EB-2012-0031

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

AND IN THE MATTER OF an application by Hydro One Networks Inc. for an order or orders approving a transmission revenue requirement and rates and other charges for the transmission of electricity for 2013 and 2014.

BEFORE: Paula Conboy
Presiding Member

Cynthia Chaplin
Vice Chair and Member

Emad Elsayed
Member

DECISION AND ORDER
2013 EXPORT TRANSMISSION SERVICE RATES
June 6, 2013

Hydro One Networks Inc. ("Hydro One") filed an application with the Ontario Energy Board (the "Board") on May 28, 2012. The application was filed under section 78 of the *Ontario Energy Board Act, 1998*, c.15, Schedule B, seeking approval for changes to its 2013 and 2014 transmission revenue requirement and for changes to the provincial uniform transmission rates charged for electricity transmission, to be effective January 1, 2013 and January 1, 2014.

A Settlement Conference was held in which parties achieved settlement on all but one issue, namely Issue #23 from the approved Issues List: "What is the appropriate level for Export Transmission Rates in Ontario?" Export Transmission Service ("ETS") rates are charged to customers using the transmission system to export and wheel-through transactions at the point of interconnection with neighbouring markets. The Independent Electricity System Operator ("IESO") collects and remits the ETS revenue on a monthly basis to Hydro One as a revenue offset used to reduce transmission rates paid by domestic customers.

The Settlement Proposal was approved by the Board in an oral decision on November 8, 2012. On December 7, 2012 the Board issued a Decision on Interim Rates and Procedural Order #10, declaring Hydro One's current ETS rate of $2.00/MWh final as of January 1, 2013 until such time as the Board makes its decision in this proceeding.

The Board issued a rate order on December 20, 2012, approving the Ontario Uniform Transmission Rates, effective January 1, 2013.

Background

In 1999, when Ontario's electricity market opened, the Board set an ETS rate of $1.00/MWh as a "placeholder" with the acknowledgment that the rate was "not the product of an objective, principled or pragmatic study."[1]

The Board next considered changes to the ETS rate in 2010 as part of its decision concerning Hydro One's 2011 and 2012 Transmission Rates (EB-2010-0002) and increased the rate to $2.00/MWh. However, the Board concluded that, "…the most pressing requirement is that a genuinely comprehensive study be undertaken to identify a range of proposed rates and the pros and cons associated with each proposed rate in time for the next transmission rate application."[2] The Board directed the IESO to undertake this comprehensive study.

The IESO engaged Charles River Associates ("CRA") to perform the study which was then filed as part of the evidence in this proceeding ("CRA Study").

CRA, with input from stakeholders, studied five ETS rate options:

[1] RP-2009-0044, page 66
[2] EB-2010-0002, page 75

1. the status quo of $2.00/MWh;
2. unilateral elimination (i.e., a $0.00/MWh);
3. an increase to the current Equivalent Average Network Charge ("EANC") of $5.80/MWh;
4. a tiered rate of $5.80/MWh during on-peak hours and $0.00/MWh during off-peak hours; and
5. a tiered rate of $3.50/MWh on-peak and $1.00/MWh off-peak.

CRA reviewed the tariff and structures in neighbouring markets and assessed the proposed rate options against generally accepted rate making principles (consistency, simplicity, fairness and efficiency). CRA also analyzed the impact of each option on Ontario consumers, producers and the Ontario Market as a whole by estimating the impacts on consumer welfare, producer welfare (more commonly referred to throughout the proceeding as “consumer surplus” and “producer surplus”) and Intertie Congestion Revenue (“ICR” or “IC Revenue”). In aggregate, CRA indicated that these three elements provide a measure of “total welfare” or “total surplus” to Ontario as a whole. The CRA Study also assessed the impact of each option on the frequency and duration of surplus baseload generation [3](“SBG”). CRA did not attach any weighting or preferences to the criteria or provide a recommendation on the most appropriate ETS rate.

The Association of Power Producers of Ontario (“APPrO”) and Hydro Quebec Energy Marketing Inc. (“HQEM”) each filed expert evidence in response to the CRA Study.

APPrO retained Navigant Economics (“Navigant”) which filed a report outlining the shortcomings of the quantitative analysis component of the CRA Study, some of which Navigant maintained were material. Navigant argued for the lowering or elimination of the ETS rate. APPrO also filed evidence by Mr. Marc-Andre Laurin, Senior Trader at Brookfield Energy Marketing LP. Mr. Laurin’s evidence assessed the CRA options from the perspective of “real world” electricity trading. His analysis concluded that given the current state of the wholesale power market in Ontario and in surrounding jurisdictions, any ETS rate higher than $0 would greatly reduce the incentive to export out of Ontario, especially in periods of SBG.

[3] Surplus Baseload Generation occurs when electricity production from baseload facilities (such as nuclear, hydro and wind) is greater than Ontario demand.

HQEM engaged Elenchus Research Associates ("Elenchus") to assess how the ETS rate should be set. Elenchus concluded that it would be inappropriate for the Board to establish an ETS rate in the absence of a proper cost allocation study. Elenchus recommended applying the principle of cost causality to determine the ETS rate and suggested that it could be achieved by creating a separate rate class for exporters.

An expert pre-hearing conference was held on December 12 and 13, 2012. The experts (CRA, Navigant, and Elenchus) subsequently filed a Joint Written Statement with the Board on January 16, 2013.

The experts testified during an oral hearing on February 25 and 26, 2013 as a concurrent witness panel. Mr. Darren Finkbeiner of the IESO was included on the concurrent expert witness panel for the purpose of answering clarification questions regarding the IESO market. Mr. Laurin appeared as a separate witness panel.

The IESO filed its final submission on March 8, 2013. On March 22, 2013, the Board received submissions from HQEM, APPrO, the Association of Major Power Consumers in Ontario ("AMPCO"), the Consumers Council of Canada ("CCC"), Canadian Manufacturers and Exporters ("CME"), Energy Probe, the School Energy Coalition ("SEC"), the Vulnerable Energy Consumers Coalition ("VECC"), the London Property Management Association ("LPMA"), the Power Workers Union ("PWU") and Board staff. The IESO filed its reply submission on April 1, 2013.

Board Findings

The Board has determined that the ETS rate should remain unchanged at $2.00/MWh. In coming to this conclusion, the Board considered the following alternatives:

- Setting the ETS rate to the Equivalent Average Network Charge. This approach was favoured by VECC, SEC and CCC.
- Eliminating the ETS rate. This approach was supported by the IESO, APPrO and the PWU.
- Setting a two-tiered ETS rate, as supported by CME.
- Retaining the $2.00 ETS rate. This approach was supported by Energy Probe, HQEM, LPMA and Board staff.

Each of these alternatives is discussed below.

Should the Equivalent Average Network Charge apply?

In arguing that the ETS rate be set to the same level as domestic transmission (EANC of $5.80/MWh), VECC, SEC and CCC submitted that the service offered to export customers is fundamentally the same as that offered to domestic customers. VECC and SEC raised the “user pay” argument which, from a “fairness” perspective, would require the user of an asset to contribute towards its costs. SEC submitted that the “user pay” principle should apply unless different customer types have different transmission rights (and hence different access to the system) or significant system benefits that warrant another rate-setting approach. CCC supported VECC’s submissions.

APPrO and HQEM submitted that export customers are treated differently than domestic customers. In their view, the Ontario transmission system was designed and built to serve domestic load; export customers use only excess capacity and therefore impose no incremental cost. These parties argued that the IESO largely operates the Ontario transmission grid in a way that benefits domestic loads over exports. For example, export customers in Ontario, unlike exporters in other jurisdictions, can be curtailed and are unable to participate in capacity markets of neighbouring jurisdictions. In their view, export service should be viewed as interruptible service when setting appropriate rates.

The Board will not increase the ETS rate to $5.80/MWh for three reasons. First, whether curtailments originate from generation issues or transmission issues, the Board agrees that export service does not receive the same priority access as domestic service. The Board accepts that the market rules treat exporters more as an interruptible load. This difference in treatment related to generation capacity has consequences for the overall service, even if export transmissions rights are technically as firm as domestic transmission rights. As a result, the Board finds that it may be appropriate for the export service to be viewed as a separate class. Second, absent a cost allocation study, the degree to which the differences in service should be reflected in a rate differential is unknown. There is simply no clear evidence in this proceeding as to the costs caused by export customers in Ontario. Third, increasing the ETS rate from $2.00/MWh to the current Equivalent Average Network Charge of $5.80/MWh in one step would represent an unacceptable increase in the rate paid by exporters.

Should the ETS rate be eliminated?

The IESO, PWU and APPrO argued that given the results of the CRA study, the appropriate ETS rate is zero. These parties focussed on the following factors:

- benefits to Ontario consumers, producers and the province as a whole;
- enhanced Ontario market efficiency, including during SBG events; and
- consistency with neighbouring jurisdictions who have zero tariffs.

The Board's conclusion is that there is insufficient evidentiary support for these factors to warrant the elimination of the ETS rate. Each factor is discussed below.

Generally, the CRA study concluded that lower export tariffs lead to higher levels of exports, resulting in higher market prices in Ontario. These changes are largely offset by changes in Global Adjustment payments so that the net impact on consumers' bills and producers' net income is generally small. The main impact on the surplus estimation comes from the level of Inter-Tie Congestion Revenue ("ICR"). These amounts flow to the IESO in the form of congestion rents. There was disagreement amongst the experts, and amongst the parties, as to how the allocation of the producer surplus and ICR should be viewed. The allocation of these amounts to Ontario consumers, either directly or indirectly, impacts which ETS rate option appears to provide the greatest benefit.

For example, while CRA treated net income earned by Ontario Power Generation ("OPG") on its non-prescribed hydroelectric operations as producer surplus, some parties argued that OPG's revenues ultimately flow to Ontario consumers. The factor which has the largest impact on the results is the ICR. The experts differed as to how much of that the ICR benefit flows to customers (versus traders), and how directly (via payments from the IESO). Navigant expert witness, Mr. Hamal, testified that that the ICR should be interpreted as flowing completely to Ontario consumers, and he pointed to recent IESO payouts as support for this interpretation. CRA did not agree, and maintained that some of the ICR would likely flow to traders. Further complicating the issue is the fact that the IESO is undertaking a review in this area, which may subsequently affect the level and distribution of congestions rents, auction revenue, etc.

The IESO submitted that compared to the other options, elimination of the ETS rate would best encourage the efficient operation of the wholesale market, specifically efficiency in the generation, transmission and sale of electricity. This conclusion was supported by PWU and APPrO. APPrO submitted that other benefits of eliminating the ETS rate are even greater than those quantified in the CRA study.

Those who did not support the elimination of the ETS rate pointed to disagreement among parties on the calculation and allocation of the system benefits. Issues were raised with respect to the treatment of uplift charges, the validity of the assumptions about the Western Climate Initiative, the allocation of the ICR benefits, etc.

The Board agrees that there may be instances when it is appropriate to depart from strict cost causality when setting a rate. One circumstance might be where there will be demonstrable and significant benefits from an alternative approach. However, the benefits would have to be compelling and substantial to justify providing exporters with a service for which they make no contribution to the associated cost. In this case, it is certain that eliminating the ETS rate will raise transmission rates for all other customers, however small that increase may be. Balanced against this are uncertain benefits flowing from a more efficient generation market. There is further uncertainty as to the distribution of those benefits amongst the various parts of the market. It is therefore highly uncertain whether the customers bearing the increased transmission costs will receive benefits of a similar magnitude.

With respect to the impact on SBG, the CRA study found that none of the tariff options would materially affect the volume of exports during SBG periods. However, APPrO argued that increased exports resulting from the elimination of the ETS rate would help reduce the incidence of SBG, and the resulting costs of managing SBG. The PWU made similar submissions.

All parties agreed that there are non-price factors that limit the ability of marketers to sell outside the province to take advantage of the price separations during SBG periods. The Board notes that IESO is continuing to take steps to reduce these non-price limitations and to generally mitigate SBG. The Board concludes that those initiatives are likely to have a greater impact on reducing the incidence of SBG than eliminating the ETS rate would. As with the general system efficiency benefits discussed above, the Board is not convinced that the potential benefits from reduced SBG are sufficient to warrant the increase in transmission rates to other customers.

With respect to comparisons with other jurisdictions, APPrO argued that eliminating the ETS rate would bring the all-in costs payable by Ontario exporters more in line with the costs payable by exporters in neighbouring jurisdictions. APPrO noted the elimination of ETS rates between New York Independent System Operator and Independent System Operator New England, and between MISO and PJM and argued that Ontario should also eliminate its ETS rate. VECC submitted that it is more important to look at the comparability of the methodologies underlying the derivation of the ETS tariffs than the comparability of the actual level of the ETS rates themselves across jurisdictions. This was supported by SEC. VECC noted that the elimination of tariffs in the cited examples was the result of reciprocal bilateral arrangements between the two jurisdictions and not unilateral decisions by one jurisdiction as is proposed in this case. AMPCO and CME made similar submissions that elimination of the ETS rate in Ontario should not be done unilaterally as other neighbouring jurisdictions would have no reason to reduce their rates if Ontario had already done so. The IESO noted that for most of Ontario's neighbouring jurisdictions establishing reciprocal transmission pricing agreements is not a priority.

Some jurisdictions near Ontario have cost based export charges; some have arranged bilateral agreements to eliminate export charges. On the basis of these comparisons, the Board finds that the arguments for eliminating the ETS rate are not persuasive. There is no proposal before the Board for the mutual elimination of export charges.

Should the Board adopt a two-tiered approach to setting the ETS rate?

The CRA Study also provided two two-tier options: Option A ($5.80/MWh on-peak and $0.00/MWh off-peak) and Option B ($3.50/MWh on-peak and $1.00/MWh off-peak). Only CME submitted that a two-tiered option was preferable, but suggested an alternative two-tiered option that was not part of the CRA Study: $5.80/MWh on-peak and $1.00/MWh off-peak. In addition, Board staff suggested that apart from the *status quo*, the option suggested by APPrO witness Mr. Hamal of $2.50/MWh on-peak and $0.00/MWh off-peak could be an alternative worth considering, but that there was insufficient evidence on the record in order for the Board to consider it properly.

The Board concurs with most parties' submissions that the two-tiered options put forward did not provide compelling benefits that would justify moving to a more complex and administratively difficult methodology. Mr. Laurin, an electricity trader, testified that a two-tiered structure would be more difficult for trading in the market. The Board also notes that the options suggested by CME and Board staff were not addressed in the CRA Study with little or no evidence to support the potential benefits of those scenarios.

In addition, these options have no demonstrable basis in cost causality. Therefore, the Board finds that the two-tiered options are not preferred solutions.

Should the ETS rate stay at $2.00/MWh?

Board staff submitted that there was no compelling evidence that the current $2.00/MWh rate is not in the best interests of consumers or that it causes economic inefficiency, which are the Board's statutory objectives most relevant to this proceeding. Board staff recommended that a cost allocation study be conducted to determine the actual costs of the ETS service before a rate change is approved. LPMA also submitted that there is insufficient evidence at this point to support a change to the ETS rate.

HQEM submitted that the Board should not approve any rate change and that if in the future Hydro One seeks to change the ETS it should prepare a cost allocation study that provides an evidentiary basis for a new rate.

Energy Probe also supported the conclusion that the ETS rate should remain at $2.00/MWh until a full cost allocation study is undertaken in time for Hydro One's next transmission rate case. While the PWU submitted that the evidence "overwhelmingly" supported the elimination of the ETS rate, it also submitted that if the Board decided a cost allocation study is required then the ETS should remain at $2.00/MWh until the study is completed.

The Board finds that absent an analysis of cost causality (through a cost allocation study), there is insufficient basis for the Board to conclude that any change to the ETS rate is just and reasonable. The Board concludes, therefore, that the rate should remain unchanged.

The Board will require Hydro One to perform a cost allocation study to establish a cost basis for the ETS rate. Some parties have suggested that such a study would be prohibitively costly. However, the Board accepts the Elenchus testimony that a study could be properly scaled to address the magnitude of the issue and could be completed for a reasonable cost. The Board expects that this study will be completed in time for Hydro One's next cost of service transmission rate application. While Hydro One has the responsibility for completing this study, the Board expects that the IESO will assist Hydro One as required to fully address the ETS rate issue.

THEREFORE, THE BOARD ORDERS THAT:

1. Hydro One's current Export Transmission Service rate of $2.00/MWh is confirmed as final.

2. Hydro One shall prepare a cost allocation study involving the network assets utilized by export transmission customers and report the results of this study, including a proposal of the appropriate cost based ETS rate with supporting rationale, to the Board at its next transmission rates application.

Cost Awards

The Board may grant cost awards to eligible parties pursuant to its power under section 30 of the Ontario Energy Board Act, 1998. When determining the amount of the cost awards, the Board will apply the principles set out in section 5 of the Board's Practice Direction on Cost Awards. The maximum hourly rates set out in the Board's Cost Awards Tariff will also be applied.

1. Intervenors shall file with the Board and send to Hydro One, their respective cost claims within **7 days** from the date of issuance of this Decision.

2. Hydro One shall file with the Board and send to intervenors, any objections to the claimed costs within **17 days** from the date of issuance of this Decision.

3. Intervenors shall file with the Board and send to Hydro One, any responses to any objections for cost claims within **24 days** of the date of issuance of this Decision.

4. Hydro One shall pay the Board's costs incidental to this proceeding upon receipt of the Board's invoice.

All filings with the Board must quote the file number, EB-2012-0031, and be made through the Board's web portal at www.pes.ontarioenergyboard.ca/service/, and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format.

Filings must be received by the Board by 4:45 p.m. on the stated date. Parties should use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at www.ontarioenergyboard.ca. If the web portal is not available, parties may e-mail their documents to the attention of the Board Secretary at BoardSec@ontarioenergyboard.ca. All other filings not filed via the Board's web portal should be filed in accordance with the Board's Practice Directions on Cost Awards.

ISSUED at Toronto, June 6, 2013

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary