Ontario

ONTARIO ENERGY BOARD

STAFF SUBMISSION

INDEPENDENT ELECTRICITY SYSTEM OPERATOR
2016 REVENUE REQUIREMENT AND FEES APPLICATION
EB-2015-0275

October 14, 2016

Introduction

The Independent Electricity System Operator (IESO) filed an application with the Ontario Energy Board (OEB) under section 25(1) of the *Electricity Act, 1998*, seeking approval for its 2016 expenditures, revenue requirement and fees. The IESO's application is based on its Business Plan for the fiscal year 2016 that was approved by the Minister of Energy. This is the IESO's first revenue requirement and fees application since its merger with the former Ontario Power Authority (OPA), which took effect on January 1, 2015.

Pursuant to the OEB's Procedural Order No. 3, a settlement conference took place on August 17 and 18, 2016. On September 7, 2016, the IESO filed a settlement proposal for the OEB's approval reflecting an agreement on all issues on the Issues List except Issue 2.0 which concerns the IESO's proposal for a single usage fee.

In Procedural Order No. 4, the OEB made provision for parties to make submissions on the unsettled issue. The IESO filed its argument in chief on October 7, 2016.

These are the submissions of OEB staff on the unsettled issue, Issue 2.0[1]. For the reasons set out below, OEB staff does not object to the IESO's proposal for a single usage fee.

The IESO's Proposal

The usage fee is a volumetric charge that is used to recover the revenue requirement from users of the transmission system and is represented as: Usage Fee ($/MWh) = Revenue Requirement/Charge Determinant. Prior to the merger of the IESO and the OPA, both entities recovered their respective revenue requirements by way of a usage fee that was approved by the OEB and recovered from market participants. The current IESO usage fee is charged on a gross load basis and recovered from domestic and export customers, whereas the OPA usage fee is charged on a net load basis and recovered exclusively from domestic customers. This difference recognizes the different

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[1] Issue 2.0 includes the following issues:
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?
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?

mandates and functions of the two former entities. The methodology for estimating the charge determinant component of the usage fee also differed. The charge determinant for the IESO usage fee is derived from total Ontario demand forecast plus export volumes, plus embedded generation, less transmission line losses. The charge determinant for the OPA's usage fee is derived from the total Ontario demand forecast less transmission line losses.

Currently, the former IESO usage fee ($0.803/MWh) and the OPA usage fee ($0.439/MWh) approved by the OEB in 2014 remain in effect, on an interim basis.

In this application, the IESO is proposing to discontinue the OPA usage fee and adopt a single usage fee ($1.13/MWh) to be charged on a gross load basis and recovered from all market participants – both domestic and export customers. On a nominal basis this is a decrease of 9% relative to the combined 2014 usage fees ($1.24/MWh) of the formerly separate entities and represents a 5% reduction in the overall revenue requirements.

Submission

OEB staff does not object to the IESO's proposal for a single usage fee to be charged on a gross load basis and recovered from all market participants, effective January 1, 2016.

In its 2011 fees application (EB-2010-0279), the OPA proposed to include export volumes in the calculation of the Charge Determinant and the resultant usage fee be recovered from export customers as well as domestic customers. The OEB did not approve the OPA's proposal for four reasons. First, the OEB noted that the statutory mandates of the OPA and the (former) IESO were not comparable and that the work of the two former entities was clearly different and distinguishable. The OEB also noted that the IESO's objects required it to work with authorities outside Ontario, while the OPA's responsibilities emphasized work "for Ontario" and "in Ontario". Second, the OEB was "not convinced that, in executing its objectives pursuant to the Electricity Act that the OPA creates benefits for export customers in the manner asserted by the parties supporting the extension of the fee to exporters." Third, the proposed usage fee was not supported by empirical evidence such as a cost allocation study. Lastly, the OEB found that the OPA had not undertaken "meaningful and substantive" consultation with stakeholders.[2]

[2] Decision and Order, July 8, 2011 (EB-2010-0279), pp. 16-17.

As the IESO's request in the present case is similar to that of the OPA's in EB-2010-0279, the IESO has attempted to address the concerns that were noted by the OEB in EB-2010-0279.

With respect to its statutory mandate, the IESO states that it operates the market to serve all market participants and that many of the objects of the IESO as set out in section 6 of the *Electricity Act, 1998* benefit both domestic and export customers. Specifically with respect to the OEB's concerns, expressed in EB-2010-0279, that the work of the IESO and OPA were not comparable, the IESO states that since the merger all of the objects of the OPA were merged with the IESO's objects and therefore the concerns that existed in EB-2010-0279 no longer apply.

As noted earlier, one of the reasons the OEB rejected the OPA's proposal was because it was not convinced that the OPA in executing its objectives pursuant to the *Electricity Act* creates benefits for export customers. On this matter, the IESO asserts that following the merger of the two entities, the work of the IESO is heavily integrated and interdependent and is carried out equally for the benefit of both domestic and export customers. The IESO argues that it operates the market for the benefit of all market participants and, in taking this holistic view, believes its work benefits both export customers and domestic customers equally and both classes of customers should therefore pay for the work. For these reasons the IESO argues that a single usage fee is appropriate.

One of the other reasons put forward by the OPA for changing the allocation of the usage fee in EB-2010-0279 was that its mandate was comparable to that of the IESO's. The OEB disagreed and found that the mandates of the two entities were markedly different. Following the merger the objects of the two former entities have been combined and through integration of work activities the entities have been fully integrated.

OEB staff agrees that the concerns that existed in EB-2010-0279 are no longer material. OEB staff accepts that the IESO's integration of planning, market operation and other electricity system functions has unified a once-clearer delineation between agencies and their activities; as a consequence, concerns about differences in costs and beneficiaries that were raised in the earlier case were predicated on a dichotomy that is no longer as identifiable as it may once have been. On the matter of the integration of work functions of the former entities, OEB staff supports the efforts that the IESO has made in this regard as these efforts have resulted in a $9 million reduction in revenue requirement when comparing the revenue requirement of the combined entity with the revenue requirements of the former entities prior to the merger (IESO's 2014 revenue requirement was $129.9 million and the OPA's 2014 revenue requirement was $60.3 million). OEB staff therefore agrees with the IESO's argument that it operates the market for the benefit of domestic and export customers equally and therefore a single usage fee is appropriate.

In order to address the concerns that were noted by the OEB in EB-2010-0279 related to the lack of empirical evidence, the IESO retained Elenchus Research Associates (Elenchus) to undertake a cost allocation study. The cost allocation study[3] reviews the design of the existing IESO and OPA usage fees and examines options for a usage fee for the new IESO. As part of the study Elenchus examined 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.

In order to analyze the single fee option and the two fee option, Elenchus developed a cost allocation model for the IESO that treats domestic and export customers as if they are two separate customer classes. Under this approach, the model allocates the total revenue requirement of the merged IESO to those classes using a fully allocated costing methodology. On this basis 90% of the IESO's costs ($164.1 million) were allocated to the domestic class and 10% ($18 million) to the export class. The resulting rates were $1.707/MWh and $0.960/MWh, for the domestic class and export class, respectively.

In order to assess whether it would be appropriate to charge a single rate to domestic and export customers, Elenchus measured whether the revenue-to-cost ratios for the two classes would be reasonable. The revenue-to-cost ratio is the relationship between the revenues from a particular customer class and the costs to serve that customer class. The ratio can be expressed as a decimal value, such as 0.90, or given as an equivalent percent value, such as 90%. For example, a 90% revenue-to-cost ratio would mean that the customer class is paying 90% of the costs that the distributor incurs to serve that class. The revenue-to-cost ratio is one of the factors the OEB considers when setting rates. The goal is to have each class pay for the costs of serving it.

[3] The IESO filed two versions of the cost allocation study were prepared and filed. The first study, dated January 15, 2016 was prepared using 2015 forecast revenue requirement and 2014 year-end assets as the basis for the cost allocation model. The second study dated May 10, 2016 was an update to the first study and was prepared using 2016 forecast revenue requirement and 2015 year-end assets.

Using the IESO's 2015 budget as the basis for the study, Elenchus concluded that the revenue to cost ratios for the separate classes if a single usage fee were adopted would be 98.5% and 114.3% for the domestic and export customers respectively. Based on the IESO's 2016 budget, the revenue-to-cost ratios for the separate classes if a single usage fee were adopted would be 97.88% and 119.32% for the domestic and export classes, respectively. Noting that OEB-approved revenue-to-cost ratios for many distribution customer classes range from 80% to 120%, Elenchus concludes that the single fee would be reasonable. OEB staff notes that the revenue-to-cost ratio of the charge, if applied to export customers, would represent the upper limit of the revenue-to-cost band that is typically acceptable. However, OEB staff notes that a wide revenue-to-cost band simply reflects the fact that costs are not often allocated with certainty, and in staff's view this instance is no exception. A value at the upper end of the revenue-to-cost ratio confidence interval is not statistically significantly different from a lower result. In staff's view, a value of 119.32% is no automatic barrier to a rate being just and reasonable.

Accordingly, even though Elenchus's cost allocation exercise indicated that a single rate may not be necessarily unfair from a revenue-to-cost perspective, the IESO submits in its argument in chief that the sensitivity of the model to changes in export volumes suggests a more straightforward approach is preferable. The IESO submits that the majority of the IESO's costs are akin to operational overhead or administrative/general costs of LDCs, which are difficult to directly attribute to a specific class of customers. Therefore all costs for the IESO were allocated by department based strictly on judgment rather than based on the customer class that the assets served (as an LDC would with the majority of its costs).

Notwithstanding the concerns that have been noted in respect of the cost allocation model, OEB staff is of the view that the approach employed by Elenchus is reasonable and consistent with OEB direction in EB-2010-0279 and in the absence of alternate analysis serves as a reasonable guide for assessing the IESO's proposal.

The last concern that was raised by the OEB in EB-2010-0279 dealt with stakeholder consultation. In that proceeding, the OEB found that the OPA had not undertaken "meaningful or substantive" consultation with stakeholders and that if the OPA decided to re-introduce its proposal that it would need to "engage the stakeholder community in a relevant and substantive manner". In this application, the extent of the IESO's evidence on stakeholder engagement is limited to a single sentence on page 5 of Ex B/Tab 1/Schedule 1, where it states that the usage fee proposal was discussed at two meetings of the Stakeholder Advisory Committee. In interrogatory responses it provided the minutes of the SAC meetings. A review of the meeting minutes indicate that with the exception of the February 2016 meeting, the discussions on the usage fee proposal were limited and at a very high level. With respect to the February 2016 meeting, this meeting occurred a month after the IESO had already filed this application with the OEB, thereby providing no opportunity for stakeholder concerns to be addressed. The evidence also states that export customers were not specifically consulted.

In OEB staff's view, the information provided by the IESO and the level of engagement undertaken falls short of the expectations of the OEB as set out in EB-2010-0279. If the OEB decides to approve the IESO's proposal, the OEB may wish to mitigate any concerns about the sufficiency of consumer engagement by requiring that the IESO undertake a review of the single usage fee methodology after three years to assess whether it continues to be appropriate.

Such a review would also address three additional concerns. First, the review would also allow the IESO to assess the impact, if any, on export volumes resulting from an increase in usage fees – an analysis that the IESO says it has not undertaken in relation to the usage fee. Second, the IESO has not undertaken a jurisdictional survey to assess how its proposal compares with the approach in other jurisdictions; a review could provide an opportunity for IESO to present any results from the survey should the OEB find merit in ordering it. Third, the IESO's mandate is evolving and may continue to evolve and therefore it makes sense to have the ability to reallocate costs and reconsider rate design.

All of which is respectfully submitted