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November 11, 2017
Our File: EB20170150

Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2017-0150 – IESO 2017 Fees – SEC Submissions on Unsettled Issues

We are counsel to the School Energy Coalition (“SEC”). Pursuant to Procedural Order No. 3, this is SEC’s Final Argument on the two unsettled issues in the Independent Electricity System Operator’s (“IESO”) application for approval of its 2017 fees.

A. Issue 4.4: Variance Account

SEC submits the Board should approve a variance account to track the difference between the 2017 approved Market Renewal Program (“MRP”) costs and actuals.¹

The MRP is different than any other program or expense that the IESO, or either of its predecessors (the former IESO and the Ontario Power Authority), has undertaken since its fees began being regulated by the Board. The total budget is forecasted to be \$195.9M and span a number of years.² This includes very significant capital spending.³ The annual cost is expected to increase in the next few years⁴, with implementation costs continuing through until 2023.⁵

The IESO’s rationale for opposing the establishment of the account is that it’s unnecessary since it is tracking the individual costs for the MRP and reporting on it separately from the rest of its operation. In addition, there is the Forecast Variance Deferral Account (“FDVA”) which records the difference between forecast and approved costs and revenues for all aspects of the revenue requirement and fees. SEC submits both rationales are insufficient for what the purpose of the variance account is in this particular case.

¹ While the Issue states ‘Should the IESO establish a separate Market Renewal Program Deferral Account?’, the Board approved settlement clarifies the issue to be “the dispute is about the creation of a specific variance account related to the Market Renewal Program”, (Exhibit S, Tab 1, Schedule 1, p.17)

² *Ibid*

³ Exhibit I Tab 1.6 Schedule 2.45 BOMA 45

⁴ Exhibit A, Tab 2, Schedule 2, p.13

⁵ Exhibit I, Tab 1.6, Schedule 5.07 Energy Probe 7, Attachment 1, p.89;

The problem with the IESO's view is it is focused on the tracking nature of a variance account. While variance may allow for more rigorous accounting of costs, the primary purpose for rate-making or in this case fee-making, is that it allows ring-fencing of certain costs to ensure a regulatory review of any over or underspending.⁶ The problem with the existing FDVA is it only allows for review if the overall actual IESO costs exceed the actual revenue it collects. For example, if MRP costs are higher than approved, but it is balanced out against lower IESO costs in other parts of the organization, there may be no review. Further, if there are higher than approved MRP costs but the revenues collected by the IESO were higher than forecasted, there would also likely be no review. Even if the above analysis is incorrect, and the MRP costs can be reviewed in isolation as part of the FDVA, there is no harm to the IESO if the Board approves this additional variance account. Doing so will provide certainty to all parties and the Board that the information will be tracked separately and reviewed separately.

The need for a variance account for this specific project is heightened not just by the uniqueness of the project, but the way it has been undertaken. The IESO's evidence is much of the MRP has not yet been determined. In fact, no business case has been developed yet. In fact, it will not be presented to the IESO Board of Directors until Q3 2018.⁷ At this stage, the MRP cost estimates are really extremely high level forecasts and there is a strong chance the forecast budget will be incorrect. This year alone, the IESO is forecasting to spend 25% less than its budgeted amount.⁸

The IESO argues that because it must file an annual application for its revenue requirement, expenditures, and fees, there is sufficient oversight and so no account is required. SEC disagrees. While the IESO is required to file an application with the Board annually once its Business Plan has been approved by the Minister⁹, if there is no ministerial sign-off, no application gets filed. This has happened on numerous occasions in the last five years. The IESO did not file an application for 2015 fees, nor did the OPA or the former IESO file an application for fees for the 2012 and 2013 fiscal years.¹⁰ A program specific variance account will allow securitizing this program if there are cost overruns, or in years where there is no application, the entire cost.

While the IESO is different than other entities the Board rate regulates, as it does not earn a return on its invested capital, it does not mean that the Board and ratepayers should not be able to review any overspending of the MRP for prudence. The IESO's unique structure and statutory fee scheme does not immunize it from review. It may be that the consequences (i.e. a disallowance) are different, but that is a debate the Board will have to have, if required, at the time the issue arises in a future proceeding.

SEC submits the Board should approve a Market Renewal Variance Account to track the difference between annual approved amounts for the MRP, and those actually spent. In doing so, the Board

⁶ *Handbook of Utility Rate Applications*, October 13 2016, Appendix 2, p. iii

⁷ Exhibit I, Tab 1.6, Schedule 10.18 AMPCO 18

⁸ Exhibit I Tab 1.6 Schedule 6.02 PWU 2(c) [Updated]

⁹ *Electricity Act*, section 25(1)

¹⁰ The following full applications for annual fees have been filed by the IESO or its predecessor organizations since 2011. 2017: EB-2017-0150 (IESO), 2016: EB-2015-0275 (IESO), 2015: None, 2014: EB-2013-0326 (OPA) EB-2013-0381 (IESO), 2013: None, 2012: None, 2011: EB-2010-0279 (OPA), EB-2010-0046 (IESO)

should ensure the current terms of the FDVA are slightly altered, to remove the MRP program from that account, and to ensure there is no double counting.¹¹

B. Issue 5.1: Regulatory Scorecard

The IESO agreed as part of the approved 2016 Settlement Proposal to consult with intervenors to develop a scorecard to file in its next revenue requirement submission. The Settlement Proposal stated that “it is intended that this scorecard will be a tool for the Board and intervenors to use in evaluating the IESO’s proposed expenditures and revenue requirement.”¹² SEC recognizes that by its nature, nobody will be entirely satisfied by the scorecard as there is a balance to be struck between number of measures, and the potential universe of them.

History of the Issue. The backdrop to the 2016 Settlement Proposal was many years of struggle between the IESO (and its predecessor, the OPA), ratepayers, and the Board on this issue. Ratepayers and the Board have been trying to get the IESO to adopt metrics and milestones to allow a better assessment of its expenditures subject to Board approval since the OPA’s 2010 fees application.

In the OPA’s 2010 fees application, its Business Plan included various milestones it was to achieve and specific efficiency metrics to measure the cost efficiency of its programs. Parties were not satisfied with the reporting on the milestones and the metrics and issues surrounding it went to the Board for adjudication.¹³ In its Decision, the Board “direct[ed] the OPA to include more precise and informative documentation of its performance metrics for review through the fees case process.”¹⁴

The next year, in the OPA’s 2011 fees case, the Board found that the OPA had not adequately responded to its 2010 decision.¹⁵ The Board wrote:

The Board is of the view that the performance and efficiency metrics and milestones filed in conjunction with this application were of little or no assistance to the Board in its determination of whether the applied-for Net Revenue Requirement, as adjusted, was appropriate, nor whether the OPA is achieving a reasonable standard of effectiveness and efficiency in performing the functions it is mandated to undertake.

Put simply, the metrics proposed by the OPA and presented, presumably in response to the panel’s direction in EB–2009–0347 do not measure productivity or efficiency. They record performance, but do not provide any insight with respect to the efficiency or effectiveness with which the OPA is completing its work.¹⁶

¹¹ Exhibit S, Tab 1, Schedule 1, p.17. The Approved Settlement Proposal includes the following regarding Issue 4.4:

The Parties also agree the scope of this contested issue includes not just the establishment of the account, but also, i) any related changes to the approved Forecast Deferral Variance Account that may be required as a result of the creation of a separate Market Renewal Program Deferral Account.

¹² EB-2015-0275, Exhibit S, Tab 1, Schedule 1, p.17

¹³ EB-2009-0375, Exhibit S, Tab 1, Schedule 1, p.7

¹⁴ *Decision and Order* (OPA 2010 Fees - EB-2019-0347), April 27 2010, p.6

¹⁵ *Decision and Order* (OPA 2011 Fees - EB-2010-0279), July 8 2011, p.9

¹⁶ *Ibid*, p.11

The Board directed that for the 2012 application, the OPA was to “develop a more complete and informative set of performance and efficiency metrics, cost benchmarking, and program milestone tools in order to assist the Board with its determination that the applied-for Net Revenue Requirement is appropriate.”¹⁷ While the OPA did retain an external consultant and conducted a stakeholder session to help develop metrics¹⁸, it never filed a 2012 or 2013 fees application.

In its 2014 fees application, it proposed some metrics, but as its Business Plan at the time stated, the development of final metrics was put on hold as the OPA focused resources on its upcoming merger and integration with then separate system operator only IESO.¹⁹ In its Decision, the Board recognizes the past decisions on this issue and the issue “remain[s] generally unresolved at this time”.²⁰ It noted that there continued to be “weaknesses in the OPA’s setting and achievement of performance targets and metrics.”²¹ While repeating the same language as the EB-2009-0347 decision, it directed “the merged entity’s first fees submission will show an improvement in the setting and achievement of performance targets and metrics.”²²

In its first fees application after the merger (2016 fees), the IESO did not heed the Board’s direction in the view of most intervenors. The only metrics it included were its Corporate Performance Measures that were not developed for the purposes of measuring the efficiency and effectiveness of the Board regulated expenditures and revenue requirement.²³ They were developed for a broader purpose to assist management, stakeholders and the IESO’s Board to monitor key initiatives in a given year. In the approved Settlement Proposal there was agreement that the IESO would retain a consultant to help develop a scorecard, with the input of stakeholders, to help in future cases to evaluate its expenditures and revenue requirement.²⁴

As the above history demonstrates, getting to even this point has been a long arduous task for both ratepayers and the Board.

Proposed Scorecard. There still remain a number of deficiencies with the proposed scorecard. SEC’s comments below are focused on only three of them. We understand other intervenors will provide comments on other areas of the scorecard. While SEC is not proposing the Board accept or reject the specific scorecard explicitly, we do provide some specific suggestions which we hope the Board will consider and direct the IESO to undertake.

- a. Financial Tracking Limitations.** There is a limitation on a number of potential metrics due to the way the IESO internally tracks financial information. With the exception of the MRP, the IESO tracks its financial information in only two ways, either by business unit²⁵, or by

¹⁷ *Ibid*, p.11

¹⁸ *Decision and Order* (OPA 2014 Fees - EB-2013-0326), November 6, 2014, p.9

¹⁹ *Ibid*, p.9

²⁰ *Ibid*, p.8

²¹ *Ibid*, p.8

²² *Ibid*, p.19

²³ EB-2015-0275, Exhibit I Tab 6.2 Schedule 1.08 OEB Staff 8

²⁴ EB-2015-0275, Exhibit S, Tab 1, Schedule 1, p.17

²⁵ Exhibit S, Tab 1, Schedule 1, p.23

general category (i.e. compensation & benefits, professional & consulting fees, etc.),²⁶ across the entire organization.

The problem with using business unit is that it is not the same thing as a program or initiative that the IESO undertakes. For many, they span multiple business units in whole or in part. For example, the IESO cannot create a metric for contract management that measures capacity or number of contracts managed per dollar spent on the activity. This is because while there is a contract management business unit, other elements within the organization contribute to the function.²⁷ The IESO does not track the time and thus cost, of different units contributions to the contract management function. At best, Elenchus recommended creating a measure that compared capacity and contracts managed as a function of FTEs that are part of the contract management business unit only.²⁸ Elenchus recognized that this was imperfect.

A similar issue has been trying to get the IESO to report using similar tables to what the Board requires from electricity distributors and transmitters, to report costs on a program basis. The IESO has done the best that it can do based on its current financial reporting system but that is on a business unit basis, not program or initiative basis.²⁹

The inability to report financial information on a program or initiative basis prevents the creation of robust metrics to determine cost effectiveness – measuring an activity/output as a ratio of dollars spent on it. The Board should require the IESO to develop a financial reporting system to be able to do this. This is required of all other rate regulated entities of the Board who have to report on a program/activity basis.³⁰ The IESO clearly has the ability to track information on this basis. It has said that it is doing so with respect to the MRP.³¹

b. Market Assessment and Compliance. IESO has refused suggestions to include any metrics regarding its market assessment and compliance work. One of the IESO's main tasks is to 'police' the market to ensure the Market Rules are being complied with, and where they are not, ensure those entities are penalized. SEC submits this important task is ripe for measurement to ensure that the IESO has the appropriate resources to undertake this very important task that has significant impact on ratepayers. The IESO collects the data on the number of investigations and market rules breaches, amounts collected through settlement

²⁶ For example, see Exhibit C, Tab 2, Schedule 1, Attachment 2

²⁷ Exhibit C1, Tab 1, Schedule 1, Attachment 1, p.34

²⁸ *Ibid*

²⁹ See Appendix 2-JC Exhibit S, Tab 1, Schedule 1, p.23

³⁰ For example see: Filing Requirements For Electricity Distribution Rate Applications - 2017 Edition for 2018 Rate Applications (July 20 2017), section 2.4.3:

As identified previously, applicants must complete the revised Appendix 2-JC: OM&A Programs Table, making best efforts to identify OM&A costs by program, and, if not, by major functions" [emphasis added]

³¹ IESO Argument-in-Chief, p.4

or penalties³², but refused to create any metrics due to what it argues are confidentiality concerns.³³

SEC accepts that individual cases and investigations may be subject to confidentiality, but aggregate annual data is not. Other similar regulatory agencies provide aggregate data without issue. For example, the Ontario Securities Commission provides aggregate data on its enforcement activities, including their outcomes, in its annual report.³⁴ This includes, among other information, the investigations and enforcement proceedings commenced, and the quantum of administrative penalties collected.³⁵ Similarly, the Alberta Electricity System Operator releases publically quarterly reports providing aggregate data on its compliance activities.³⁶

What is most surprising is that the IESO has recently internally measured the performance of Market Assessment and Compliance Division (“MACD”) and that could easily be part of the scorecard. In 2016, MACD measured its activities on a value-for-money basis, comparing the net ratepayer value of various functions, rule enforcement, and market design recommendations which it had generated.³⁷ It appears the IESO has only done it over the time period since market opening (comparing the value versus cost since 2002), but there is no reason it cannot be done for each year.³⁸ An annual version of this metric seems like a good way to measure the efficiency of the IESO’s market assessment and compliance function.

SEC submits the IESO’s market assessment and compliance is a key component of its operations and is wholly funded by Board approved fees. The scorecard should include a metric to measure its cost-effectiveness year-over-year.

- c. Annual Targets.** The IESO does not want to set annual targets now. In its view, it requires a history of the underlying data to allow it to realistically set targets for each metric.³⁹ The Board should require the IESO to set annual targets right away. The Board has been troubled by the IESO’s metrics and milestones (i.e. targets) since its 2010 fees application. The IESO should not once again be allowed to push this requirement off until some future application. The Board expects continuous improvement from the entities it regulates⁴⁰, and the setting of targets is the way to push performance.

³²Exhibit C1, Tab 1, Schedule 1, Attachment 1, p.33; Exhibit I, Tab 5.1, Schedule 7.20 SEC 20(a)

³³ Exhibit I, Tab 5.1, Schedule 7.20 SEC 20(a)

³⁴ Ontario Securities Commission, *Annual Report 2017*, p.14-15
<http://www.osc.gov.on.ca/documents/en/Publications/Publications_rpt_2017_osc-annual-rpt_en.pdf>

³⁵ *Ibid*

³⁶ See <https://www.aeso.ca/rules-standards-and-tariff/compliance/>

³⁷ Exhibit I, Tab 5.1, Schedule 7.20 SEC 20(b)

³⁸ Exhibit I, Tab 5.1, Schedule 7.20 SEC 20(b)

³⁹ Exhibit I, Tab 5.1, Schedule 1.11 OEB Staff 11(a)

⁴⁰ *Handbook of Utility Rate Applications*, October 13 2016, p.3:

Operational Effectiveness: Utilities are expected to demonstrate ongoing continuous improvement in their productivity and cost performance while delivering on system reliability and quality objectives.



SEC submits the Board should direct the IESO to improve its financial reporting to allow for new and better metrics to be included in future scored. It should also direct the IESO to include a market assessment and compliance metric, and set annual targets.

Yours very truly,
Shepherd Rubenstein P.C.

Mark Rubenstein

cc: Wayne McNally, SEC (by email)
Applicant and interested parties (by email)