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BY EMAIL AND RESS

September 6, 2022

Ms. Nancy Marconi
Registrar
Ontario Energy Board
Suite 2700, 2300 Yonge Street
P.O. Box 2319
Toronto, ON M4P 1E4

Dear Ms. Marconi,

EB-2021-0243 – Generic Hearing on Uniform Transmission Rates-Related Issues and the Export Transmission Service Rate – Submission

Pursuant to Procedural Order No. 3 dated August 26, 2022, please find enclosed Hydro One Networks Inc.'s submission.

An electronic copy of the submission has been submitted using the Board's Regulatory Electronic Submission System.

Sincerely,

Stephen Vetsis

cc. EB-2021-0243 parties (electronic)

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15 (Sched. B) (the "Act");

AND IN THE MATTER OF a motion by the Ontario Energy Board under sections 19, 21 and 78 of the Act to consider various issues related to Ontario's Uniform Transmission Rates.

HYDRO ONE NETWORKS INC.

SUBMISSIONS

OEB File No. EB-2021-0243

September 6, 2022

Submissions of Hydro One Networks

INTRODUCTION

Through a procedural order issued as part of Hydro One Networks Inc.'s ("Hydro One") joint transmission and distribution rate application, the Ontario Energy Board (the "OEB") advised of its intention to commence a generic proceeding on its own motion to review a number of issues related to Uniform Transmission Rates (UTRs).[1] The OEB issued Procedural Order No. 1 in this generic proceeding on November 30, 2021, indicating that the first phase of the proceeding would focus on reviewing and setting the Export Transmission Service (ETS) rate.[2] Hydro One is an intervenor in this proceeding. The following are Hydro One's submissions in respect of the ETS rate.

Background

In response to the OEB's direction and to support the first phase of this generic proceeding,[3] Hydro One and the Independent Electricity System Operator ("IESO") jointly filed evidence, along with clarifications of their respective views, regarding the ETS rate (the "Joint Evidentiary Submission").[4] The Joint Evidentiary Submission included background information about the ETS rate, including the history of ETS rate-setting since market opening. This showed that, to date, the ETS rate in Ontario has been established either on an interim basis or on the basis of OEB-approved settlements, or by maintaining the prior settlement-based rate which was informed by a cost allocation study.[5] The Joint Evidentiary Submission

[1] See EB-2021-0110, Procedural Order No. 1 dated September 17, 2021, p. 3.
[2] See EB-2021-0243, Procedural Order No. 1 dated November 30, 2021.
[3] See EB-2021-0110, Procedural Order No. 1 dated September 17, 2021, p. 4.
[4] Hydro One and IESO, Joint Evidentiary Submission (EB-2021-0243), October 14, 2021.
[5] At the time of market opening, the OEB determined on an interim basis that the ETS rate should be fixed at $1.00/MWh. At the time, the $1.00/MWh was considered a reasonable compromise among competing interests. The ETS was maintained at $1.00/MWh by OEB-approved settlement agreement in EB-2006-0501. A few years later in EB-2010-0002, the OEB increased the ETS rate to $2.00/MWh while also requesting an additional study on the ETS rate. The rate was lowered to $1.85/MWh by approved settlement agreement in EB-2014-0140, with $1.85/MWh being the mid-point between a cost-allocation based rate and the then-current rate in effect. The rate of $1.85/MWh has subsequently been confirmed in multiple Hydro One transmission proceedings. For further details, see Hydro One and IESO, Joint Evidentiary Submission (EB-2021-0243), October 14, 2021, pp. 2-6.

also included the following three reports that were initially filed in Hydro One's joint distribution and transmission rate application:

- First, as directed by the OEB in Hydro One's last transmission rates application,[6] Hydro One engaged Elenchus Research Associates ("Elenchus") to prepare an ETS cost allocation study which uses a methodology that includes options for the allocation of shared network costs to exporters (the "Elenchus Cost Allocation Study").[7]

- Second, as further directed by the OEB in Hydro One's last transmission rates application,[8] Hydro One engaged Charles River Associates (CRA) to prepare an updated ETS rate jurisdictional review (the "Jurisdictional Review").[9]

- Third, recognizing that the operation of the electricity market is the responsibility of the IESO, the jointly filed evidence included a report from the IESO regarding the Ontario market implications of changing the ETS rate.[10]

Pursuant to Procedural Orders No. 1 and 2, this proceeding has included interrogatories on the Joint Evidentiary Submission, intervenor evidence filed by the Association of Power Producers of Ontario ("APPrO") and interrogatories on the APPrO evidence, a two-day technical conference, a Presentation Day, as well as an untranscribed discussion among parties. Hydro One has participated in each of these procedural steps. In addition, for purposes of the technical conference and to assist the parties, Hydro One made available the experts from Elenchus and CRA, as well as certain of its own staff with relevant knowledge and expertise.

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[6] EB-2019-0082 Decision and Order dated April 23, 2020, p. 180.
[7] *Export Transmission Service Rate Cost Allocation Methodology,* report prepared by Michael Roger, Andrew Blair, Elenchus Research Associates Inc. dated July 21, 2021, filed in EB-2021-0110 as Exhibit H-09-01, Attachment 1 and subsequently filed as part of the Joint Evidentiary Submission on the ETS Rate, Attachment 1, October 14, 2021.
[8] EB-2019-0082 Decision and Order dated April 23, 2020, p. 180.
[9] *Jurisdictional Review of Export Transmission Service (ETS) Rates Study* prepared by Charles River Associates dated March 29, 2021, filed in EB-2021-0110 as Exhibit H-09-01, Attachment 2 and subsequently filed as part of the Joint Evidentiary Submission on the ETS Rate, Attachment 2, October 14, 2021.
[10] *Market Implications of the Export Transmission Service Rate* prepared by the IESO dated July 2021, filed in EB-2021-0110 as Exhibit H-09-01, Attachment 3 and subsequently filed as part of the Joint Evidentiary Submission on the ETS Rate, Attachment 3, October 14, 2021.

In its capacity as an intervenor in this proceeding, as the owner of Ontario's intertie infrastructure, and as both a distributor and transmitter, Hydro One is uniquely positioned to contribute to the OEB's understanding and consideration of the issues in this proceeding. Hydro One is also uniquely positioned to assist the OEB in understanding and considering any implementation matters in respect of any potential changes in the ETS rate, and has provided input on these matters over the course of this proceeding.

Summary of Hydro One's Position

In Hydro One's view, the ETS rate serves an important purpose and should continue to exist. Specifically, the ETS rate is intended to recover the cost of export customers' use of the transmission system from which they benefit. The ETS rate therefore limits cross-subsidization between Ontario transmission customers and export customers. Moreover, the purpose of the ETS rate is distinct from the purpose served by the IESO's intertie congestion pricing ("ICP") mechanism, which is a market-based mechanism used to allocate capacity on the interties when there is more demand than capacity.[11]

With respect to the level of the ETS rate, Hydro One's position is that the OEB's primary consideration should be on setting an ETS rate that balances recovery of an appropriate level of costs from exporters with achieving the broader cost and system benefits to the Ontario electricity system.[12] Hydro One is a customer-focused utility and is cognisant of total bill pressures faced by its customers. Hydro One defers to the IESO's expertise and responsibility to advise on Ontario market implications and to the OEB's expertise and responsibility for setting an ETS rate that best balances the various interests affected by the ETS rate.

Finally, Hydro One notes that while the OEB may choose not to set the ETS rate based only on the results of a cost allocation study, the Elenchus Cost Allocation Study is informative to the setting of a cost-based ETS rate and can provide a good starting point for the final ETS rate. In Part II of these submissions, Hydro One provides an example of how the OEB may use the rates which result from the Elenchus Cost Allocation Study as a starting point for setting an updated ETS rate.

[11] See IESO response to OEB Staff Interrogatory 34 b).
[12] Presentation Day Transcript, August 4, 2022, p. 18.

In the sections below, Hydro One elaborates on its submissions relative to the relevant issues from the approved issues list in this proceeding.

I. IS IT APPROPRIATE TO CONTINUE TO RELY ON AN EXPORT TRANSMISSION SERVICE (ETS) RATE AND ON INTERTIE CONGESTION PRICING (ICP) TO CHARGE FOR EXPORT SERVICE?

Hydro One submits that it is appropriate to continue to rely on an ETS rate as well as on ICP to charge for export service because they each serve a different purpose.

ETS is transmission service relating to the use of the IESO-controlled grid for transmission of energy out of the IESO-control area and into neighbouring transmission systems, for which charges must be collected by the IESO in accordance with the Market Rules.[13] Pursuant to Chapter 10, section 4.5 of the Market Rules, rates and charges, if any, for ETS are to be established by the OEB from time to time pursuant to the OEB Act. Also significant is that, pursuant to Chapter 10, section 4.1.1 of the Market Rules, Network UTRs are not applicable to the use of the IESO-controlled grid by export customers for transmission of energy from Ontario to a neighbouring jurisdiction.

In contrast, the purpose of the ICP is to allocate access to Ontario's interties when there is more demand than capacity. Specifically, as explained by the IESO:

> The purpose of the ICP mechanism is to competitively, fairly, and transparently allocate access to an intertie when there is more demand than capability, resulting in efficient use as part of the operation of the wholesale electricity market… The key difference between the ICP and the ETS is that the ICP is dynamic and adjusts automatically to changing market conditions (hour to hour) ensuring there are no adverse impacts on economically efficient trade.[14]

The ETS rate serves an important purpose: to recover the cost of export customers' use of the transmission system. As stated by the OEB in RP-1999-0044, the proceeding in which the OEB first set the ETS rate on an interim basis, exporters "in addition to paying to the [IESO] the specific transaction costs, also utilize the assets and facilities of the Ontario transmission system. The issue is how to assess transmission costs

[13] Ch. 10, s. 4.1.2 of the Market Rules requires the IESO to collect charges for ETS from each transmission customer that uses the IESO-controlled grid for transmission out of the IESO-control area.
[14] See response to OEB Staff Interrogatory 34 b).

to these transactions."[15] Absent an ETS rate, export customers would not contribute to recovery of the costs of the transmission assets from which they benefit. While the ETS rate recovers costs for export customers' use of the transmission system, ICP serves the different purpose of allocating capacity on the interties based on willingness to pay.[16] In response to Interrogatory APPrO-1(e), Hydro One confirmed that ICP does not directly contribute to recovery of the costs of Ontario transmitters, such as Hydro One. As Mr. Vetsis explained during the technical conference:

> I think it is important to give you a little bit of context on costs. When we talk about them at Hydro One, we're talking about transmission costs as the costs to build, maintain, operate the transmission system. And, you know, we're talking about our assets basically. And the ICP -- the ETS differs from the ICP. The ETS clearly is remitted to us and offsets the recovery of our specific costs. The ICP does not.[17]

Mr. Blair of Elenchus also noted the distinction between the ETS and the ICP, noting that "I would say that the inter-tie congestion pricing is paid for capacity on inter-ties, whereas the ETS is for use of the shared transmission system for the province."[18]

Furthermore, as noted by CRA in the Jurisdictional Review, all neighbouring jurisdictions to Ontario have some form of rate for export transmission service which is linked to the recovery of a portion of the local transmitters' revenue requirements.[19] Additionally, the Jurisdictional Review did not identify any jurisdictions with a "zero" regulated transmission network charge for export out of state or province.[20]

In sum, it is Hydro One's view that the ETS rate and the ICP mechanism serve different but complementary purposes which together have allowed for efficient and effective operation of the IESO-controlled grid while recovering costs for export customers' use of the transmission system. For these reasons, it is appropriate to continue to rely on an ETS rate as well as on ICP to charge for export service.

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[15] RP-1999-0044, Decision with Reasons, Section 3.8.2.
[16] See response to OEB Staff Interrogatory 34 b).
[17] See Technical Conference Day 1 Transcript, p. 24.
[18] Technical Conference Day Two Transcript, p. 109, lines 12-15.
[19] See CRA Jurisdictional Review, p. 4 and response to OEB Staff Interrogatory 20.
[20] See response to Naren Pattani Interrogatory 3.

II. IF AN ETS RATE WERE TO CONTINUE TO EXIST ALONGSIDE ICP, WHAT APPROACH SHOULD BE USED TO SET THE ETS RATE?

A) If a cost-based approach is used to set the ETS rate, what methodology should be used?

If the OEB determines that a cost-based approach should be used to set the ETS rate, Hydro One submits that the cost-allocation based methodologies underlying each of the options in the Elenchus Cost Allocation Study are sound methodologies that would each provide a good starting point for a cost-based rate. In this regard, Hydro One notes the importance of recognizing the distinction between a cost allocation-based rate on the one hand and a cost-based rate on the other. As explained in response to Interrogatory VECC-33, ETS rates may be "cost-based" if they are derived from an understanding of a transmitter's costs,[21] but cost-based rates are not necessarily based solely on the results of a cost-allocation study.

It is also important to recognize that there is a distinction between cost allocation and rate design. While cost allocation refers to the process of identifying and apportioning costs between classes based on cost causality principles, rate design refers to the process of setting rates that balance a myriad of factors, including cost causality. In order to take into consideration the balance of interests in the electricity sector and what is best for Ontario ratepayers, Hydro One submits that the OEB should use the cost allocation results from the Elenchus Cost Allocation Methodology as a starting point, but not as the sole basis for setting the ETS rate. There are precedents where the OEB uses the rate design process to set rates on a basis which does not recover exactly 100% of the costs identified through a cost allocation study from all classes (i.e. a revenue-to-cost ratio of 1). For example, as part of the OEB's rate design process for electricity distribution rates, a range of revenue-to-cost ratios is considered acceptable by the OEB. In that context, OEB guidance identifies that acceptable revenue-to-cost ratios range from +/-15% to +/- 20%, depending on the rate class. The OEB may consider whether a similar approach could be appropriate for the ETS rate, albeit with a different range of acceptable revenue-to-cost ratios, as discussed below.

[21] See response to VECC Interrogatory 33 as well as section 5.4 of the Elenchus Cost Allocation Study.

Specifically, when the OEB considers re-setting the ETS rate, it may begin with the costs allocated to export customers from the Elenchus Cost Allocation Study[22] and then limit changes in the ETS rate to circumstances where the revenues recovered through the status-quo ETS rate would result in a revenue-to-cost ratio that is not within an OEB-prescribed range (discussed below). For example, if the current ETS rate would result in ETS revenues that are below the lower bound of costs to be collected, the ETS rate would be adjusted upwards until the revenue-to-cost ratio was at the lower bound.

Given the link between the market-based ICP mechanism and operational implications associated with the level of ETS rate,[23] the OEB may consider a larger range of revenue-to-costs ratios (as compared to those used in the context of setting distribution rates) to be appropriate, such as +/- 50%, in order to balance cost recovery from exporters with the broader operational issues raised by the IESO in this proceeding.[24] Such an approach would have the advantage of yielding a repeatable methodology for updating the ETS rate over time, such as at each Hydro One transmission rebasing application, while still allowing for a balancing of interests as discussed in Part III below.

B) How often should the ETS rate be set?

Provided that the OEB approves a specific, repeatable methodology for establishing the ETS rate in this proceeding, Hydro One submits that setting the ETS rate every five years concurrently with Hydro One transmission rebasing applications provides a good balance between having a rate that can be updated based on underlying costs on the one hand and a methodology that provides for rate stability and does not impose excessive administrative costs on the other hand. As noted in the response from Hydro One and Elenchus to Interrogatory SEC-12:

[22] For example, see response to VECC Interrogatory 24, Attachment 2, Tab O1, Cell E45 for the 2023 costs allocated to the export rate class in Elenchus's 100% Shared Net Fixed Assets allocation methodology.
[23] See discussion of operational implications in Part III C), below.
[24] Hydro One notes that Elenchus Cost Allocation Study includes three different proposals for allocating shared net fixed assets to export customers. If the OEB selects an Elenchus cost allocation methodology in which the allocation is not on the basis of 100% of shared net fixed assets, the acceptable range of revenue-to-cost ratio is unlikely to need to be as wide as +/-50% as the allocation approaches already include a reduction to the shared net fixed asset costs allocated to export customers.

> For the purposes of simplicity and stability of rates, Hydro One and Elenchus do not propose annual mechanistic adjustments to the ETS rate. This approach is consistent with how the ETS rate has been treated historically in past multi-year Hydro One applications and is analogous to the treatment of many specific service charges on electricity distribution tariffs where the charges are established at the time of rebasing and not adjusted throughout the incentive rate-setting term.

In respect of when another review of the ETS rate should be undertaken, given the significant upcoming changes in Ontario's electricity sector (e.g. IESO procurements, IESO Market Renewal, etc.) Hydro One submits that a review of the ETS rate would most appropriately be triggered a few years after the implementation of the IESO's Market Renewal project to ensure sufficient time has passed for data to be available to examine whether the current structure remains appropriate. Such a review should be considered as part of another generic proceeding, rather than as part of a Hydro One Transmission revenue requirement application so that broader market implications can more appropriately be addressed by the relevant parties.

III. ARE THERE OTHER KEY ISSUES THE OEB SHOULD CONSIDER RELATED TO THE ETS RATE?

A) Balancing recovery of costs from exporters with achieving broader cost and system benefits

In respect of the principles that Hydro One believes the OEB should consider in setting the ETS rate, Hydro One's view is that the OEB's primary consideration should be on setting an ETS rate that balances recovery of an appropriate level of transmission costs from exporters with achieving the broader cost and system benefits to the Ontario electricity system. While rate design principles such as those of full cost recovery, fairness and efficiency are among the principles that the OEB should consider in determining the ETS rate, Hydro One's view is that setting an ETS rate that appropriately balances cost recovery with supporting broader cost and system benefits, including taking into consideration the potential impacts on ICP, represents the most suitable approach in the circumstances.

B) No "free-riders" principle

Hydro One believes that the "no free riders" principle should be given sufficient weight in the OEB's consideration as to preclude the elimination of the ETS rate. The "no free riders" principle is described in the Elenchus Cost Allocation Study as follows:

> As stated by the OEB in its report on Pole Attachment Charges, when developing a cost-based methodology, consideration can also be given to the value that users obtain from leveraging an established network. This means that there should not be users of a shared network that do not pay their fair share of costs for use of the shared network, also referred to as "free riders".[25]

In their research, Elenchus considered the value obtained from leveraging the seller network in addition to pure costs, and considered that this "aligned with the no free riders principle, which is often used as a principle in cost allocation."[26] As noted by Mr. Blair at the Presentation Day:

> We note that the FERC's order 1000 dealing with transmission cost allocation states that costs should be allocated in a way that is roughly commensurate with benefits as their first cost allocation principle. And we also note that … the Régie in Quebec has a long-standing, no-free-service guiding principle for cost allocation and rate design.[27]

In sum, Hydro One submits that consideration of the no free-riders principle is appropriate in the context of setting ETS rates.

C) Operational considerations for the IESO

Hydro One submits that it is appropriate for the OEB to take into consideration the practical operational considerations noted by the IESO in their evidence in this proceeding. In its Presentation Day presentation, the IESO states that "An increase in the ETS rate will reduce exports and increase the risk that during periods of excess generation, over and above domestic needs, the IESO will need to take expensive and undesirable control actions to maintain reliability."[28] More details were provided by the IESO's witness Mr. Chapman as part of the Presentation Day:

> We have 5- to 6,000 megawatts of intertie capability, and they play a critical role, not a discretionary role, a critical role, in balancing supply and demand both in the short and the long term. They effectively act as a safety valve during periods where we have excess supply over and above, you know, Ontario's domestic needs. They provide an opportunity for that power to flow into our neighbouring markets to alleviate operational constraints and considerations, and also to monetize that power that then ultimately helps pay down some of the fixed costs to the system.[…]

[25] Elenchus Cost Allocation Study, Section 6.1.
[26] Presentation Day Transcript, p. 37.
[27] Presentation Day Transcript, p. 37.
[28] IESO Presentation Day presentation dated August 4, 2022, slide 5.

> So I can't emphasize enough just how important intertie trade is in Ontario, and I would argue that it is actually significantly more important than many of the other jurisdictions in North America. And the reason I say that is because Ontario has a high share of baseload facilities in its supply mix. It has a far higher share of baseload nuclear, baseload hydroelectric, and increasing amounts of wind generation compared to our neighbouring jurisdictions and most other jurisdictions in North America.[29]

Hydro One submits that the OEB's decision should take into account the above operational considerations noted by the IESO.

CONCLUSION

Based on the foregoing, Hydro One submits that the OEB should maintain the ETS rate alongside the ICP mechanism. In respect of the level of the ETS rate, Hydro One's view is that the OEB should use cost allocation as a starting point but, ultimately, the OEB should establish a rate that balances cost recovery from exporters with the objective of achieving the broader cost and system benefits to the Ontario electricity system.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 6TH DAY OF SEPTEMBER, 2022

[29] Presentation Day Transcript, pp. 84-85.