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BY EMAIL & RESS

April 28, 2017
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 2016
(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, 2016 (the "2016 Report"). The enclosed 2016 Report represents the SME's fourth annual filing with Board for the Smart Metering Charge (the "SMC") that is in effect from May 1, 2013 to October 31, 2018.

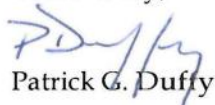
The enclosed 2016 Report addresses the matters identified in section 1.4(d) of the approved Settlement Agreement dated March 28, 2013 (the "Settlement Agreement") and section 6 of the Accounting Order dated May 14, 2013 (the "Accounting Order") in EB-2012-0100/EB-2012-0211.

As described in the 2016 Report the SME will file an application for a new Smart Meter Charge by September 2017 and seeking an effective date of January 1, 2018.

By copy of this letter, we are providing the 2016 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 2016 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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2016 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 2016, high level considerations on the SME operations covering the remainder of the current SMC period, and recommendation for the next steps on a new SMC submission with supporting analysis and rationale.

More specifically, the 2016 Report provides:

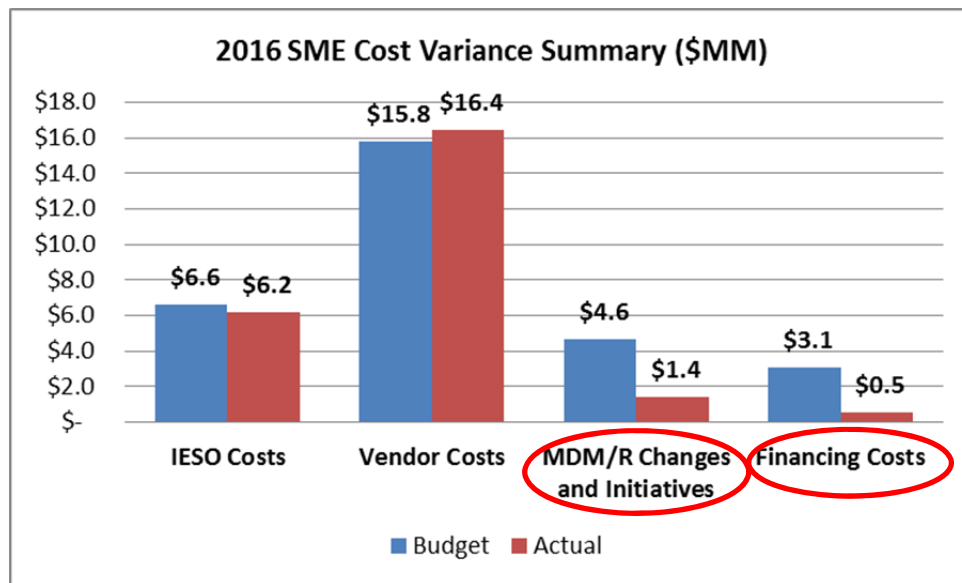
1. **Financial Results** – for the fiscal year ending 2016, the SME's budgeted and actual revenue and the budgeted and actual costs (Table 1 – 2016 SME Cost Variance Summary) with an explanation for any material variances.
2. **Smart Metering Debt** - providing the historical and projected position on the SME Debt recovery (Table 2 – Smart Metering Debt – Projected Recovery)
3. **Service Level Credit Balance** – providing current service level credits and the total balance in the Service Level Credit variance account.
4. **Smart Metering Charge (SMC)** - providing the rationale for the continued use of the current Smart Metering Charge until the end of 2017 and the plans to apply for a new SMC by September, 2017
5. **Accounting Changes** – providing an update of the IESOs adoption of rate regulated accounting and the impact on the SME
6. **SME Variance Account Report** – providing 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 3 – SME Variance Account Report)
7. **Appendices** – This includes the **SME Annual Cost Report** which provides a breakdown of actual and budgeted revenues and cost with variance explanations in the format of Appendix C to the Settlement Agreement (Table 4 – SME Annual Cost Report), the **Smart Metering Statement of Financial Position as of December 31, 2016** (Table 5 – SME Statement of Financial Position) and a **reconciliation of the SME Annual Cost Report and the IESO Audited Financial Statements** (Table 6 – 2016 SME Financial Report Reconciliation to IESO Audited Financial Statements).

1. Financial Results

Smart Metering revenues collected in 2016 were \$46.7MM, which is \$1.4MM higher than the budgeted \$45.2MM included in the Smart Metering's rate application in EB-2012-0100/ EB-2012-0211. This is due to the increased number of smart meters in use in the province as noted in the *2015 Yearbook of Electricity Distributors* published by the OEB.

Smart Metering expenses for 2016 were \$24.6MM, which is \$5.5MM less than the budgeted amount for 2016 of \$30.1MM included in the SME's rate application. A summary and explanation of any material variances for each variance category is below and shown in the following table (Table 1 – SME Cost Variance Summary).

Table 1 – 2016 SME Cost Variance Distribution



The following is a summary and explanation of material variances:

- **MDM/R Changes and Initiatives were \$1.4MM for the year which is \$3.2MM lower than planned**
 - The MDM/R 7.7 upgrade including deployment, testing and resources was able to deliver a successful implementation ahead of schedule. In addition efforts dedicated to meeting the requirements of the OEB order (EB-2015-0297), specifically the collection of the additional information from the LDCs (postal codes, distributor and commodity rate classes and occupant change date) deferred the start of major technical projects such as the MDM/R 8.x upgrade strategy. Also, no significant effort was applied to the Toronto Hydro Integration as the project start date was moved back to 2017.
- **Financing Costs were \$0.5MM for the year which is \$2.5MM lower than planned**
 - This variance is the combined result of the lower interest rates and the accelerated pay down of the SME debt over the past four years. The accelerated pay down of debt is due to higher revenues collected than planned and ongoing costs savings due to ongoing operational savings and the rescheduling of certain key technical projects.

2. Smart Metering Debt

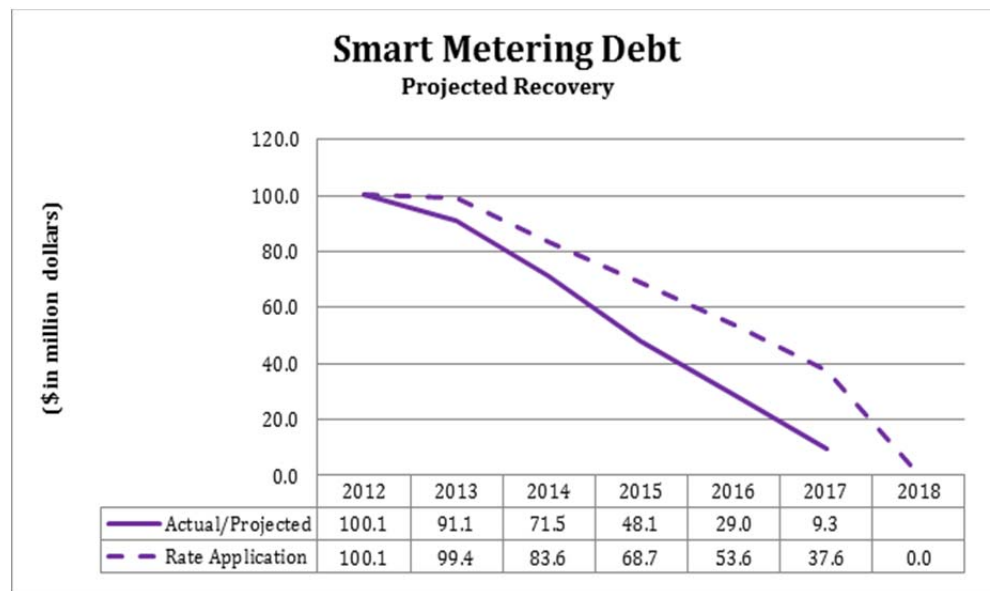
The Smart Metering debt at the beginning of the Smart Metering Charge collection period in 2013 was \$100.1MM. As of December 31st, 2016 the Smart Metering debt was \$29.0MM (vs. \$48.1MM in December 2015) which represents an additional \$24.6MM of debt recovered compared to the debt recovery in the Smart Metering's rate application (EB-2012-0100/ EB-2012-0211).

The ongoing favourable variances in the Smart Metering variance accounts (Table 4 – SME Variance Account Report) has resulted in the accelerated by down of the Smart Metering Debt. This has also resulted in significant financing costs savings for ratepayers.

The Smart Metering Debt is projected to be \$9.3MM at the end of the current approved Smart Metering expense period (December 31, 2017).

Table 2 – Smart Metering Debt – Projected Recovery

The graph shows the projected debt recovery assumed in the SME Rate Application and the actual/projected debt recovery



3. Service Level Credit Balance

To ensure the optimal operation of the MDM/R, the Operational Service Provider must consistently meet all service level operating requirements for the MDM/R. In the event that a service level target is missed, the Operational Service Provider applies a service level credit which then gets passed back to ratepayers, as directed by the OEB.

The cumulative life-to-date Service Level Credit variance account balance at the end of 2016 was \$390,408.

In 2016, the Operational Service Provider for the MDM/R met all the service level requirements, which resulted in no service level credits.

4. Smart Metering Charge

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:

- An application to set the SMC 2018 – 2022 period will be submitted to the Board by September 2017 and will replace the current SME fee recovery that goes until October 2018. The application will incorporate the residual favourable variance.
- The SME faces additional budgeting considerations required in light of the 2016 OEB Order(s) implementation (EB-2015-0297 and EB-2016-0284) and specifically the Third Party Access plan which is currently under development for full deployment in 2018 and beyond.
- The SME has utilized the SMC variance to minimize its outstanding debt which will result in a lower SMC in the 2018-2021 period.

New SMC application by September 2017

The new SMC application will be filed by September 2017 and will include a new four year budget that will cover the 2018 – 2021 operational period and will align the budget with the current term of the SME licence (currently approved until the end of 2021).

Additional budgeting considerations in light of 2016 OEB Orders

In 2016 the SME received two new OEB orders¹ which had implications on resources and budgets that were not initially planned for. These orders required the SME to file a plan to implement the following:

“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, and
- d. Occupant change data.

In the first phase to comply with the orders the SME developed the protocols for collection of the above information within the requested timelines and in full observance of privacy requirements, and as of the date of this report all LDCs have complied with the data transmission requirements to the MDM/R (with over 99% of the required data having been submitted).

¹ On January 26th 2016 (EB-2015-0297) and November 24th 2016 (EB-2016-0284)

With the first phase successfully completed, the SME is now focusing its efforts on the second, more complex phase, specifically the development of a Third Party Access plan for this enhanced MDM/R data. An assessment of the cost implications of the required Third Party Access plan, which is underway at this time, will be included in the next SMC application.

This next phase will continue to draw on SME resources with unbudgeted costs required for a wide range of activities from the running of the working groups and stakeholder engagement effort, to consulting costs associated with the privacy analysis to ensure that the data collected is rendered non-personal and the correct processes and policies are put in place for testing and piloting, communications, etc.

Minimize Outstanding Debt

As of December 31st, 2016 the IESO's SME related debt for the development, implementation and operation of the MDM/R was \$29MM (Table 5), a further reduction of over \$19MM over the past year.

Paying down the debt faster has resulted in the savings of millions of dollars for ratepayers since 2013 due to lower financing costs. The SME will continue to take full advantage of opportunities to minimize the cost of debt and therefore costs to Ontario ratepayers.

The originally approved budget assumed the full \$100.1MM SME debt recovery by the end of the collection period in October 31st 2018 but only included operational costs up to December 31st, 2017.

For the above reasons, the SME submits that the current SMC should remain unchanged until the end of 2017, to allow the SME to fully consider the costs associated with the OEB implementation Order, and to be able to start the new budgeting cycle 2018 – 2021, with a new SMC that minimizes the debt component of the outstanding debt as of Dec 31st 2017 (estimated at \$9MM) while reflecting the cost associated with the requirements of maintaining the high performance service levels of the MDM/R.

5. Accounting Changes

As of January 1st, 2016, the IESO made changes to its accounting policies to increase transparency and to report certain costs as regulated assets, consistent with the accounting policies of other regulated entities in North America. This change, which has been applied retroactively, has resulted in a change in the way the amount representing past Smart Metering expenses that are to be recovered from future SMC collection are reflected on the IESO's Statement of Financial Position, specifically the conversion of the previously reported accumulated deficit as a Smart Metering regulatory asset (\$21.6MM as of December 31st, 2016 and \$40.8MM as of December 31st, 2015). (See Table 5 – SME Statement of Financial Position).

This accounting change has no impact on the SME financial operations or the annual cost and variance account report results.

6. SME Variance Account Report - Table 3

	For the 2016 Reporting Period		
Variance Account	SMC Revenue Requirement	Actual	Variance (SMC Revenue Requirement - Actual)
Cost	\$ 30,085,202	\$ 24,575,724	\$ 5,509,478
Revenue	\$ 45,206,527	\$ 46,651,100	\$ (1,444,573)
Service level Credit	\$ -	\$ -	\$ -

	For the 2013 - 2016 Reporting Period		
Variance Account	SMC Revenue Requirement	Actual	Variance (SMC Revenue Requirement - Actual)
Cost	\$ 119,226,192	\$ 98,331,918	\$ 20,894,273
Revenue	\$ 165,757,267	\$ 168,745,982	\$ (2,988,715)
Service level Credit	\$ -	\$ (390,408)	\$ 390,408

7. Appendices

Table 4 - SME Annual Cost Report

SME Financial Cost Report						
	Calendar Year: 2016					
BUDGET LINE ITEM DESCRIPTION	OEB Approved Budget	Budget Transfer (1)	Budget	Actual	Variance (Actual - Budget)	Explanation
MDM/R OPERATIONS						
IESO Costs						
IESO Project Team costs						
IESO Staff Costs	\$ 3,780,589	-213,339	3,567,250	2,644,461	922,789	The positive variance is the combined result of an average 1.5 FTE vacancies year to date, temporary resources backfilling regular staff and less labour expenses for IESO support functions transferred than planned. Additional cost savings resulted from lower overtime, less students and other expenses as planned, despite some additional support required for the OEB Order implementation.
Contractor Costs	\$ 2,211,999		2,211,999	2,543,795	-331,796	
Total IESO Project Team Costs	\$ 5,992,588	-213,339	5,779,249	5,188,256	590,993	
External Fees and Expenses	\$ 527,965	213,339	741,304	802,057	-60,753	The variance is due to increases in the cost of IBM Smart Cloud support, computer leases, CSAE audit and other miscellaneous expenses offset by less legal and training expenses than planned.
Regulatory Process: Licensing & Cost Recovery	\$ 10,000		10,000	188,058	-178,058	A portion of the annual OEB cost allocation (\$173 thousand) paid by the IESO was allocated to the SME starting in 2016. This will be an ongoing expense.
IESO Communications Support	\$ 56,275		56,275	0	56,275	
Total IESO Costs	\$ 6,586,828	0	6,586,828	6,178,370	408,458	Overall total IESO Costs were lower than budgeted by 6% or \$408K.
Vendor Costs						
Vendor Base Contract Costs	\$ 13,911,384	0	13,911,384	14,016,584	-105,200	The variance is due to the operating fees for the new Data Mart & Web Service Facility which were not part of the original OEB Budget submission and offset by lower than planned MDMR operating fees.
Software Licenses	\$ 1,528,059	360,000	1,888,059	2,258,421	-370,362	The variance is mostly due to the exchange rate on US support and maintenance contracts plus the additional support for the Data Mart & Web Service Facility
Total Vendor Costs	\$ 15,439,443	360,000	15,799,443	16,443,383	-643,940	Overall total Vendor costs were 4% over budget, or \$643K
Total MDM/R Operations Costs	\$ 22,026,271	360,000	22,386,271	22,621,753	-235,482	Overall total MDM/R Operations Costs (consisting of IESO and Vendor costs) were on budget with 1% positive variance, or \$235K
MDM/R Changes and Initiatives						
Provision for MDM/R Upgrades, Maintenance and Changes	\$ 5,000,000	-360,000	4,640,000	0	4,640,000	Factors contributing to the significant positive variance were the successful delivery of the MDM/R 7.7 upgrade, as well as the deferral of major technical projects such as the MDM/R 8.X upgrade strategy due to OEB order requirements. Additionally, no significant effort was applied to the Toronto Hydro Integration as the project start date was moved to 2017.
Total MDM/R Changes and Initiatives Costs	\$ 5,000,000	-360,000	4,640,000	1,412,481	3,227,519	Overall total MDM/R Changes and Initiatives costs were 70% under budget, by \$3.2MM
SUB-TOTAL (Before Financing Costs)	\$ 27,026,271	0	27,026,271	24,034,234	2,992,037	
Financing Costs	\$ 3,058,931		3,058,931	539,523	2,519,408	The over 80% positive variance is due to lower interest rates than projected and an accelerated pay down of debt resulting in lower financing costs of \$2.5MM, a significant saving for ratepayers
TOTAL COSTS	\$ 30,085,202	0	30,085,202	24,573,757	5,511,445	Overall MDM/R costs for 2016 were 18% under budget, or by \$5.5MM
TOTAL REVENUE	\$ 45,206,527	0	45,206,527	46,651,100	1,444,573	The variance is a result of more smart meters installed at the start of 2016, than planned (an additional 153,000). The Smart Metering Entity collects \$0.788/smart meter/month, within Ontario.

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 Statement of Financial Position

Statement of Financial Position
Smart Metering Entity

As at (in thousands of Canadian dollars)	December 31, 2016	December 31, 2015
FINANCIAL ASSETS		
Regulated Asset - SME	21,622,840	40,848,713
TOTAL FINANCIAL ASSETS	21,622,840	40,848,713
LIABILITIES		
Accounts payable & accrued liabilities	778,415	3,622,108
Debt	29,032,088	48,130,341
TOTAL LIABILITIES	29,810,504	51,752,449
NET DEBT	(8,187,663)	(10,903,736)
NON-FINANCIAL ASSETS		
Property & Equipment		
Meter Data Management/Repository (MDM/R)	7,721,718	10,571,222
Short-term prepaid expenses	465,946	332,514
TOTAL NON-FINANCIAL ASSETS	8,187,663	10,903,736
TOTAL ACCUMULATED SURPLUS / (DEFICIT)	-	-

Table 6 – 2016 SME Financial Report Reconciliation to IESO Audited Financial Statements

SME Financial Report Reconciliation to the IESO Audited Financial Statements	
Smart metering charge - actual revenue	46,651,100
Smart metering charge - annual report	27,425,227
Amount to reconcile	19,225,873
Smart metering expenses - actual expenses	24,575,724
Smart metering expenses - actual report	27,425,227
Amount to reconcile	(2,849,503)
Total amount to reconcile	16,376,370
Add: change in regulated asset	19,225,873
Add: capital spend on MDM/R	1,011,356
Less: amortization expense	3,860,859
Less: service level credits	0
Total reconciled	16,376,370