Shepherd Rubenstein

BY EMAIL and RESS

Mark Rubenstein
mark@shepherdrubenstein.com
Dir. 647-483-0113

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1E4

October 25, 2019
Our File: EB20190002

Attn: Christine Long, Registrar & Board Secretary

Dear Ms. Long:

Re: EB-2019-0002 – IESO 2019 Fees – SEC Submissions

We are counsel to the School Energy Coalition ("SEC"). Pursuant to Procedural Order No. 7, these are SEC's submissions on the unsettled issues in the application by the Independent Electricity System Operator ("IESO") for approval on its proposed expenditures, revenue requirement, and fees for 2019, pursuant to section 25(1) of the *Electricity Act.*

Considering that the 2019 fiscal year is almost complete, the unique nature of IESO as an organization, and the task before the Board, SEC's submissions are focused on a number of discrete issues which require highlighting. Silence on any other issue or forecast cost should not be construed as acceptance that they are appropriate.

Market Renewal Program Costs

A significant portion of the IESO's budget is spending related to its Market Renewal Program ("MRP"). The MRP was intended to be a set of initiatives that would help evolve Ontario's electricity market into one that is more efficient and able to meet the province's supply needs in a more cost-effective manner.

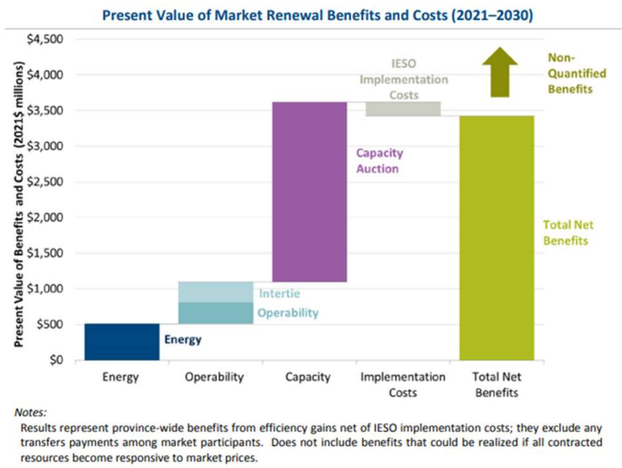
Evidence related to both the MRP, and costs related to it, have been included in previous IESO fee applications and budgets for a number of years now. The MRP has significantly changed from when it was first proposed. It originally included three distinct work streams, energy, capacity, and operability.[1]

The IESO has yet to complete, let alone approve, its business case for the MRP. When the MRP was first presented to the Board as part of the 2017 fees application, IESO provided a "benefits case" analysis undertaken by the Brattle Group.[2] That analysis showed that the net benefits were

[1] EB-2017-0150, Exhibit I, Tab 1.6, Schedule 10.013 AMPCO 13

[2] *The Future of Ontario's Electricity Market: A Benefits Case Assessment of the Market Renewal Project (Brattle Group), April 20 2017.* < http://www.ieso.ca/-/media/Files/IESO/Document-Library/engage/me/Benefits-Case-Assessment-Market-Renewal-Project-Clean-20170420.pdf> The report was referenced as part of the IESO 2017 Business Plan (See EB-2017-0150, Exhibit A-3-1, Page 13 of 56), and a full copy provided by way of link in EB-2018-0143, Exhibit I, Tab 6.1, Schedule 2.13 AMPCO 13 . The IESO also discusses it Exhibit C, Tab 2, Schedule, p.14

substantial.[3]



IESO originally expected to complete a business case for the MRP program by Q3 2018.[4] This was then delayed to Q3 of 2019.[5]

The IESO previously removed the operability work stream from the MRP. In July of 2019, the IESO announced that it would no longer move forward with the capacity work stream, as its planning outlook indicated that over the next decade, there is limited need for additional capacity if existing resources are reacquired when their contracts expire.[6]

The IESO has spent considerable time and ratepayer funds working on the MRP over a number of years, including the capacity work stream. While the IESO provided evidence that it intended to engage stakeholders to help inform changes to culture capacity auction designs in Ontario, that was not done, and in the result a lot of money has been spent for nothing. This is not to say the IESO should have gone ahead with the Incremental Capacity Auction ("ICA") if it was unneeded, but it does reveal that the IESO's approach to business planning is inappropriate. The formal business case process should have been undertaken much earlier in the process, before significant funds are expended. If the business case had been undertaken as originally proposed in 2018, a significant amount of ratepayer funds could have been saved.

In light of the abrupt cancellation of the capacity stream, the Board should require the IESO to ensure that it makes no spending commitments related to the MRP besides the bare minimum required to complete the business energy stream business case, at least until there is Board of Directors approval of the comprehensive business case. The evidence shows that IESO forecasts to spend a greater share overall of its 2019 energy stream detailed design budget (which are classified as capital expenditures), before it gets business case approval.[7]

SEC's greatest concern with this approach is the IESO's planned new $10M Dispatch Scheduling and Optimization (DSO) project, which is a significant IT capital project.[8] SEC asked the IESO in interrogatory 27, if it would "confirm that the IESO will not make any legally binding financial commitments for a new DSO system until the approval of the business case by the IESO Board of

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[3] *Ibid,* p.vii
[4] EB-2017-0150, Exhibit I, Tab 1.6, Schedule 6.04 PWU 4(a)
[5] Exhibit I, Tab 6.0, Schedule 3.12 VECC 12
[6] Exhibit C, Tab 2, Schedule 2, p.1
[7] Exhibit I, Tab 6.0, Schedule 10.28 SEC 28
[8] Exhibit I, Tab 6.2 Schedule 1.26 OEB Staff 26

Directors."[9] The IESO's response was less definitive than SEC had hoped for. It only stated that it "anticipates that any financial commitments for a new DSO system will not occur until after the approval of the business case."[10] SEC submits that it should not simply anticipate that it will not, but specifically commit, that it will not make *any* legally binding financial commitment under the approval of the business case. If not, then the entire business case process is a window dressing exercise.

MRP Budget For 2019

Even with the cancellation of one of the remaining two MRP work streams, IESO surprisingly forecasts that there will be no change in its overall revenue requirement. The IESO's rationale is two-fold. First, certain costs have already been incurred that it had planned to capitalize, but now those costs cannot be capitalized, and so must be expensed in 2019.[11] This has the effect of offsetting reduced spending on the MRP in 2019. Second, the IESO proposed that certain work continue under the umbrella of the capacity stream "to support the development of options and tools to meet resource adequacy needs as well as auction enhancements to support an enduring auction."[12] SEC accepts the immediate revenue requirement impact of the reduced spending on the MRP will be offset due to the accounting treatment of certain past costs, and some residual work that will be done in the capacity stream. But what is of concern to SEC is that the amount is entirely offset so that the revenue requirement in 2019 remains exactly as originally forecast.

The IESO proposes to spend $2.6M between the cancellation of the ICA (i.e. the work project of the capacity stream) in July and the end of the year.[13] This includes the funding of 25 FTEs to work on the capacity stream until the end of the year.[14] This is all in support of a project which has been cancelled.

SEC would expect that there would be *some* revenue requirement savings, even if some work will still remain. Yet, the requested 2019 revenue requirement amount is identical to what was requested before the cancellation of the ICA.

Metrics and Measures

Even in its more stripped down version, the MRP is still a very significant project for the IESO, and it includes significant risks. SEC is concerned with how the IESO is planning to monitor and measure the MRP.

In the Board's Decision in the IESO's 2017 fees case, the Board commented, with respect to the IESO's then proposed scorecard, that it agreed that the inclusion of earned value measures, specifically, *Cost Project Index (CPI) and Schedule Performance Index (SPI)* should be included as had been suggested by AMPCO.[15] In doing so, the Board endorsed these earned value measures as an appropriate way to measure actual performance. The IESO's own internal reporting includes SPI and CPI metrics.[16]

In the IESO's 2018 fees proceeding in response to questions regarding implementation of these metrics, the IESO noted that a baseline schedule and budget must first be developed so as to

[9] Exhibit I, Tab 6.0, Schedule 10.27 SEC 27(b)
[10] *Ibid*
[11] Exhibit C, Tab 2, Schedule 2, p.2
[12] Exhibit C, Tab 2, Schedule 2, p.1
[13] Exhibit I, Tab 6.0, Schedule 10.26 SEC 26(b)
[14] Exhibit I, Tab 6.0, Schedule 10.26 SEC 26 (c)
[15] *Decision and Order,* (IESO 2017 - EB-2017-0150), December 14, 2017, p.7
[16] See for example, Exhibit I, Tab 6.1, Schedule 10.16 SEC 16, Attachment 1, Page 2

measure against the CPI and SPI. [17] As part of the approved Settlement Proposal, the IESO committed to filing at the beginning of 2019, the baseline budget and schedule.[18]

When the IESO filed that baseline budget and schedule it was only for 2019, not the entire MRP, which is expected to cover multiple years. IESO proposes to track the CPI and SPI against this 2019 budget and schedule, and then will develop a new schedule and budget for 2020 and track the new SPI and CPI in 2020.[19] SEC submits this is an entirely inappropriate way to track the progress of a multi-year program. It is not applying the concept of CPI and SPI if it simply re-sets the metrics every year. In doing so, it is not actually measuring earned value of the entire project, and masks the actual progress by re-setting the baseline every year. Tracking progress in the correct manner is integral to ensuring that, internally, the IESO manages the risks of the project, and also so the Board and intervenors can monitor the IESO performance.

SEC submits the Board should require the IESO to file a baseline budget and schedule for the entire project for the CPI and SPI purposes as soon as practical, similar to what parties believed the IESO was going to provide in January 2019.

Operating Reserve

The IESO seeks approval to retain $10M as an operating reserve in its Forecast Variance Deferral Account ("FVDA"). [20] This is an increase in the approved operating reserve of $6M that was agreed to by way of settlement in both the 2017 and 2018 fees cases.[21] SEC submits the proposal should be denied. The Board should only approve retention of $6M as an operating reserve with the remainder rebated back to customers.

The IESO's evidence is that the rationale for the increase in the operating reserve is a result of increased capital requirement and project complexities, including that related to the MRP.[22]

SEC notes that the IESO has never drawn down from its operating reserve for any of the above noted purposes.[23] Moreover, with the cancellation of the capacity work stream of the MRP, the IESO's risks have declined, and so there is less need for an operating reserve, let alone one that is larger than in previous years.

Materiality Threshold

In the Decision on the Motion and Procedural Order No.4, the Board stated it is interested in receiving submissions as part of parties' final argument to clarify for future proceedings "on whether it is appropriate to establish a materiality threshold for the IESO, and if so at what level." [24]

As SEC noted in its Motion which raised this issue, an appropriate materiality threshold would be the same as that for other rate-regulated entities. The Board is required annually to approve the IESO's operating expenses, revenue requirement, and fees, just like other rate-regulated entities.

For example, the Board's Filing Requirements for Electricity Distribution Rate Applications currently state that for an entity with a revenue requirement of between $10M and $200M, the materiality threshold for a given expense (capital expenditure or OM&A expense) is 0.5% of the revenue

[17] See for example, EB-2018-0143, Exhibit I, Tab 5.1, Schedule 10.11 VECC 11(d)
[18] *Decision and Order (*IESO 2018 - EB-2018-0143), October 25 2018, Appendix A, p.15
[19] Exhibit I, Tab 6.1, Schedule 10.19 SEC 19(b)
[20] Exhibit B, Tab 2, Schedule 1, p.2
[21] Exhibit B, Tab 2, Schedule 1, p.2
[22] Exhibit I, Tab 0, Schedule 8.02 CME 2(a)
[23]Exhibit I. Tab 4.1, Schedule 1.18 OEB Staff 18(a)
[24] Decision and Procedural Order No.4, p.6

requirement.[25] For the IESO, which has a revenue requirement of $190M in 2019, than that would have meant a materiality threshold of 954K.

SEC, as well as, other intervenors have been frustrated over the years in its review of the IESO's annual applications. The IESO provides very little information regarding its spending, capital projects, and the variances year-to-year, in its pre-filed evidence. It is only at the interrogatory stage where the IESO is required to produce additional information that would have been expected to be filed as part of a rate application.

The Board has a duty under the *Electricity Act* to review the IESO expenditures and revenue requirements. While the Board's authority is different than its ratemaking authority, under the *Ontario Energy Board Act*, that does not mean that it is of a lesser kind. It is simply different in that, if the Board does not accept the proposed amounts, it cannot substitute an amount it believes is reasonable. It can only send the matter back to the IESO for further consideration with its recommendations.[26] But it still must review the proposed expenditures and revenue requirement to ensure they are appropriate. Ratepayer groups who intervene and ultimately fund the IESO, and the Board who must render a decision, must have enough information to properly scrutinize the application. SEC sees no reason why the materiality threshold for the IESO should in any way be less than what the Board requires from other entities.

A materiality threshold coupled with a requirement to provide sufficient information in the pre-filed evidence, with respect to those material costs, should be required. The Board should consider creating a set of filing requirements for the IESO.

Yours very truly,
Shepherd Rubenstein P.C.

Original signed by

Mark Rubenstein

cc: Wayne McNally, SEC (by email)
IESO and intervenors (by email)

[25] Filing Requirements For Electricity Distribution Rate Applications - 2018 Edition for 2019 Rate Applications, Chapter 2, p.5
[26] *Electricity Act*, s.25(4)