

IN THE MATTER OF section 25.(1) of the *Electricity Act, 1998*;

AND IN THE MATTER OF a Submission by the Independent Electricity System Operator to the Ontario Energy Board for the review of its proposed expenditure and revenue requirements for the fiscal year 2016 and the fees it proposes to charge during the fiscal year 2016.

**ARGUMENT IN CHIEF
OF THE
INDEPENDENT ELECTRICITY SYSTEM OPERATOR**

1. Introduction

1. On January 19, 2016, the Independent Electricity System Operator (IESO) filed with the Ontario Energy Board a Submission for Review in respect of its proposed expenditure and revenue requirements and fees for 2016. The Submission for Review is based on a Business Plan for the fiscal year 2016 that was approved by the Minister of Energy.¹

2. In its evidence filed in support of the Submission for Review, the IESO proposed to recover its net 2016 revenue requirement by way of a usage fee to be charged to all market participants based on energy withdrawn from the IESO-controlled grid (including scheduled exports) and embedded generation, effective January 1, 2016.² The proposed 2016 usage fee is \$1.13 per MWh.³

¹ Exhibit A-2-2.

² Exhibit B-1-1, p. 3.

³ Exhibit B-1-1, p. 6.

3. As a result of the merger of the IESO and the Ontario Power Authority (OPA) on January 1, 2015, the IESO is currently collecting two approved fees, namely, the former IESO fee of \$0.803 per MWh and the former OPA fee of \$0.439 per MWh. On December 22, 2015, the Board issued a Decision and Interim Order making these fees interim as of January 1, 2016.⁴

4. The IESO proposes to continue to charge both of the existing interim usage fees until the end of the month in which Board approval is received for a final 2016 usage fee. Further, the IESO proposes to charge or rebate to market participants the difference between the 2016 usage fee approved by the Board and the interim usage fees, if any, paid by them, based on their proportionate quantity of energy withdrawn, which may include scheduled exports and embedded generation, in 2016.⁵

5. In its EB-2010-0279 application for approval of its expenditure and revenue requirements and fees for 2011, the OPA proposed that its usage fee be recovered from export customers as well as Ontario customers.⁶ The Board did not approve the OPA's proposal and the Board said that, if the OPA intends to reintroduce this approach in a future case, it should be prepared to demonstrate a coherent rationale, quite possibly based on an allocation study.⁷

6. In this case, the IESO retained Elenchus Research Associates, Inc. (Elenchus) to review the design of the existing IESO and OPA usage fees which were designed to recover the revenue requirements of the separate organizations and to examine options for recovering the revenue requirement of the new IESO.⁸ Elenchus provided evidence

⁴ EB-2015-0275 Decision and Interim Order dated December 22, 2015.

⁵ Exhibit B-1-1, pp. 6-7.

⁶ EB-2010-0279 Decision and Order, pp. 14-15.

⁷ EB-2010-0279 Decision and Order, p. 17.

⁸ Exhibit B-1-1, Attachment 1, p. 5.

dated January 15, 2016 on Cost Allocation and Rate Design for the 2016 IESO Usage Fee (the Elenchus Report).⁹

7. On May 13, 2016, the IESO filed updated evidence in this proceeding. The updated evidence included an Elenchus Report on Cost Allocation and Rate Design for the 2016 Fees of the IESO (Updated with 2016 Financial Details) dated May 10, 2016 (the Updated Elenchus Report)¹⁰ and a Discussion of the Cost Allocation Study and Proposal for One Usage Fee.¹¹

8. As indicated in the updated evidence filed on May 13th, the Elenchus cost allocation model was re-run with forecast 2016 volumes and the IESO's 2016 budget. The outputs from the model were significantly different from those based on 2015 inputs; specifically a 1% change in exports as a percentage of domestic volumes between 2015 and 2016 resulted in a 5% change in the revenue-to-cost ratio for export customers.¹²

9. The Board approved an Issues List for this proceeding on June 17, 2016. The Board-approved Issues List includes the following issues with regard to the proposed 2016 usage fee (the Usage Fee Issues):

2.0 Usage Fee

2.1 Is the IESO's proposal to eliminate the OPA Usage Fee and to charge the proposed single IESO usage fee to all market participants (domestic and exporter customers) appropriate?

2.2 Is the methodology used to derive the proposed IESO Usage Fee of [\$]1.13/MWh appropriate?

2.3 Is the proposed cost allocation study in support of the proposed IESO Usage Fee appropriate?

⁹ Exhibit B-1-1, Attachment 1.

¹⁰ Exhibit B-1-1, Attachment 3.

¹¹ Exhibit B-1-2.

¹² Exhibit B-1-2, p. 2.

2.4 Is the IESO's proposal to charge the proposed single IESO Usage Fee from January 1, 2016 and to refund (or charge) market participants the difference between the 2016 single Usage Fee and the interim usage fees they paid, if any, based on their proportionate quantity of energy withdrawn, which may include scheduled exports and embedded generation, in 2016, appropriate?

2.5 What would be an appropriate effective date for the Usage Fee(s) approved in this proceeding?¹³

10. A Settlement Conference was held on August 17 and 18, 2016 and, on September 7, 2016, a Settlement Proposal was filed with the Board setting out a settlement of all issues except for those relating to the IESO's proposal for a single usage fee to be charged to all market participants based on energy withdrawn from the IESO-controlled grid, including scheduled exports.¹⁴ As reflected in the Settlement Proposal, the Usage Fee Issues are unsettled issues that remain to be determined by the Board.¹⁵

11. On September 28, 2016, the Board issued Procedural Order No. 4, which makes provision for written submissions on the unsettled issues. Specifically, the Board ordered that the IESO file its argument in chief on the unsettled issues by October 7, 2016; OEB staff and intervenors that wish to make submissions file their submissions by October 14, 2016; and the IESO file its reply submission by October 21, 2016.¹⁶

12. This is the argument in chief of the IESO, filed in accordance with Procedural Order No. 4. In this argument in chief, the IESO will address the Usage Fee Issues under the headings that follow.

¹³ Decision on Issues List and Procedural Order No. 3, June 17, 2016, Schedule A – OEB Approved Issues List, p.1.

¹⁴ Settlement Proposal dated September 7, 2016, Exhibit S-1-1, pp. 5, 7 and 12.

¹⁵ Settlement Proposal dated September 7, 2016, Exhibit S-1-1, p. 7.

¹⁶ Procedural Order No. 4, September 28, 2016, pp. 2-3.

2. The IESO Proposal for a Single Fee

13. As discussed above, the IESO proposes moving to a single IESO usage fee to be charged to all market participants based on energy withdrawn from the IESO-controlled grid (including scheduled exports) and embedded generation effective January 1, 2016.¹⁷

14. In the EB-2010-0279 Decision, the first reason given by the Board for its conclusion that it would not approve the OPA's proposal to recover the OPA's 2011 usage fee from export customers was that, in the Board's view, the mandate of the OPA was not comparable to the mandate of the IESO. Specifically, the Board referred to section 5(1)(e) of the *Electricity Act, 1998* (as it existed at the time),¹⁸ which, in the words of the Decision, "clearly states that the IESO is to work with the responsible authorities outside Ontario to co-ordinate the IESO's activities with their activities".¹⁹

15. The objects of the IESO are now found in section 6 of the *Electricity Act, 1998*.²⁰ One of the objects of the IESO continues to be "to work with responsible authorities outside of Ontario to co-ordinate the IESO's activities with the activities of those authorities".²¹ Further, many other objects of the IESO benefit both domestic and export customers, such as the following:

- ~ directing the operation and maintaining the reliability of the IESO-controlled grid;
- ~ participating in the development of standards, and enforcing criteria and standards relating to the reliability of the integrated power system;
- ~ operating the IESO-administered markets; and
- ~ collecting and making public information relating to the short term, medium term and long term electricity needs of the province.²²

¹⁷ Exhibit B-1-1, p.3.

¹⁸ S.O. 1998, ch. 15, Sch. A, as amended as of July 8, 2011, s. 5.

¹⁹ EB-2010-0279 Decision and Order, p. 16.

²⁰ S.O. 1998, ch. 15, Sch. A, as amended to date, s. 6.

²¹ *Electricity Act, 1998*, as amended to date, paragraph (f) of section 6.

²² Exhibit B-1-1, p. 4 and paragraphs (c), (d), (g) and (r) of section 6 of the *Electricity Act, 1998*.

16. As far as reliability is concerned, HQ Energy Marketing Inc. (HQEM) and the Association of Power Producers of Ontario (APPrO) asked an interrogatory in which, among other things, they sought confirmation from the IESO that the quantity of electricity exported does not, in itself, have an impact on reliability or Ontario's NERC responsibilities. The response to the interrogatory was that this proposition is incorrect. More particularly, the evidence given in response to the interrogatory includes the following:

Electricity that is exported out of Ontario has a direct impact on reliability. NERC reliability standards require the IESO to coordinate all interchange transactions with other reliability coordinators, make an internal and tie-line reliability assessment for every export transaction that is submitted to the IESO markets, and take action if exports (or imports) must be curtailed to maintain reliability either internal to Ontario or in a neighbouring jurisdiction. ... In addition, imports and exports play a key role in helping to balance the power system. The IESO has a NERC obligation to maintain our Area Control Error (ACE), which is a measure of how well the system is balanced. ACE is a function of imports, exports, Ontario generation, Ontario load, and system frequency.²³

17. The IESO does not operate the market to serve single customers or only export or domestic customers; rather, the IESO operates the market to benefit all market participants without discretion. In taking a holistic view of its operations, the IESO believes that as both domestic and export classes of customers benefit from the work that the IESO carries out, both should pay for the work performed by the IESO. Given that the work to fulfill the IESO's objects benefits both domestic and export customers and that these objects permeate the entire organization and the work that it performs, the IESO submits that it is neither reasonable nor appropriate to endeavor to separate out specific functions within the IESO for the purpose of allocating costs.²⁴

²³ HQEM-APPrO Interrogatory 4, Exhibit I, Tab 2.1, Schedule 6.04 HQEM-APPrO 4, part (iv).
²⁴ Exhibit B-1-1, p. 4.

18. The IESO submits that its activities are not compatible with a methodology that seeks to allocate costs on the basis of customer “classes”. The proposed single usage fee is simple to understand and administer and it is fair and equitable in that it charges for the usage of IESO services as measured by energy purchases.

19. Nevertheless, given the comments about a lack of empirical evidence in the Board’s EB-2010-0279 Decision regarding the determination of the OPA’s 2011 usage fee, the IESO retained Elenchus to prepare a cost allocation study.²⁵

3. The Elenchus Reports

20. The Elenchus Report indicates that, in light of the merger of the IESO and the OPA, it is appropriate to consider merging the two usage fees into a single fee.²⁶ Elenchus posited two different rate design options for the 2016 IESO usage fee: one standard fee to be charged to all domestic and export customers and separate usage fees for domestic and export customers that reflect differences in their allocated costs.²⁷ With respect to these two options, the Elenchus Report says that:

The key considerations in assessing these options are the principles of administrative simplicity and equity, where equity is indicated by the level of the actual or implied revenue-to-cost ratios of the classes under each option.²⁸

21. In order to analyze the “standard” and “differentiated” fee options, Elenchus developed a cost allocation model for the IESO that treats domestic and export customers as if they are two customer classes and allocates the total revenue requirement of the merged IESO to those classes using a fully allocated costing methodology.²⁹ Elenchus used the IESO’s 2015 budget in this cost allocation model³⁰

²⁵ Exhibit B-1-1, p. 5.

²⁶ Elenchus Report, Exhibit B-1-1, Attachment 1, p. 9.

²⁷ Elenchus Report, Exhibit B-1-1, Attachment 1, p. 12.

²⁸ Elenchus Report, Exhibit B-1-1, Attachment 1, p. 6.

²⁹ Elenchus Report, Exhibit B-1-1, Attachment 1, p. 13.

³⁰ Elenchus Report, Exhibit B-1-1, Attachment 1, p. 14.

and concluded that the revenue to cost ratios for the separate classes if a single usage fee is adopted would be 98.5% and 114.3% for the domestic and export customers respectively.³¹

22. The Elenchus Report goes on to say that, using the Board-approved revenue-to-cost ratio range for most distribution classes of 80% to 120%, it can be concluded that the uniform rate would be deemed to be equitable for both domestic and export customers. Elenchus noted that it is appropriate to consider revenue-to-cost ratios in the context of a Board-approved range, given the degree of uncertainty inherent in cost allocation and other rate making principles.³² Elenchus also noted that:

A decision on whether to establish separate domestic and export rate classes may also involve balancing the goal of equity with other objectives such as simplicity and the cost of supporting a more complex rate structure. In particular, if the dollar impact on any group of customers is small, it may justify adopting a single usage fee for all customers despite R/C ratios that might otherwise be considered inequitable.³³

23. The Updated Elenchus Report uses the IESO's 2016 budget in the cost allocation model developed by Elenchus.³⁴ On the basis of the IESO's 2016 budget, Elenchus concluded that the revenue-to-cost ratios for the separate classes if a single usage fee is adopted would be 97.88% and 119.32% for the domestic and export classes, respectively.³⁵ Elenchus also concluded that, if the Board-approved revenue-to-cost ratio range that is used for most electricity distribution customer classes (i.e., 80% to 120%) is approved for the IESO, the uniform rate would be deemed to be equitable for both the domestic and export classes of customers.³⁶

24. As stated above, the outcome of re-running the Elenchus model using forecast 2016 volumes and the IESO's 2016 budget, rather than 2015 inputs, revealed that a 1%

³¹ Elenchus Report, Exhibit B-1-1, Attachment 1, p. 13.

³² Elenchus Report, Exhibit B-1-1, Attachment 1, p. 36.

³³ Elenchus Report, Exhibit B-1-1, Attachment 1, p. 15.

³⁴ Updated Elenchus Report, Exhibit B-1-1, Attachment 3, p. 14.

³⁵ Updated Elenchus Report, Exhibit B-1-1, Attachment 3, p. 15.

³⁶ Updated Elenchus Report, Exhibit B-1-1, Attachment 3, p. 38.

change in exports as a percentage of domestic volumes led to a 5% change in the revenue-to-cost ratio. This clearly demonstrates that slight variations in exports as a percentage of total withdrawals have a disproportionate impact on the results from the model.³⁷

25. Variances in Ontario demand or export volumes, such as those captured in the forecast change between 2015 and 2016, do not impact the IESO's work or costs. The IESO's activities do not fluctuate in the short run or the long run based on domestic and export volumes and there is no discernible link between domestic and export volumes and work levels or expenditures at the IESO. For example, the number of staff in the control room does not increase or decrease based on the forecast level of exports.³⁸

26. The IESO focuses its efforts on ensuring efficient trade for the overall benefit of the market and this role involves essentially fixed costs that are an overhead for the Ontario electricity system.³⁹ As observed in the Updated Elenchus Report, the IESO's costs that are recovered through its usage fee consist largely of costs that would be treated as operational overhead or administrative and general (A&G) costs in the cost allocation models typically used by regulated electricity utilities for their rate setting processes.⁴⁰

27. A&G costs are not viewed as costs that are directly caused by customers in the process of providing service and they are commonly allocated essentially as an overhead to other capital and operating costs that are caused more directly by consumers.⁴¹ However, the IESO has no other operating and maintenance expenses to use as a basis for deriving cost factors for an allocation of A&G costs. Consequently, Elenchus allocated the IESO's costs to the domestic and export classes on the basis of

³⁷ Exhibit B-1-2, p. 2.

³⁸ Exhibit B-1-2, pp. 2-3.

³⁹ Exhibit B-1-2, p. 3.

⁴⁰ Updated Elenchus Report, Exhibit B-1-1, Attachment 3, p. 10.

⁴¹ Updated Elenchus Report, Exhibit B-1-1, Attachment 3, p. 10.

a “presumed causal relationship” and the revenue-to-cost ratios that result from the model may not be as indicative of a true causal relationship as can be achieved in the typical utility cost allocation model.⁴²

4. Approval of the IESO’s Proposal

28. From the point of view of cost allocation, Elenchus has expressed the view that the results of the use of its model are “the best indicator available”.⁴³ As stated, the results of the model based on both 2015 and 2016 inputs are within the Board-approved revenue-to-cost ratio range that is used for most electricity distribution customer classes. To the extent that the Board will look to cost allocation evidence in making its decision regarding the 2016 usage fee, the IESO submits that the cost allocation evidence of Elenchus supports the approval of the single usage fee proposed for 2016 by the IESO.

29. However, the IESO submits that the proposal to move to a single IESO fee to be charged equally to all market participants should be accepted on its own merits. It is not a correct or reliable premise that, if the Ontario electricity system was not specifically built for one particular class of customer, that class of customer should not share equally in the costs of the system. The Ontario electricity system planned and operated by the IESO is an integrated system that is not designed or operated for one particular market participant type and the costs of the system cannot be separated by customer types in an accurate or administratively simple manner.⁴⁴

30. The work planned for and performed by the IESO is not dependent on or related to the participation level of an individual market participant, or a particular “class” or type of market participant: the IESO’s work serves all types of customers.⁴⁵ Given the integrated nature of the electricity system, the IESO submits that it is appropriate to

⁴² Updated Elenchus Report, Exhibit B-1-1, Attachment 3, p. 11.

⁴³ Updated Elenchus Report, Exhibit B-1-1, Attachment 3, p. 11.

⁴⁴ Exhibit B-1-2, p. 4.

⁴⁵ Exhibit B-1-2, p. 4.

charge all market participants one fee on a similar basis to the manner in which the IESO has historically charged its usage fee.

5. Order Requested

31. Subsection 25.(4) of the *Electricity Act, 1998* provides that the Board may approve the IESO's proposed expenditure and revenue requirements and the proposed fees, or it may refer them back to the IESO for further consideration with the Board's recommendations. For all the reasons given above, the IESO submits that the Board should approve the 2016 usage fee proposed by the IESO.

All of which is respectfully submitted.

October 7, 2016

ORIGINAL SIGNED BY

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