO.

10 Our third and final point is concerned -- Board Staff
11 is concerned with the concept that the Board would allow
12 the IESO to retain monies accumulated in 2010 for the
13 period for which this fees case covers, which of course is
14 2011, even though the IESO has no intention - and Mr.
15 DeRose has pointed you to the transcript reference - to use
16 the surplus in 2011. In other words, the fee remains
17 stable in 2011, without having to use any of the
18 13.1 million that the IESO proposes to retain.

19 Board Staff is of the view that this Board Panel is
20 constituted to review the 2011 fees case, and that it is
21 not appropriate or necessary for you to authorize the
22 retention of funds in 2011 to cover risks of increased
23 costs or lower demand in subsequent years.

24 I would point out just one additional point in
25 relation to a question you asked, Member Hare, with respect
26 to the Minister's -- or it may have been Member Taylor, I'm
27 not sure, but with respect to the Minister's approval of
28 the IESO's proposed fees, and that is that by my review of

1 the evidence, and I am subject to be corrected on this, but
2 the additional 8.1 million was something that was requested
3 once they realized that there was a greater surplus than
4 they had originally projected, and that request was made
5 some time in February.

6 So they amended their application in February, and the
7 Minister's approval of the plan had been some time in 2010,
8 I believe in November 2010.

9 So whether or not it is relevant, I am not sure that
10 the Minister was aware of this additional request for
11 \$8.1 million.

12 Subject to any questions, those are Board Staff's
13 submissions.

14 MS. TAYLOR: The Panel has no questions. Mr. Zacher,
15 would you like a few minutes to organize your thoughts for
16 reply or...

17 MR. ZACHER: Sure. Thank you very much.

18 MS. TAYLOR: So perhaps we will reconvene at noon
19 sharp.

20 --- Recess taken at 11:43 a.m.

21 --- On resuming at 12:02 p.m.

22 MS. TAYLOR: Mr. Zacher, are you ready?

23 MR. ZACHER: I am. Thank you. I appreciate the
24 break.

25 **REPLY ARGUMENT BY MR. ZACHER:**

26 MR. ZACHER: What is clear, Madam Chair and Ms. Hare,
27 in my friends' submissions, is that the IESO can't be
28 viewed through the lens of an ordinary utility. It really

1 is, in many ways, different.

2 And that is reflected in the past treatment that the
3 Board has accorded to it, including with regards to the
4 particular deferral account we're talking about.

5 It does, as a precondition to applying to this Board
6 for approval of its fees case, have to have its business
7 plan approved by the Minister, and that is a three-year
8 business plan.

9 Just to correct one comment that my friend Ms. Sebalj
10 made, the business plan in this case did make explicit
11 reference to the projected increase in costs, decline in
12 demand and the request that would be made of the Board in
13 this fees case to use surplus for rate stabilization
14 purposes over the planning period. So that was very
15 explicit in the business plan that went to the Minister and
16 was approved.

17 What is also unique is that the IESO, while it plans
18 on a three-year planning horizon, really, anything shorter
19 than that wouldn't be prudent. It wouldn't make sense to
20 just plan your business out over a year, and then start
21 over again the next year.

22 The IESO plans for three -- every three years, but
23 then every year before it becomes before this Board, it
24 updates its business plan, so it is almost like a three-
25 year rolling business plan.

26 What my friends suggested to you, Mr. DeRose in
27 particular, is that what the IESO is effectively asking for
28 in this fees case -- which I agree is only for the purpose

1 of setting 2011 rates -- is to effectively ask to use
2 monies for the purposes of 2012 and 2013, which is not the
3 subject of this fees case.

4 But with all due respect, that is not what the IESO is
5 asking for.

6 It is a necessary -- because of the three-year
7 horizon, the IESO necessarily looks ahead, but the IESO is
8 not effectively asking for this Board's approval to take
9 the money retained and to use it in 2012 and 2013. And the
10 reason for that is because the IESO will be back before you
11 next year.

12 And so if circumstances change, if next year the
13 forecast for demand is higher and/or if the forecast for
14 costs is lower, then the IESO will certainly be proposing
15 different treatment for the surplus that it continues to
16 hang on to, and intervenors will have an opportunity to
17 make submissions on that.

18 What you are approving today doesn't make the use of
19 these monies in 2012 and 2013 a foregone conclusion. And
20 what the IESO has demonstrated each and every year that it
21 has come before this Board, is, as Ms. Nicholson said, just
22 because its budget is approved and it has money to spend,
23 it spends it. It doesn't do that.

24 It has been extremely prudent in how it's managed the
25 budget that's been approved by this Board.

26 Why we're asking in this case for the particular
27 amount of the surplus to be approved and retained in this
28 way is because the IESO does forecast an increase in costs

1 and a decrease in demand, because of what are absolutely
2 unprecedented and unique circumstances surrounding the
3 unfolding of the Green Energy Act.

4 It really is a step change in Ontario, and it is a
5 step change if you compare Ontario to any other
6 jurisdiction in North America.

7 On the other hand, to respond to one of my friend --
8 Mr. Buonaguro's point, the IESO is not suggesting that
9 these -- this increase in costs or this reduction in demand
10 is a forever scenario.

11 To the contrary, the IESO has identified the effects
12 of the Green Energy Act over the next three years. That is
13 principally when a lot of this new feed-in tariff renewable
14 generation is coming on line. And it is over that period
15 of time that the IESO requires additional resources to deal
16 with renewable integration.

17 So it is not a case where this is -- where the IESO is
18 forecasting this to go on forever. But what the IESO is
19 saying is if today we see out in the horizon two or three
20 years hence that we've got a balloon in costs and a
21 reduction in demand that is going to cause an unprecedented
22 increase in our fee, and we have money today, why not set
23 that money aside -- not all of it, part of it -- in order
24 to be there for the purposes of rate mitigation?

25 And if the IESO is right in its forecast or if, in
26 fact, demand goes lower and costs are even higher than
27 forecast, at least that money will be there in order to
28 defray costs, in order to soften the impact on customers.

1 But if the IESO is wrong, that money is there to be subject
2 to disposition and approval by this Board next year.

3 I want to address one other point that Mr. DeRose made
4 and I believe Ms. Sebalj made, and that has to do with
5 transparency of costs.

6 In my submission, the IESO is being very transparent
7 in its costs. It is highlighting the fact, in its business
8 plan, that it sees -- foresees an increase in costs, and
9 what it is simply proposing is measures that will soften
10 the impact of those costs on customers, which I submit is
11 an accepted ratemaking principle, accepted by this Board.

12 So in summary, there is no perfect treatment, but what
13 the IESO is proposing in this case -- to reiterate what I
14 said earlier -- is to try and strike a reasonable and
15 appropriate balance. It is to put some money, earmark some
16 money that is available now, to be there to guard against
17 and mitigate rate increases in the future, albeit subject
18 to what intervenors have to say next year and subject to
19 approval of this Board next year, and to take the balance
20 of the monies that are in the accumulated surplus account,
21 \$10.2 million, and to refund that amount immediately.

22 Subject to any further questions you may have, those
23 are my submissions.

24 MS. TAYLOR: The Panel has no questions.

25 So based on the submissions, we would like to issue an
26 oral decision this afternoon. We are proposing to break
27 for an hour and a half, so I believe that would bring us
28 back at quarter to 2:00, at which time we will give you our

1 decision as it relates to issue 3.3.

2 MR. ZACHER: Thank you very much.

3 MS. TAYLOR: Thank you.

4 --- Luncheon recess taken at 12:12 p.m.

5 --- On resuming at 2:00 p.m.

6 MS. TAYLOR: Please be seated.

7 **DECISION:**

8 MS. TAYLOR: The Board has been asked to approve a
9 proposal by the IESO to retain 13.1 million in operating
10 surpluses from years prior to 2011 to stabilize potential
11 future increases in IESO fees in 2012 and 2013. Although
12 this is a new concept from the point of view of the use of
13 the operating surplus, rate stabilization is an acceptable
14 and known regulatory tool.

15 However, rate stabilization is normally done once the
16 rate impact is known and after analysis and testing of
17 costs has occurred. It is also normally done when the
18 anticipated rate increase is likely to trigger a threshold
19 pursuant to which mitigation or smoothing is required.

20 Were the Board to accept this proposal as filed by the
21 IESO, it would be doing so without benefit of evidence that
22 costs in 2012 and 2013 will increase, that demand will
23 decline in a manner put forth by the IESO, and that the
24 IESO will not be able to manage its affairs to mitigate
25 anticipated increases in costs.

26 The IESO is thus asking the Board to approve a rate
27 mitigation plan with limited and untested evidence that one
28 will be required or that other options are unavailable to

1 address the increase in fees.

2 The Board also notes that although the IESO did file
3 its three-year business plan for the years 2011 to 2013,
4 the sole purpose of this proceeding is to approve the
5 proposed revenue requirement and the proposed fees for
6 2011.

7 All parties agreed that the 2011 fees are not affected
8 by the magnitude of the amount rebated to market
9 participants.

10 The Board agrees with the submissions of parties and
11 of Board Staff that transparency of the true costs is an
12 important principle, and that using a portion of the
13 operating surplus from previous years to reduce future fees
14 has the effect of masking the true cost pressures faced by
15 the IESO.

16 Doing so would also potentially create
17 intergenerational inequity, the avoidance of which is also
18 an important regulatory principle.

19 Even if the effect were small, as suggested by the
20 IESO, it remains an important regulatory principle.

21 If the IESO was like any other distributor, the Board
22 would order the return of the entire surplus. However, the
23 Board acknowledges that the IESO is not like a distributor
24 and that the retention of some of the surplus is
25 appropriate to enable the IESO to respond to revenue and
26 cost variances from forecasts, uncertainties that are
27 unforeseeable and beyond the control of IESO management,
28 such as ABCP and debt costs.

1 Since 2005, the IESO has retained a surplus for this
2 purpose of 5 million. The Board is of the view that
3 surpluses should be used -- or, rather, should not be used
4 primarily to mitigate future increases in fees that may or
5 may not occur.

6 Accordingly, the Board finds that it is appropriate
7 for the IESO to maintain a surplus of 5 million, which is
8 consistent with practice since 2005, and return
9 18.3 million to market participants via the existing
10 mechanism that would otherwise have been used to refund the
11 proposed 10.2 million to market participants.

12 Are there any questions?

13 MR. ZACHER: Other than I just -- the proposal would
14 be to rebate the money, the \$18.1 million, in the next
15 billing period, which I understand practically speaking
16 would be the May settlement statement. So even though
17 we're in April, to do it in the next few days might
18 logistically -- would be too difficult.

19 MS. TAYLOR: Are you suggesting that is a May or June?

20 MR. ZACHER: May.

21 MS. TAYLOR: May? That's fine.

22 MS. HARE: Can I understand? Can you do it in May
23 logistically or does that create a problem?

24 MR. ZACHER: It can be done in May, for the May
25 settlement statement.

26 I don't have my -- the application right in front of
27 me, but I believe we propose to do the rebate in the next
28 billing period.

1 So I just want to be clear that that wouldn't be
2 April, because it can't be done in the next couple of days.
3 So May is doable. Thank you.

4 MS. TAYLOR: If there are no further questions, this
5 proceeding is adjourned. Thank you.

6 --- Whereupon the hearing concluded at 2:06 p.m.

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