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BY EMAIL & RESS

April 29, 2016
File No. 101926-1078

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Dear Ms. Walli:

**Re: Smart Meter Entity Annual Cost and Variance Account Report for 2015
(EB-2012-0100/EB-2012-0211)**


On behalf of the Independent Electricity System Operator (the "IESO") in its capacity as the Smart Metering Entity ("SME"), we are providing the Ontario Energy Board (the "Board") with the SME's Annual Cost and Variance Account Report for the year ended December 31, 2015 (the "2015 Report"). The enclosed 2015 Report represents the SME's third annual filing with Board for the Smart Metering Charge (the "SMC") that is in effect from May 1, 2013 to October 31, 2018.

The enclosed 2015 Report addresses the matters identified in section 1.4(d) of the approved Settlement Agreement dated March 28, 2013 (the "Settlement Agreement") and section 6 of the Accounting Order dated May 14, 2013 (the "Accounting Order") in EB-2012-0100/ EB-2012-0211.

By copy of this letter, we are providing the 2015 Report to all Board approved intervenors in EB-2012-0100/ EB-2012-0211 as required by the Settlement Agreement and the Accounting Order. The Settlement Agreement states that intervenors are to have an opportunity to submit comments on the 2015 Report to the Board.

We trust the foregoing will be satisfactory. If you have any questions, please contact the undersigned at the address above.

Yours truly,



Patrick G. Duffy

PD/
c.c.: Sorana Ionescu, IESO
Adrian Pye, IESO
Registered Intervenors for EB-2012-0100/EB-2012-0211
encl.

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2015 Annual Cost and Variance Account Report

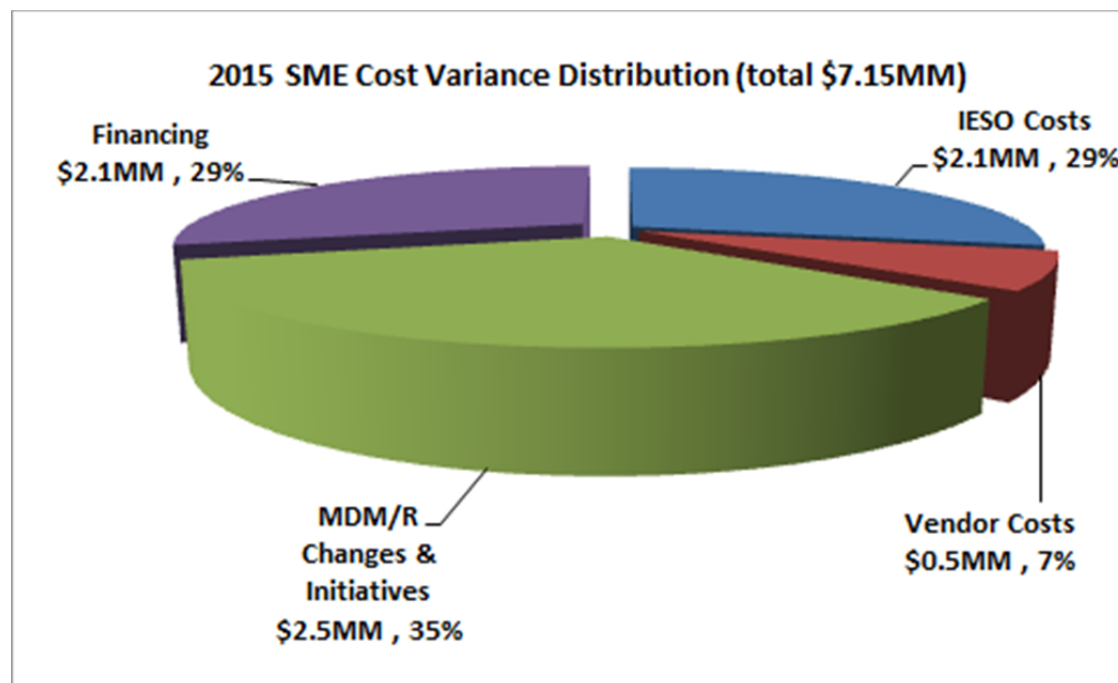
The following SME Annual Cost and Variance Report provides an overview of the SME's financial status as of the end of 2015, high level projections on the SME operations covering the remainder of the current SMC period and the IESO's recommendation for maintaining the current SMC with supporting analysis and rationale.

More specifically, the 2015 Report provides:

- The 2015 variances between the SME's budgeted and actual costs for 2015 presented in the form of a summary with a distribution view and rationale for each variance category (Table 1 – 2015 SME Cost Variance Distribution) and an overall 2015 Cost Variance Summary (Table 2 – SME Cost Variance Summary)
- A graph outlining the historical and projected position on the SME Debt Recovery (Table 3 – SME Debt Recovery Projection)
- The SME Annual Cost Report attached as Appendix C to the Settlement Agreement (Table 4 – SME Annual Cost Report)
- The balances of the Costs Account, the Revenue Account and the Service Level Credits Account in the form of the Sample Report set out by section 5 of the Accounting Order (Table 5 – SME Variance Account Report)
- The SME Statement of Financial Position which shows the debt owed to the IESO as of December 31, 2015 (Table 6 – SME Statement of Financial Position)
- The 2015 SME Financial Reconciliation to the IESO Audited Financial Statements (Table 7)

As shown in the 2015 Report, the SME's actual costs for 2015 were \$23.1MM, this is \$7.15MM less than the budgeted amount for 2015 of \$30.3MM included in the SME's rate application in EB-2012-0100/ EB-2012-0211. A more detailed view of the allocation of these variances is shown in Tables 1 and 2 below.

Table 1 – 2015 SME Cost Variance Distribution



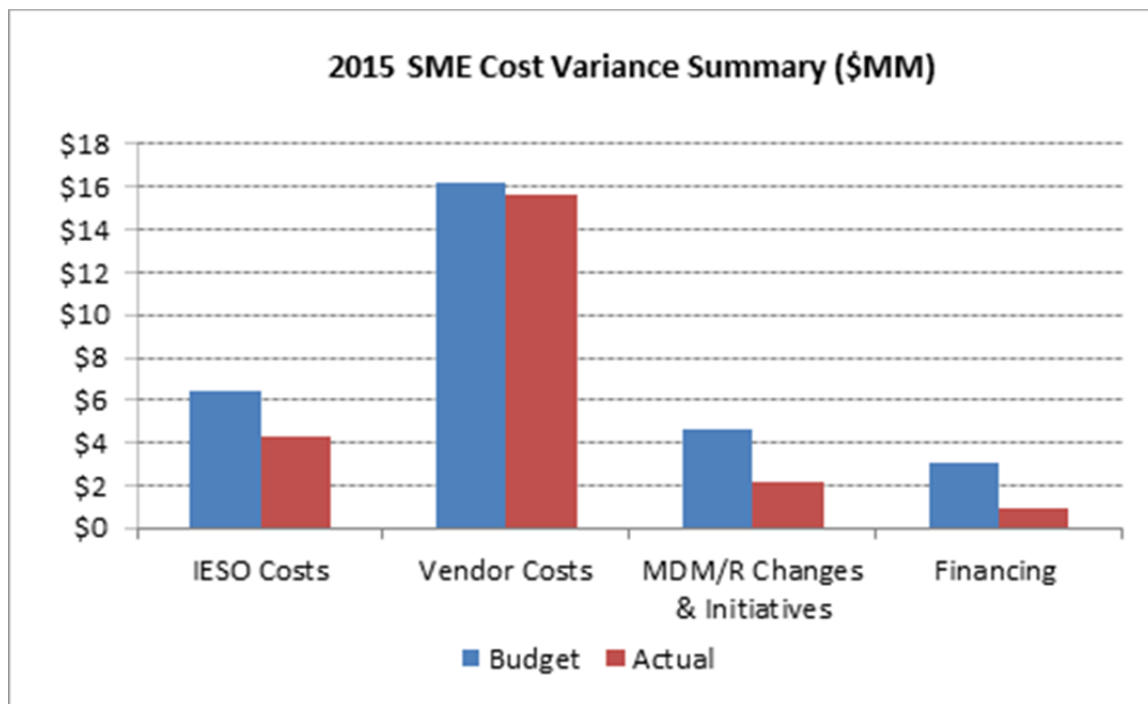
The following is a summary and rationale for each variance category:

- **Lower IESO costs of \$2.1MM, representing 29% of the total cost variance in 2015**
 - This is a trend continued from previous years, in part as a result of the conservative business model assumed by the SME given the planned transition of the SME from the IESO to the Electricity Distributors Association (the “EDA”) (this matter was concluded in the fall of 2015 with the EDA indicating they are no longer interested in assuming governance of the SME). Other factors contributing to the variance were an IESO hiring freeze in 2015, the lower costs of temporary resources, delays in the filling of a management position, and overall lower contractor costs due to deferral of technical projects such as the Meter Data Management and Repository (“MDM/R”) 7.7 platform upgrade, the ongoing status of the Toronto Hydro MDM/R Integration and the re-scheduling of the deployment of the MDM/R Data Mart from 2015 to 2016.
- **Lower MDM/R Changes and Initiatives Costs of \$2.5MM, representing 35% of the total variance**
 - The deferral of technical projects such as the MDM/R 7.7 upgrade, Toronto Hydro Integration and the MDM/R Data Mart, each contributed approximately equally to the variance. These deferrals were in part a result of a cascaded effect from previous years’ delays (such as, a delay in the implementation of MDM/R Release 7.6 and the

Measurement Canada 2012 Upgrade from 2014 to early 2015). As a result MDM/R Release 7.7 version is now scheduled to start in 2016 with a completion date of Q1 2017. Toronto Hydro delayed their integration with the MDM/R pending approval of the necessary budget by the Board (which was received on December 29, 2015). The implementation of the MDM/R Data Mart was also deferred to allow the SME to ensure an optimum solution was deployed that would fully meet the needs of the Local Distribution Companies (LDCs) and other users.

- **Lower Financing Costs of \$2.1MM, representing 29% of the total 2015 variance**
 - This variance is the combined result of the lower interest rates and the accelerated pay down of the SME debt over the past three years. The accelerated pay down of the SME debt (originally sitting at \$100.1MM in 2013 at the start of the current SMC collection period) took place as revenues were collected at just slightly higher than originally budgeted levels, while costs have come under budget mostly thanks to ongoing operational savings or the rescheduling of certain key technical projects.

Table 2 – SME Cost Variance Summary



Under section 1.4(d) of the Settlement Agreement, the SME is required to bring an application to adjust the SMC when its annual costs are over or under forecast by more than \$2MM or explain why an application is not required:

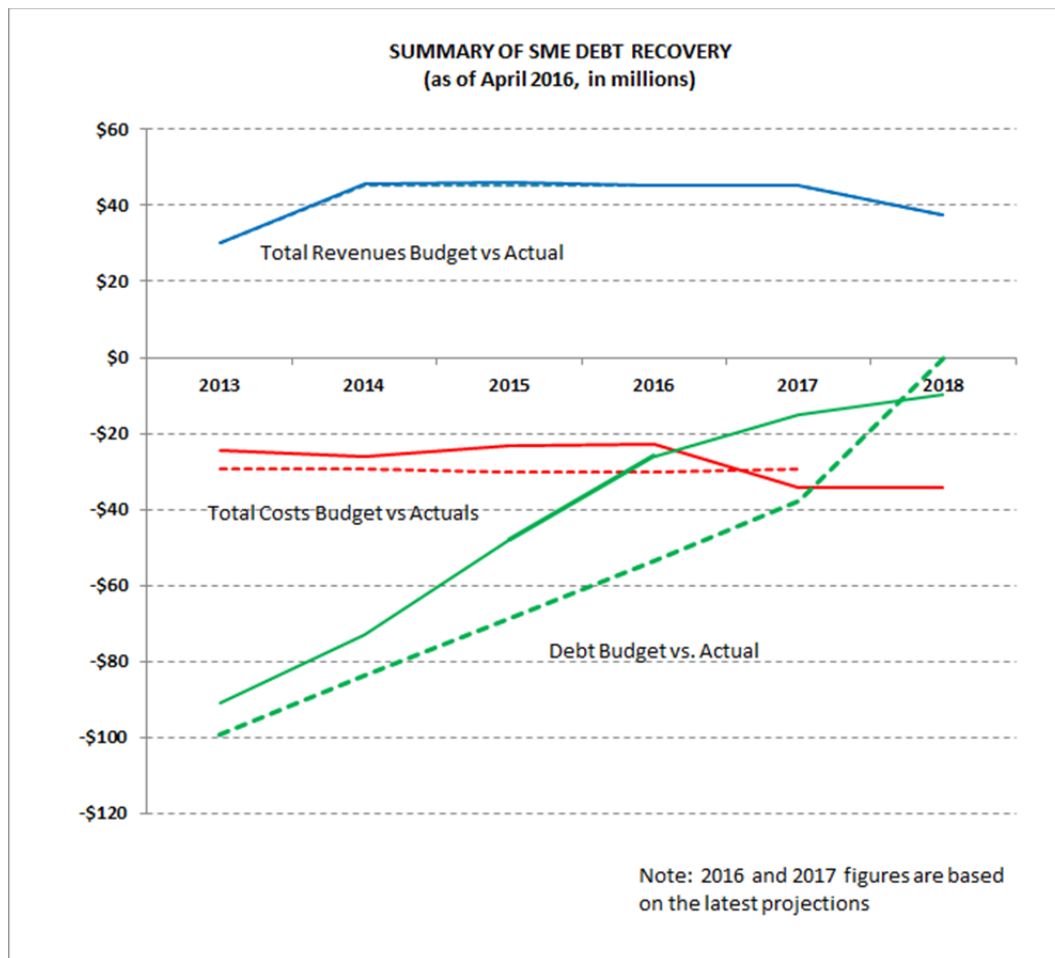
“If the SME’s total actual costs for a calendar year are over or under the forecast for that calendar year by more than \$2MM, then the SME shall bring an application to adjust the SMC unless it provides a satisfactory explanation to the Board for why an application to adjust the SMC is not required.”

The SME submits that an application to adjust the SMC is not warranted at this time for the following reasons:

- As of December 31, 2015 the IESO's SME related debt for the development, implementation and operation of the MDM/R was \$48.1MM (Table 6). Any unallocated revenues collected during previous years should continue to go towards recovering the SME's debt. Paying down the debt faster is resulting in **significant savings for ratepayers** on financing costs and the SME should continue to take full advantage of current predictive interest rates to accelerate the collection and minimize the cost of debt.
- The originally approved budget assumed the full \$100.1MM SME debt recovery by the end of the collection period in October 31, 2018 but only included operational costs up to December 31, 2017. While the overall SME costs have come under budget in previous years, the SME has now entered a stage of end of life / support for various technology components and is therefore required to undertake some significant upgrade projects which will require committed investments starting in 2016 through to completion in 2018/2019 (for example the MDM/R Upgrade 8.X is a multi-year re-platforming project with an estimated cost of over \$20MM in the period 2017 – 2019). Retention of the current favourable spending variance would allow the SME to significantly reduce its debt, cover for the unbudgeted 2018 operational cost requirements and potentially reduce the revenue collection in 2018 (originally budgeted at \$37.7MM).
- Table 3 below summarizes the budgeted debt recovery versus the projected debt recovery by 2018 under the assumption that these upgrades will have to be committed to as mentioned above – this will put an additional strain on SME’s ability to fully recover the debt by the end of 2018.
- The accelerated repayment of the outstanding historic debt described above is allowing the assets and associated debt to be paid for by the beneficiaries of those assets, thereby reducing intergenerational inequity. The SME’s debt dates back as far as March 1, 2008 when the MDM/R originally went into service¹. As stated earlier the assets associated with this debt have now entered a stage of mandatory upgrades to ensure that the system continues to perform at the required service levels. The accelerated repayment of the outstanding historic debt that the SME has been able to undertake means the beneficiaries of the assets associated with that debt are paying for those assets and the associated financing costs.

¹ Eb-2012-0100 ExC/T1/Pg2: The period over which the costs would be recovered is based on the estimated asset service life for the MDM/R of approximately ten years: from the date it initially went into operation on March 1, 2008 to December 31, 2017

Table 3 – SME Debt Recovery Projection



- Furthermore, over the last two years of the current SMC, the SME will be finalizing certain deferred projects such as the MDM/R Data Mart project - the project has successfully completed the pilot phase in Q1 2016 and preparations are now underway for the go live in mid-2016. This project is also a key dependency for the successful completion of the January 2016 OEB Order (more details below) as the additional fields requested to be available by January 1, 2017 will be sourced from the MDM/R Data Mart. The MDM/R Data Mart was not originally included in the SME budget and costs associated with the operationalization of the Data Mart are projected to be as high as \$1MM in the 2016 – 2017 period.
- The SME also received two new OEB orders in January 2016, one final and one draft:
 - 1) The first OEB order (EB-2015-0297), which has implications on resources and budgets that were not initially planned for, extended the SME's licence and the SME/LDC Agreement to December 31, 2016 and requires the SME to file a plan to implement the following with its next licence renewal application: "Effective

January 1, 2017, the SME shall collect the following information associated with each meter (modified where necessary to sufficiently render it non-personal information):

- a. The postal code.
- b. The distributor rate class.
- c. The commodity rate class.
- d. Occupant change data.

The next SME licence application (Fall 2016) will also be required to address the Implementation Plan with respect to third party access to this enhanced SME data, including an assessment of the cost implications.

This new OEB initiative will draw on SME resources with unbudgeted costs required for a wide range of activities from the running of the working group, technical implementation of the new data specifications, consulting costs associated with the privacy analysis to ensure that the data collected is rendered non-personal, technical testing, to LDC communications.

- 2) The second January 2016 OEB draft order requires the SME to file by December 31, 2016 an application with a recalculated SME charge. This is to include a five-year forecast of costs, including consideration of the costs of the “Implementation Plan”, no later than December 31, 2016. In its reply, the SME requested that the filing for a new SMC be extended to Q2 2017 or later. This timing would allow the SME to consider the following factors, which would result in a more accurate projection of costs:

- The implementation plan and cost implications with respect to 3rd party access to the enhanced SME data
- 2016 IESO audited financial statements, including the balance of the SME’s outstanding accumulated deficit, 2016 revenues and costs, and
- Work currently underway to review other key factors (such as, new technical projects or a new vendor architecture associated with the additional SME deliverables) - this work is not expected to be completed until end of 2016/early 2017.

For the above reasons, the SME recommends that the SMC should remain unchanged, to allow the SME to fully recover its debt by end of 2018 while maintaining the high level of performance of the MDM/R as a valuable provincial asset, as well as meeting the evolving requirements of the stakeholders in the province.

Table 4 – SME Annual Cost Report

BUDGET Category	Calendar Year: 2015					Explanation
	Smart Metering Charge Revenue Requirement	Budget Transfer (1)	Budget	Actual	Variance (Budget - Actual)	
MDM/R OPERATIONS						
IESO Costs						
IESO Project Team costs						
IESO Staff Costs	\$ 3,670,475	-\$ 207,125	\$ 3,463,350	\$ 2,515,919	\$ 947,432	The SME incurred lower costs through a combination of lower IESO labor costs and lower contractor resources utilization due to deferred technical projects.
Contractor Costs	\$ 2,147,572		\$ 2,147,572	\$ 1,217,640	\$ 929,932	
Total IESO Project Team Costs	\$ 5,818,047	-\$ 207,125	\$ 5,610,922	\$ 3,733,559	\$ 1,877,363	
External Fees and Expenses	\$ 512,587	\$ 207,125	\$ 719,712	\$ 523,122	\$ 196,590	The MDM/R Data Mart project was re-scheduled to go into production in 2016, therefore the pre-audit preparatory activities originally scheduled in 2015 were deferred to reflect the new go live date.
Regulatory Process: Licensing & Cost Recovery	\$ 10,000		\$ 10,000	\$ 9,611	\$ 389	
IESO Communications Support	\$ 54,636		\$ 54,636	\$ 69,846	-\$ 15,210	
Total IESO Costs	\$ 6,395,271	\$ -	\$ 6,395,271	\$ 4,336,138	\$ 2,059,133	
Vendor Costs						
Vendor Base Contract Costs	\$ 14,311,101	\$ -	\$ 14,311,101	\$ 14,222,260	\$ 88,840	The IBM OSP contract has a variable, fluctuating annual inflation factor that is calculated based on the Economic Change Adjustment (ECA). For 2015, the inflation factor was 2.4% (for reference, in 2014 the inflation factor was 2.9%).
						The variance is mainly caused by a prepaid balance of \$333K for software maintenance that will be fully reflected in 2016. The remainder of the variance is caused by deferred additional test environments to support expanded LDC testing requirements (e.g. LDC Mergers & Acquisitions) as well as in support of the SME's long term MDM/R re-platforming strategy.
Software Licenses	\$ 1,546,099	\$ 360,000	\$ 1,906,099	\$ 1,472,149	\$ 433,950	
Total Vendor Costs	\$ 15,857,200	\$ 360,000	\$ 16,217,200	\$ 15,694,409	\$ 522,790	
Total MDM/R Operations Costs	\$ 22,252,470	\$ 360,000	\$ 22,612,470	\$ 20,030,547	\$ 2,581,923	
MDM/R Changes and Initiatives						
						The delay in initiating a MDM/R EnergyIP Release 7.7 upgrade project (following the shift in the completion date of the MDM/R EnergyIP Release 7.6 upgrade project from 2014 to early 2015) limited the need for the use of contractors and external temporary resources in 2015. Those costs are committed for the launch of the MDM/R Release 7.7 upgrade project in 2016, and scheduled for completion in Q1 2017.
MDM/R Changes	\$ -	\$ 2,300,000	\$ 2,300,000	\$ 1,303,249	\$ 996,751	The SME anticipated a significant portion of the activities related to the integration of Toronto Hydro with the MDM/R would occur in 2015, however Toronto Hydro requested that no further work be pursued until their OEB rate case was approved, which occurred at the end of December 2015. Work has resumed in 2016 for the Toronto Hydro integration with MDM/R, therefore some costs will start to materialize in 2016 and 2017 depending on the project implementation schedule.
						The MDM/R Data Mart project was scheduled to go live in 2015, requiring additional resources from an Operational Service Provider (OSP) to operate and maintain the system. Due to technical issues with a specific component of the solution, the production date has been rescheduled to mid 2016. This rescheduling has shifted a significant portion of the 2015 budgeted costs into 2016 and beyond.
Provision for MDM/R Upgrades, Maintenance and Changes	\$ 5,000,000	-\$ 2,660,000	\$ 2,340,000	\$ 862,724	\$ 1,477,276	A total of \$2,660,000 was transferred from the budget for Provision for MDM/R Upgrades, Maintenance and Changes to: (1) \$2,340,000 to MDM/R Changes and (2) \$360,000 to Software Licenses.
Total MDM/R Changes and Initiatives Costs	\$ 5,000,000	-\$ 360,000	\$ 4,640,000	\$ 2,165,973	\$ 2,474,027	
SUB-TOTAL (Before Financing Costs)	\$ 27,252,470	\$ -	\$ 27,252,470	\$ 22,196,520	\$ 5,055,950	
						Lower financing costs can be attributed to two main factors: lower than anticipated interest rates and an accelerated pay down of debt due to deferred project costs as well as cost savings in prior years.
Financing Costs	\$ 3,047,698		\$ 3,047,698	\$ 952,174	\$ 2,095,525	
TOTAL	\$ 30,300,169	\$ -	\$ 30,300,169	\$ 23,148,694	\$ 7,151,475	

(1) Budget transfer: IESO Board of Directors approved change in budget allocation of the operation of the MDM/R and for MDM/R Changes and Initiatives.

Table 5 – SME Variance Account Report

	Year: 2015		
Variance Account	SMC Revenue Requirement	Actual	Variance (SMC Revenue Requirement - Actual)
Cost	\$ 30,300,169	\$ 23,148,694	\$ 7,151,475
Revenue	\$ 45,206,527	\$ 46,215,367	\$ (1,008,840)
Service level Credit	\$ -	\$ (21,698)	\$ 21,698
	Cumulative (2013 to 2015)		
Variance Account	SMC Revenue Requirement	Actual	Variance (SMC Revenue Requirement - Actual)
Cost	\$ 89,140,990	\$ 73,756,195	\$ 15,384,795
Revenue	\$ 120,550,739	\$ 122,094,881	\$ (1,544,142)
Service level Credit	\$ -	\$ (390,408)	\$ 390,408

Table 6 – SME Statement of Financial Position

SME Statement of Financial Position		
As at	December 31, 2015	December 31, 2014
	\$	\$
Short-term prepaid expenses	332,514	-
Meter Data Management/Repository (MDM/R)	10,571,222	13,629,038
TOTAL ASSETS	10,903,736	13,629,038
Accounts payable & accrued liabilities	3,622,108	1,503,290
Debt	48,130,341	73,005,016
TOTAL LIABILITIES	51,752,449	74,508,306
Accumulated deficit - SME fees	(40,848,713)	(60,879,268)
TOTAL ACCUMULATED SURPLUS / (DEFICIT)	(40,848,713)	(60,879,268)
TOTAL LIABILITIES & SURPLUS	10,903,736	13,629,038

Table 7 – 2015 SME Financial Report Reconciliation to the IESO Audited Financial Statements

2015 SME Financial Report Reconciliation to the IESO Audited Financial Statements	
Smart metering charge - actual revenue	46,215,367
Smart metering charge - annual report	46,215,367
Amount to reconcile	0
Smart metering expenses - actual expenses	23,148,694
Smart metering expenses - annual report	26,184,812
Amount to reconcile	-3,036,118
Add: capital spend on MDM/R	465,924
Less: amortization expense	3,523,740
Less: service level credits	-21,698
Total reconciled	-3,036,118