

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.

**REPLY ARGUMENT
OF THE
INDEPENDENT ELECTRICITY SYSTEM OPERATOR**

A. Introduction

1. The Settlement Proposal filed with the Board in this proceeding on September 7, 2016 sets out a settlement of all issues except for those relating to the proposal by the Independent Electricity System Operator ("IESO") for a single usage fee to be charged to all market participants based on energy withdrawn from the IESO-controlled grid, including scheduled exports.¹ As reflected in the Settlement Proposal, issues relating to the proposed usage fee (Issues 2.1 to 2.5 in the Board-approved Issues List) are unsettled issues that remain to be determined by the Board.²

2. Procedural Order No. 4 makes provision for written submissions on the unsettled issues. It requires that OEB staff and intervenors file their submissions by October 14, 2016 and that the IESO file its reply submission by October 21, 2016.³ The IESO has received the following submissions that have been filed in accordance with Procedural Order No. 4:

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

² Settlement Proposal dated September 7, 2016, Exhibit S-1-1, p. 7.

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

- (i) Staff Submission filed by Ontario Energy Board Staff ("Board Staff");
- (ii) Submissions ("Energy Probe Submissions") filed by Energy Probe Research Foundation ("Energy Probe");
- (iii) Submissions ("HQEM/APPrO Submissions") filed by HQ Energy Marketing Inc. ("HQEM") and the Association of Power Producers of Ontario ("APPrO");
- (iv) Submissions ("SEC Submissions") filed by the School Energy Coalition ("SCE");
- (v) Submission ("Society Submissions") filed by The Society of Energy Professionals ("Society"); and
- (vi) Final Submissions ("VECC Submissions") filed by the Vulnerable Energy Consumers Coalition ("VECC").

3. All of the submissions filed in this proceeding, but for one, support the IESO's proposed usage fee. The only submission opposing the IESO's usage fee proposal was filed by HQEM/APPrO. Thus, the IESO's reply submission will be framed primarily as a response to the arguments made by HQEM/APPrO.

B. Issues Raised by HQEM/APPrO

4. The submissions by HQEM/APPrO with regard to the proposed usage fee are based on two previous decisions of the Board. The first of the two decisions relied on by HQEM/APPrO is the Board's Decision and Order in respect of a submission by the Ontario Power Authority ("OPA") for the review of the OPA's proposed expenditure and revenue requirements for 2011 (the "OPA Decision").⁴ The second decision relied on by HQEM/APPrO is the Board's Decision and Order - 2013 Export Transmission Service Rates that was issued in respect of an application by Hydro One Networks Inc.,

⁴ EB-2010-0279 Decision and Order dated July 8, 2011.

(“Hydro One”) for, among other things, approval of changes to Hydro One’s 2013 and 2014 transmission revenue requirement (the “Hydro One Decision”).⁵

5. HQEM/APPrO submit that the Board should not approve the usage fee proposed by the IESO for two reasons. First, they submit that the IESO has failed to demonstrate that it has satisfied “concerns raised by the Board” in the OPA Decision. Second, they submit that the IESO “continues to provide the differentiated services to domestic and import [*sic*] customers that led the Board to approve a reduced rate for export transmission customers” in the Hydro One Decision.⁶

6. As well, HQEM/APPrO have made submissions about the appropriate effective date for any usage fee approved in this proceeding. These submissions culminate with an assertion that any change in the IESO’s usage fees should not be effective at any date prior to the Board’s decision in this proceeding.⁷

7. In the submissions that follow, the IESO will respond to the two lines of argument advanced by HQEM/APPrO in support of their position on the proposed usage fee and then the IESO will address the arguments of HQEM/APPrO with respect to the appropriate effective date for any usage fee approved in this proceeding.

C. Arguments Based on the OPA Decision

8. HQEM/APPrO submit that, in the OPA Decision, the Board refused to approve a proposal by the OPA to recover fees from export customers in light of certain factors. HQEM/APPrO proceeded to make submissions about these “factors”, namely, statutory purposes, stakeholder consultation and cost allocation evidence. In responding to the HQEM/APPrO arguments, the IESO will address the “factors” upon which HQEM/APPrO have based their arguments.

⁵ * The IESO notes that Hydro One’s 2013 and 2014 Uniform Transmission Rates were approved in different Board decisions on different dates but under the same case number of EB-2012-0031. References to the “Hydro One decision” throughout this document will refer to all decisions made under the case number unless otherwise specified.

⁶ HQEM/APPrO Submissions, p. 3, para. 9.

⁷ HQEM/APPrO Submissions, p. 23, para. 83.

(a) Statutory Purposes

9. HQEM/APPrO contend that the statutory purposes of the “Predecessor OPA” have not changed since the OPA decision and that subsection 6(1) of the *Electricity Act, 1998* “is no more than an aggregation of the objects of the Predecessor Organizations”.⁸ However, the attempt by HQEM/APPrO to build their position on a comparison between the current objects of the IESO and the objects of the Predecessor OPA does not support their arguments about the proposed usage fee.

10. First, one of the objects of the Predecessor OPA that is not continued as a statutory object of the IESO was to “develop integrated power system plans for Ontario”.⁹ This object of the OPA as at the time of the OPA Decision clearly was Ontario-related, but the IESO does not have the same Ontario-related responsibility to develop integrated power system plans.

11. Second, as pointed out by the IESO in argument in chief, the first reason given by the Board in the OPA Decision for its conclusion regarding the OPA’s usage fee was that the objects of the IESO clearly indicated that the IESO is to work with responsible authorities outside Ontario, while the objects of the OPA at the time were expressed differently.¹⁰ It continues to be the case that one of the objects of the IESO is “to work with responsible authorities outside of Ontario to co-ordinate the IESO’s activities with the activities of those authorities”.¹¹

12. Third, and most importantly, the distinction that HQEM/APPrO rely on between the “Predecessor IESO” and the “Predecessor OPA” misses the point that, as a result of the merger of the two organizations, it is not possible to draw a bright line between responsibilities and activities of the “Predecessor OPA” and those of the current IESO. On the contrary, the evidence in this case, which stands completely uncontradicted, is that the work of the IESO is integrated and interdependent; the integrated system is not

⁸ HQEM/APPrO Submissions, p. 5, para.14.

⁹ HQEM/APPrO Submissions, p. 5, para.14 (second bullet point).

¹⁰ IESO Argument in chief, p. 5, para. 14.

¹¹ *Electricity Act, 1998* (“EA”), as amended to date, paragraph (f) of section 6.

designed or operated for any particular market participant type; and the IESO's work serves all types of customers.¹²

13. This point was not missed by Board Staff. The Staff Submission 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".¹³ As a consequence, Board Staff says, concerns about differences in costs and beneficiaries that were raised in the earlier (OPA) case were predicated on a dichotomy that is no longer as identifiable as it may once have been.¹⁴

14. In short, the HQEM/APPrO Submissions ignore, and are contrary to, the evidence in this case. Previously, there were two organizations with two separate sets of objects, but now the OPA no longer exists and the IESO has only one single set of objects. The evidence is clear that the work of the IESO to fulfill its responsibilities is integrated and interdependent and serves all types of customers. This evidence is unchallenged on the record of this proceeding. The effort by HQEM/APPrO to rely on what Board Staff described as "a once-clearer delineation between agencies and their activities" must fail because it does not take account of the evidence before the Board in this case.

(b) Stakeholder Consultation

15. The HQEM/APPrO Submissions sketch out a brief summary of discussions at three meetings of the IESO's Stakeholder Advisory Committee ("SAC")¹⁵ and then conclude on this area of argument with a submission that the Board's requirements for meaningful and substantive consultation were not met.¹⁶ The summary of SAC meetings given by HQEM/APPrO, however, is by no means a full report on the discussions that occurred through the forum of the SAC.

¹² Exhibit B-1-2, p. 4.

¹³ Staff Submission, p. 4.

¹⁴ *Ibid.*

¹⁵ HQEM/APPrO Submissions, pp. 6-7, paras.19-23.

¹⁶ HQEM/APPrO Submissions, p. 7, para. 24.

16. The IESO's business plan, as approved by the Minister of Energy, was presented at a meeting of SAC on February 10, 2016.¹⁷ The notes of this meeting make clear that Mr. David Butters, on behalf of APPrO, was very familiar with the usage fee issue and took the opportunity to express his views on different aspects of the issue. It is apparent that Mr. Butters had gained a good understanding of the contents of the report prepared by Elenchus Research Associates, Inc. ("Elenchus") because he was able to give his summary of the report. It is also apparent from the meeting notes that John Todd from Elenchus participated in the discussion and responded to comments from Mr. Butters about the report. Further, another member of SAC, Mr. Jack Burkom, expressed his views about the Elenchus report and participated in the discussion during which the IESO's representative responded to points from Mr. Butters.¹⁸

17. The notes of the SAC meeting on February 10, 2016 indicate that, at the outset of the discussion regarding the proposed usage fee, Mr. Butters said that "generators will be looking to contest it". Given, on the one hand, the outcome of the Elenchus report and all the reasons why the IESO considers the proposed usage fee to be appropriate and reasonable¹⁹ and, on the other hand, the determination of certain stakeholders to contest the proposed usage fee, it is not at all clear how further consultation with stakeholders would have been of any value.

18. Further, HQEM/APPrO have not explained how or why their submissions about stakeholder consultation affect the fundamental proposition that the usage fee proposed by the IESO is appropriate and reasonable. For its part, Board Staff suggests that the Board 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.²⁰ Should the Board agree with the submissions of Board Staff about a review of the usage fee after three years, the IESO confirms that it would undertake the review at that

¹⁷ <http://www.ieso.ca/Documents/consult/sac/SAC-20160210-Presentation.pdf>

¹⁸ <http://www.ieso.ca/Documents/consult/sac/SAC-20160210-Meeting-Notes.pdf>

¹⁹ IESO Argument in chief, pp. 5-11, paras. 13-30.

²⁰ Staff Submission, p. 7.

time. As pointed out by Board Staff, such a review would allow the usage fee to be considered in the light of additional information about the impact, if any, of the fee on export volumes and the extent to which there has been any ongoing evolution of the IESO's mandate.²¹

(c) Cost Allocation Evidence

19. The Elenchus report dated January 15, 2016 and entitled "Cost Allocation and Rate Design for the 2016 IESO Usage Fee" was filed by the IESO as part of its evidence in this proceeding.²² On May 13, 2016, the IESO filed updated evidence, including a new version of the Elenchus report that provided the results of re-running the Elenchus cost allocation model with forecast 2016 volumes and the IESO's 2016 budget.²³

20. It was apparent from the updated evidence that the cost allocation model outputs 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. The IESO pointed out that these results demonstrate that slight variations in exports as a percentage of total withdrawals have a disproportionate impact on the outputs from the model.²⁴

21. HQEM/APPrO have picked up on the evidence that dramatic changes in cost allocations resulted from minor changes in data input²⁵ and, in reliance on this evidence, have argued that the IESO should "go back and consider other cost allocation approaches".²⁶ In making this argument, though, HQEM/APPrO have relied on certain aspects of the evidence filed in this case, but ignored other evidence that undermines their argument. More particularly, HQEM/APPrO have ignored the evidence of

²¹ *Ibid.*

²² Exhibit B-1-1, Attachment 1 ("Elenchus Report").

²³ Cost Allocation and Rate Design for the 2016 IESO Usage Fee (Updated with 2016 Financial Details), Exhibit B-1-1, Attachment 3 ("Updated Elenchus Report").

²⁴ Exhibit B-1-2, p. 2.

²⁵ HQEM/APPrO Submissions, p. 9, para. 31.

²⁶ HQEM/APPrO Submissions, p. 9, para. 33.

Elenchus, in the updated Elenchus report, that the results of the model are “the best indicator available for allocating costs in a manner consistent with the IESO’s existing MWh based Usage Fee”.²⁷

22. In the OPA Decision, the Board said that, if the OPA intends to reintroduce a usage fee to be recovered from export customers as well as Ontario customers, the OPA should be prepared to demonstrate a coherent rationale, quite possibly based on an allocation study.²⁸ It was indeed Mr. Todd from Elenchus who suggested an allocation study in that case.²⁹

23. In this case, the IESO engaged Mr. Todd from Elenchus to review the design of the existing IESO and OPA fees and to examine options for recovering the revenue requirement of the new IESO. Elenchus developed a cost allocation model and provided its report setting out the results of the model. More specifically, Elenchus developed a cost allocation model that treats domestic and export customers as two customer “classes” and allocates the total revenue requirement of the IESO to those classes using a fully allocated costing methodology.³⁰

24. The updated Elenchus report explains the need to take a “non-standard” approach because the IESO’s costs are in the nature of administrative and general (“A&G”) costs that, in the cost allocation models typically used by regulated electricity utilities, are not viewed as costs directly caused by customers in the process of service being provided to them.³¹ In this context, Elenchus said that the revenue to cost ratios resulting from the model may not be as indicative of a true causal relationship as can be achieved in the typical utility cost allocation model.³² Elenchus also said, as referred to above, that the results of the model are the best indicator available for allocating costs in a manner consistent with the IESO’s existing MWh based Usage Fee.

²⁷ Updated Elenchus Report, Exhibit B-1-1, Attachment 3, p. 11.

²⁸ OPA Decision, p. 17.

²⁹ *Ibid.*

³⁰ Elenchus Report, Exhibit B-1-1, Attachment 1, p. 13.

³¹ Updated Elenchus Report, Exhibit B-1-1, Attachment 3, pp. 10-11.

³² Updated Elenchus Report, Exhibit B-1-1, Attachment 3, p. 11.

25. On the basis of this evidence, HQEM/APPrO assert that there are “flaws in the methodology” that could not be “repaired” because the IESO “ran out of time”.³³ It is most certainly not the case that there are flaws in the Elenchus methodology. The facts are that, given the Board’s comments in the OPA Decision about empirical evidence, the IESO engaged Elenchus to perform work that included a cost allocation study and the work of Elenchus revealed that a non-standard approach to cost allocation was necessary (and the “best indicator”), given the nature of the IESO’s costs. The evidence in this regard, as with all of the evidence in this case, has not been challenged and it provides no basis for an assertion that there are “flaws in the methodology”.

26. The evidence in this case is that the IESO’s costs “cannot be separated in an accurate or administratively simple manner”.³⁴ In light of this unchallenged evidence, the IESO submits that it is not a sensible proposition that further time and resources should be put towards additional cost allocation work.

27. Given the integrated and interdependent nature of the IESO’s work, it is not surprising that an exercise of allocating the IESO’s costs between domestic and export customers cannot be performed with precision. This is not a reason for the IESO to “go back and consider other cost allocation approaches”, as suggested by HQEM/APPrO. On the contrary, it is a reason why the proposal for a single IESO usage fee to be charged equally to all market participants should be accepted on its own merits.

28. Elenchus concluded that, if a single usage fee is adopted, the revenue to cost ratios for domestic and export customers would be within the Board-approved range for most classes of electricity distribution customers.³⁵ On the subject of revenue to cost ratios, the HQEM/APPrO Submissions refer to the Board’s November 2007 Report on Application of Cost Allocation for Electricity Distributors.³⁶ These submissions make no mention of other guidance from the Board on revenue to cost ratios, as reflected in a

³³ HQEM/APPrO Submissions, p. 9, para. 32.

³⁴ Exhibit B-1-2, p. 4.

³⁵ Elenchus Report, Exhibit B-1-1, Attachment 1, p. 36.

³⁶ EB-2007-0667 Report of the Board, November 28, 2007.

2010 Board decision, where it is said that: "The Board has indicated in various decisions that distributors are not obligated to adjust ratios closer to 1.00 once a class is within the Board's target range but may do so if adequately supported with evidence."³⁷

29. HQEM/APPrO also submit that "the IESO decided not to lead evidence to demonstrate that its proposed usage fee meets the requirements of sound rate design".³⁸ As already stated, the evidence is that the proposed single usage fee is appropriate and reasonable on its own merits and, further, that using the Board-approved revenue to cost ratio range for most classes of electricity distribution customers, the "uniform rate", if adopted, would be equitable for both domestic and export customers.³⁹ In as much as the evidence unequivocally supports only one usage fee to recover the IESO's revenue requirement, there is no rate design to be done in this case.

30. The impact of the proposed usage fee is estimated to be an increase of approximately 2% of the amount paid by exporters to purchase the electricity commodity in Ontario (and it is reasonable to assume that the increase would be even less as a percentage of sale prices achieved by exporters in other jurisdictions).⁴⁰ The evidence is that the proposed fee is not expected to have a material impact on trading volumes.⁴¹ In fact, export volumes increased the year after the Export Transmission Rate was increased by 100% from \$1.00/MWh to \$2.00/MWh.⁴²

³⁷ EB-2009-0096 Decision with Reasons, April 9, 2010, p. 68.

³⁸ HQEM/APPrO Submissions, p. 12, para. 44.

³⁹ Elenchus Report, Exhibit B-1-1, Attachment 1, p. 36 and Updated Elenchus Report, Exhibit B-1-1, Attachment 3, p. 38.

⁴⁰ Response to HQEM/APPrO Interrogatory 8, part (iv), Exhibit I-2.1, Schedule 6.09 HQEM/APPrO 8. By way of comparison, the Board's threshold for the filing of a mitigation plan has been total bill increases for any customer class or group that exceed 10%: see the 2006 Electricity Distribution Rate Handbook, May 11, 2005, at p. 131 and the Report of the Board on a Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach, October 18, 2012, p. 23.

⁴¹ Response to HQEM/APPrO Interrogatory 3, part (iv), Exhibit I-2.1, Schedule 6.03 HQEM/APPrO 3.

⁴² *Ibid.* And see the Hydro One Decision as to the increase in the Export Transmission Rate.

D. Arguments Based on the Hydro One Decision

31. HQEM/APPrO submit that, in the Hydro One Decision, the Board found that the IESO's rules provide priority service to domestic loads over exports and that, as a result of these rules, the Board would require a separate transmission rate for domestic loads and exports.⁴³ HQEM/APPrO say that the Board approved an export rate that was 34% of the domestic rate.⁴⁴

32. HQEM/APPrO rely on the Hydro One Decision to develop an argument that the IESO "provides a priority service to domestic customers over export customers".⁴⁵ The fundamental difficulty with this argument is that it has no grounding in the evidence in this case. The evidence in this case is that "the IESO operates to benefit all sector participants without discretion."⁴⁶ While, as noted by HQEM/APPrO, transmission export service provided by Hydro One was deemed by the Board to be interruptible⁴⁷, the IESO does not perform functions or provide services on an "interruptible" basis. The arguments of HQEM/APPrO must be based on the evidence in this case and previous Board rulings like the Hydro One Decision cannot be used to re-create the evidence into something that it is not.

33. The 34% ratio of export rate to domestic rate drawn by HQEM/APPrO from the Hydro One Decision simply has no connection with the evidence in this case about the IESO's responsibilities and activities. Hydro One's transmission services, and the costs associated with providing them, are very different from the functions of the IESO and the costs associated with those functions. Transmission costs (such as the costs of poles and wires) can be allocated using a typical cost allocation process that is consistent with cost causality principles. As discussed above, the IESO's costs are in

⁴³ HQEM/APPrO Submissions, p. 15, para. 52.

⁴⁴ HQEM/APPrO Submissions, p. 3, para. 7.

⁴⁵ HQEM/APPrO Submissions, p. 15, para. 55.

⁴⁶ Exhibit B-1-1, p. 4.

⁴⁷ HQEM/APPrO Submissions, p. 13, para. 48.

the nature of A&G costs that, in typical cost allocation models, are not viewed as costs directly caused by customers in the process of service being provided to them.⁴⁸

34. In the Hydro One Decision, the Board said that, absent a cost allocation study, the degree to which the differences in service should be reflected in a rate differential is unknown. The Board also said that there was “simply no clear evidence ... as to the costs caused by export customers in Ontario”.⁴⁹

35. There can be no doubt that the evidence in this case is entirely different from the evidence that was before the Board when it rendered the Hydro One Decision. A cost allocation study has been filed in evidence in this case and, from it, the Board can see the outcome of performing a cost allocation exercise in accordance with cost causality principles. The Board can see clearly from the statutory objects that the IESO is responsible for activities (such as working with authorities outside Ontario) that have implications beyond the borders of Ontario. The Board has before it the evidence of the IESO that discusses in some detail how the work of the IESO to fulfill its responsibilities is integrated and interdependent and serves all types of customers.⁵⁰

E. Effective Date of the Approved Usage Fee

36. As referred to above, HQEM/APPrO conclude their submissions regarding the effective date for the approved usage fee with a statement that any change to the usage fee should not be effective at any date prior to the Board’s decision in this proceeding.⁵¹

37. The IESO does not agree with the argument by HQEM/APPrO that the legislative framework prevents the Board from making the approved fee effective prior to the date of the decision, nor with the arguments based on an incorrect assertion about the timing

⁴⁸ Updated Elenchus Report, Exhibit B-1-1, Attachment 3, pp. 10-11.

⁴⁹ EB-2012-0031 2013 Hydro One ETS Decision dated June 6, 2013, p. 5.

⁵⁰ Exhibit B-1-2, pp. 3-4.

⁵¹ HQEM/APPrO Submissions, p. 23, para. 83.

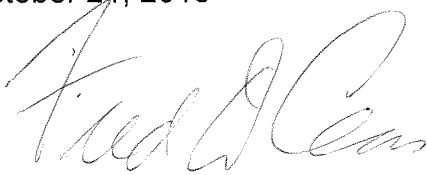
of submission of the business plan by the IESO.⁵² Nevertheless, given that it is now close to the end of October and this proceeding has not yet concluded, the IESO agrees that, in this particular case, it is appropriate that a new usage fee approved by the Board take effect as of the date of the decision regarding the fee.

F. Conclusion

38. The IESO therefore submits that the Board should approve the single proposed 2016 usage fee and that the effective date for the approved fee should be the date of the Board's decision on the unsettled issues.

All of which is respectfully submitted.

October 21, 2016



Fred D. Cass
Counsel for the Independent Electricity System Operator

⁵² HQEM/APPrO say that "the IESO did not even submit its business plan to the IESO [*sic*] until November 16, 2015": HQEM/APPrO Submissions, p. 20, para. 71. In fact, the IESO's 2016-2018 business plan was "constructed over a matter of months" and first submitted to the Minister of Energy on September 1, 2015: response to AMPCO Interrogatory 6, part a), Exhibit I-1.2, Schedule 2.06 AMPCO 6.