

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act*, 1998, S.O. 1998, c. 19, 21, and 78;

AND IN THE MATTER OF a Generic Hearing on Uniform Transmission Rates – Related Issues and the Export Transmission Service Rate.

**WRITTEN SUBMISSIONS OF THE
INDEPENDENT ELECTRICITY SYSTEM OPERATOR**

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A INTRODUCTION

1. These are the written submissions of the Independent Electricity System Operator (“**IESO**”) in this generic proceeding initiated by the Ontario Energy Board (the “**OEB**”) to establish a rate for the Export Transmission Service (“**ETS**”).

2. The IESO supports the continued use of the ETS to charge for export service alongside the Intertie Congestion Price (“**ICP**”). Considering the operational and economic risks associated with a higher ETS rate as detailed below, along with the lack of any corresponding benefit for Ontario consumers, it is the IESO’s position that the ETS rate should be set at zero or no higher than its current level of \$1.85/MW for a period of 2023-2027 to coincide with the duration of Hydro One Networks Inc.’s (“**HONI**”) current rate-setting period in its Custom Rate Application.

3. Any increase in the current ETS rate above \$1.85/MWh would be a concern for the IESO – even a relatively small increase in the ETS rate could have a material impact on export volumes. Reduced export volumes increase the probability that the IESO will have to take control actions to manage the grid, which are undesirable from both an operational and market participant perspective and will result in higher system costs that would need to be recovered from domestic consumers through increased Global Adjustment charges.

4. Evaluating the risk associated with an increase of the ETS rate is particularly difficult at the present time as the Ontario market is facing a time of transformative change and attendant uncertainty in the years ahead due to, amongst other things, the emerging capacity need in 2025, the roll out of the IESO’s Market Renewal Program (“**MRP**”), and volatile commodity prices. In recent years, exports have become increasingly important to ensure the reliable operation of the Ontario grid and any increase to the ETS would introduce additional uncertainty at a time when market participants are managing these changes. From the IESO’s perspective, there is a need for stability in the market where possible and a strong desire to avoid unnecessary additional changes to the market during this period.

5. In contrast to the operational and economic risks identified by the IESO, the evidence in this proceeding has not demonstrated that consumers will derive significant benefits from a higher ETS rate. In the absence of such evidence, it is the IESO’s position that the ETS rate should be set at zero or no higher than its current level of \$1.85/MW.

B SUMMARY OF POSITION

6. The IESO's position on each of the issues identified by the OEB is summarized below:

- *Issue 1: 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?*
The combination of the ETS and ICP – which results in an overall export price that has both a fixed and dynamic component – has been in place since market opening and has proven to be well suited to the unique characteristics of the Ontario system. While the specifics of the two mechanisms differ, the revenue generated from both the ETS and ICP is ultimately utilized to reduce costs for Ontario consumers. The IESO supports the continued use of both the ETS and ICP to charge for export service.

- *Issue 2: If an ETS rate were to continue to exist alongside ICP, what approach should be used to set the ETS rate?* The ETS was established to recover a portion of the total transmission system costs from exporters while minimizing impediments to trade with other jurisdictions. The IESO's evidence in this proceeding is that the need for open power markets that facilitate trade has "increased significantly" due to the current characteristics of the Ontario grid. Accordingly, the OEB must consider the following when setting the ETS:
 - (i) Exports are an essential tool for the province to meet short-term operational and reliability needs.
 - (ii) The ETS rate should be set in a manner that maximizes the operational and economic benefits provided by exports; and
 - (iii) A higher ETS rate will reduce the value of Ontario's interties, leading to less system flexibility and higher costs for Ontario ratepayers.

From a purely operational perspective, the IESO would prefer an ETS rate of zero that would allow the export price to be set entirely by the ICP – a dynamic mechanism that varies by intertie and adjusts every hour to changing system conditions – and reduce the risk of having to take control measures. However, the IESO recognizes there are other relevant considerations in setting the ETS

rate and acknowledges that it has effectively managed the grid with an ETS rate within the historical range. For this reason, while the IESO would prefer an ETS rate that is lower than the current rate of \$1.85/MWh, the risks are manageable at the current rate.

- *Issue 2.1: If a cost-based approach is used to set the ETS rate, what methodology should be used?* The IESO does not support the use of a strictly cost-based approach to set the ETS rate. Revenue from the ETS is only one component of the value that Ontario receives from exports and historically has been the smallest component of the economic benefits associated with exports. Any consideration of cost allocation must be viewed holistically in conjunction with the other benefits that exports provide to Ontario.
- *Issue 2.2: Should a settlement-based approach be permitted?* The IESO does not believe there is a mechanistic formula which can be utilized to set the ETS rate, particularly in the light of the anticipated changes to the Ontario system in the foreseeable future (i.e. the next five to ten years). The history of the ETS and the evidence in this proceeding demonstrates that setting the ETS rate requires balancing different objectives, which could be facilitated through settlement discussions.
- *Issue 2.3: What other methods for setting the ETS rate should be considered?* Depending upon the design of the mechanism, the IESO could support a variable ETS rate in concept but notes there is no evidentiary basis in this proceeding, either quantitative or qualitative in nature, upon which a variable ETS rate could be based. Further study would be needed and the IESO questions whether the complexity of designing, implementing and administering a variable ETS rate would outweigh the benefits. The IESO would not support any approach that would see a gradual escalation of the ETS rate over time. There is value in stability as the Ontario market is facing a time of transformative change and the attendant uncertainty in the coming years. The IESO's concerns would not be alleviated by a gradual escalation of the ETS rate.

- *Issue 2.4: How often should the ETS rate be set?* The ETS rate should be set for a term that coincides with the duration of HONI's current rate-setting period of 2023-2027 in its Custom Rate Application proceeding. This will provide a degree of revenue certainty for HONI. The Ontario system also faces a number of near-term challenges, and by the end of 2027, there should be greater certainty on how the sector is addressing the projected capacity need and the MRP will have been implemented.
- *Issue 3: Are there other key issues the OEB should consider related to the ETS rate?* The IESO cautions the OEB against mandating further studies or ongoing monitoring by the IESO in pursuit of the "perfect" ETS rate and notes that it may need to seek an adjustment to its fee to ensure the necessary funds are available for any such work.

7. The remainder of these written submissions sets out the IESO's position on each of the issues in greater detail with reference to supporting evidence.

C BACKGROUND

8. The IESO's interest in this proceeding flows from the impact that the setting of the ETS rate can have upon the following responsibilities of the IESO:

- *Operating the power system:* The IESO ensures the reliability of Ontario's power system, balancing supply and demand for electricity 24 hours a day, 7 days a week.
- *Overseeing Ontario's electricity market:* The IESO operates and settles the wholesale electricity market, using competition to provide transparency and reliability at lowest cost.
- *Planning for Ontario's future energy needs:* The IESO forecasts and assesses the province's short and long-term electricity needs.¹

9. In its Decision and Order in EB-2019-0082, the OEB directed HONI to (i) prepare an ETS study using a cost allocation methodology that includes the allocation of shared network

¹ EB-2021-0243 Generic Proceeding on Export Transmission Service (ETS) Rate – Presentation Day (the "IESO Presentation"), Exhibit KP-1.4, slide 3.

costs to exporters and (ii) consult with the IESO in the preparation of an updated ETS jurisdictional review that includes an assessment of market implications.²

10. In response to the OEB's directions, HONI retained Elenchus Research Associates Inc. ("**Elenchus**") to prepare an update to the Export Transmission Service Rate Cost Allocation Methodology Report (the "**2021 Elenchus Report**")³ and Charles Rivers Associates ("**CRA**") to update its prior jurisdictional review (the "**2021 CRA Jurisdictional Review**")⁴.

11. Neither the 2021 Elenchus Report nor the 2021 CRA Jurisdictional Review examined the implications of a higher ETS rate for the Ontario electricity market as a whole. HONI and the IESO agreed that, given the IESO's role as system operator, it would be appropriate for the IESO to perform a qualitative review of the implications of a higher ETS rate on the Ontario electricity market. Given the significant time and expense incurred in previous proceedings to study the ETS rate, the IESO's view was that the current work should avoid unnecessary duplication of past studies and focus on new and informative insights.

12. The IESO reviewed the 2021 Elenchus Report and documented its conclusions in its report Market Implications of the Export Transmission Service Rate – July 2021 (the "**Market Implications Report**"). The Market Implications Report contains an overview of intertie trading in the Ontario market in light of the recent rule changes made by the IESO, discusses the implications of an increased ETS for the Ontario market, and comments on jurisdictional comparisons and the suitability of the OEB's pole attachment approach for setting the ETS rate. The Market Implications Report was filed as part of a joint submission from HONI and the IESO regarding the ETS rate.⁵

13. The IESO's position on the appropriate ETS rate was set out in the October 2021 joint submission:

For these reasons, the IESO maintains the view that reducing the ETS rate to zero would best encourage the efficient use of electricity and promote economic efficiency in the Ontario market. However, the market has operated with the ETS rate near its current level since market open and the IESO is mindful there are

² Decision and Order, EB-2019-0082 Hydro One Networks Inc. - Application for electricity transmission revenue requirements beginning January 1, 2020 until December 31, 2022 at p. 183.

³ 2021 Elenchus Report, Attachment 1 to ETS Rate Submissions.

⁴ 2021 CRA Jurisdictional Review, Attachment 2 to ETS Rate Submissions.

⁵ Market Implications Report, Attachment 3 to ETS Rate Submissions.

other relevant considerations the OEB must make when setting an ETS rate. Therefore, the IESO recommends the rate be set at zero or no higher than the current \$1.85/MWh to maximize efficient use of electricity and promote economic efficiency in the Ontario market.⁶

14. The IESO participated in this proceeding as an intervenor. Amongst other things, the IESO responded to interrogatory requests from OEB staff and intervenors; produced a witness panel for examination during the Technical Conference; made a presentation on the Presentation Day and responded to questions from the presiding Commissioners; and participated in the untranscribed discussion between parties held on August 9, 2022.

D SUBMISSIONS

1. 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?

15. The IESO supports the continued use of the ETS to charge for export service alongside the ICP. The combination of the ETS and ICP – which results in an overall export price that has both a fixed and dynamic component – has been in place since market opening⁷ and is well suited to the unique characteristics of the Ontario system.⁸ The fixed ETS has provided Ontario with a degree of revenue certainty from exports⁹ while allowing the dynamic ICP to extract the highest value possible from each export transaction.¹⁰

16. The IESO noted the respective contributions of the ETS and ICP to offsetting consumer costs in the Market Implications Report:

Exporters contribute to the cost of the Ontario transmission system through two mechanisms. The first mechanism is through the fixed ETS rate and the second mechanism is through the dynamic ICP mechanism. When considered together, exporters not only contribute approximately \$30-40 million per year towards the transmission system through the ETS rate but have also paid an average of \$160 million per year towards the cost of the

⁶ ETS Rate Submissions at p. 13 of 14.

⁷ See Response to Technical Conference Undertaking JT-1.11, Exhibit JT-1.11 for a description of the history and purpose of the ETS and ICP.

⁸ Relative to neighbouring jurisdictions, Ontario has a high share of low marginal cost baseload generation in its supply mix which create favourable conditions for energy exports. The IESO has “a high degree of confidence” that these structural supply mix conditions will remain in place for the foreseeable future: see Presentation Day Transcript pp. 94-95.

⁹ See Table 7 in Attachment 1 to Exhibit I-1-1 for annual ETS collected between 2015 and 2021.

¹⁰ Market Implications Report at pp. 10 and 11 of 17.

transmission system from the ICP mechanism.¹¹

17. While the specifics of the two mechanisms differ, the revenue generated from both the ETS and ICP is ultimately utilized to reduce costs for Ontario consumers¹²:

- *ETS* – Any revenue collected from the ETS is applied as a reduction to HONI's revenue requirement for the network rate pool. ETS revenue flows into a customer's bill through a reduction of the network Uniform Transmission Rate for Transmission-connected end-use customers, or through network Retail Transmission Service Rates for distribution customers.¹³
- *ICP* – Surplus ICP revenue is collected in and disbursed from the Transmission Rights Clearing Account ("**TRCA**") as a credit to load customers that offsets their wholesale market service costs.¹⁴ Where those load customers are electricity distributors (such as Hydro One Distribution), these credits reduce the amount of wholesale market service costs that the distributor passes through to their non-market participant distribution customers, thereby lowering those customers' total electricity bills.¹⁵ The most recent distribution from the TRCA in May 2022 was in the amount of \$70.8 million.¹⁶ Effective June 2021, the IESO adopted a recommendation from the OEB's Market Surveillance Panel to allocate TRCA surplus disbursements based on the proportion of transmission service charges paid. The design change will ensure that a greater portion of TRCA disbursements is returned to domestic load, compared to other market participants such as exporters. Based on historical estimates, disbursements of TRCA surplus funds to domestic load increased to 98% in 2021.¹⁷

¹¹ Market Implications Report at p. 16 of 17.

¹² See Exhibit JT-1.3 for a detailed description of how revenue from the ETS and ICP are utilized to reduce customer bills.

¹³ Exhibit JT-1.3.

¹⁴ See Exhibit I-1-35 for a description of the operations of the TRCA.

¹⁵ Exhibit JT-1.3. The ICP has been described in some documents as an offset to HONI's transmission revenue requirement. While that is not accurate, the intention that surplus revenue generated by the ICP would benefit Ontario transmission customers was part of the Ontario market design and has remained constant since that time: see Exhibit JT-1.11 for a historical review of the ETS and ICP. As the Brattle Group recognized in its report (Exhibit JT-1.6, p. 18), the current TRCA disbursement methodology "effectively meets this objective by transferring funds to transmission customers (internal load and exporters) to lower their cost of using the transmission system."

¹⁶ Exhibit JP-1.05.

¹⁷ See Table 5 in Attachment 1 to Exhibit I-1-1.

18. The IESO supports the continued use of both the ETS and ICP to generate revenue from exporters that is utilized to offset the costs for Ontario consumers.

2. If an ETS rate were to continue to exist alongside ICP, what approach should be used to set the ETS rate?

19. The ETS was established by the Board in RP-1999-0044 as a compromise between two competing objectives – the recovery of a portion of the total transmission system costs from exporters while minimizing impediments to trade with other jurisdictions.¹⁸ The Board settled upon a simple fixed ETS rate to “help defray costs for domestic transmission customers” while noting that it did not intend to “inhibit the further development of a pricing regime based on only incremental cost”.¹⁹

20. While the Ontario market has evolved over the past 20 plus years, these two fundamental objectives remain relevant today – in fact, the IESO’s evidence in this proceeding is that the need for open power markets that facilitate trade has “increased significantly” due to the current characteristics of the Ontario grid as a fixed cost system with a high share of relatively inflexible baseload and intermittent generation.²⁰ Accordingly, the OEB must ensure that it considers the following when setting the ETS rate:

- (i) Exports are an essential tool for the province to meet short-term operational and reliability needs;
- (ii) The ETS rate should be set in a manner that maximizes the operational and economic benefits provided by exports; and
- (iii) A higher ETS rate will reduce the value of Ontario’s interties, leading to less system flexibility and higher costs for Ontario ratepayers.²¹

21. In the Market Implications Report, the IESO detailed the significant operational and economic benefits that exports provide to Ontario in the current context:

Interties with neighbouring jurisdictions provide a range of operational benefits and enhance system reliability for Ontario

¹⁸ Exhibit I-1-1.

¹⁹ Decision with Reasons dated May 26, 2000, RP-1999-0044 An Application by Ontario Hydro Networks Company Inc., for an Order or Orders approving year 2000 transmission cost allocation and rate design at pp. 66 to 68.

²⁰ Exhibit KP-1.4, slide 3. See also Presentation Day Transcript p. 88.

²¹ Exhibit KP-1.4, Slide 10.

consumers. In operational terms, interties provide flexibility that enable system operators to address power system needs and reliably manage the grid during changing system conditions. Ontario exports electricity to neighbouring jurisdictions when it is surplus to domestic needs and economic to recover the operational cost of generation. Exports provide Ontario with critical operational and economic benefits to help the IESO reliably operate the grid and reduce system costs for domestic consumers.²²

22. The annual economic benefits provided by exports are significant. The IESO estimates that exports of energy from Ontario contributed between \$330 and \$520 million annually to Ontario between 2017 and 2021 in the form of congestion rent payments, ETS revenue, payment of uplifts and avoided system costs.²³ Revenue from the ETS has historically been the smallest component of the economic benefits associated with exports.²⁴

23. The current flow of exports from Ontario should not be taken for granted. Exports are driven by expected price differences between jurisdictions net of transaction costs.²⁵ The ETS is a fixed transaction cost and, as transaction costs increase, the expected net price difference between jurisdictions will decrease and export volumes will be reduced.²⁶ Unlike the dynamic ICP mechanism, the fixed ETS rate is unable to adjust to hourly changing market conditions and may render an otherwise profitable trade uneconomic.²⁷ The magnitude of economic exports reduced by an increased ETS rate will ultimately be dependent upon the level of the ETS and the price spread between Ontario and neighbouring jurisdictions.²⁸ As detailed in the Market Implications Report, export flows are particularly sensitive to an increase in the ETS under tight price spread scenarios where the margins on a trade are thin.²⁹

24. During the Presentation Day, Mr. Tom Chapman, Senior Manager, Wholesale Market Development at the IESO, discussed the potential impact of a higher ETS rate on export volumes in tight price spread scenarios, which are common on the New York intertie over which the IESO transacts approximately 6 TWh of energy each year:

²² Market Implications Report at p. 16 of 17.

²³ Market Implications Report at pp. 9 and 10 of 17; Table 10 in Attachment 1 to Exhibit I-1-1.

²⁴ Market Implications Report at pp. 9 and 10 of 17.

²⁵ Market Implications Report at pp. 6 and 7 of 17.

²⁶ Presentation Day Transcript at p. 85. See also Exhibit I-1-6.

²⁷ Market Implications Report at p. 13 of 17.

²⁸ Market Implications Report at p. 13 of 17.

²⁹ Market Implications Report at p. 13 and 14 of 17.

The price difference between Ontario and New York may be three dollars or five dollars [per MWh] on average, and if a trader has to pay three dollars in IESO uplifts and then pay \$1.85 in the ETS, that doesn't leave much of a profit margin, right? If the price difference is \$5 it is still just about economically 15 cents. But if the ETS was, for example, two dollars or \$2.25, there will be no reason to transact.

[I]t is on those interties under those conditions where we see the most difference between the ICP and the ETS. The ICP would naturally contract to facilitate -- to make sure it wasn't interfering with an efficient transaction.

[T]he ICP on the New York [tie] might drop right down to zero and allow the trade to flow. We get the operational benefits. We wouldn't collect much in the way of ICP. Whereas the ETS as a fixed charge would potentially interfere with what would otherwise be an efficient trade.³⁰

25. Any change to the ETS rate that reduces otherwise economic exports could present operability challenges for the Ontario grid and result in higher costs for Ontario consumers. When an export does not flow, the IESO does not collect congestion rent, ETS revenue or uplift charges to defray domestic consumer system costs. Further, reduced export volumes increase the probability that the IESO will have to take control actions to manage the grid, which are undesirable from both an operational and market participant perspective and will result in higher system costs that would need to be recovered from domestic consumers (referred to in the Market Implications report as "Avoided System Costs").³¹

26. During the Presentation Day, Mr. Chapman described the type of operability challenges that could arise from reduced export volumes and would necessitate control actions by the IESO:

[I]f we didn't have the exports and the exports respond very dynamically to changes in market conditions, the IESO would have to take what we would call control actions as part of our operational planning time frame to, for example, increase spill at hydro-electric units. And if we ask the large hydro generators to increase their spill, again it is not something they can turn on and turn off.

... [I]f we run into unexpected events in the real time, our supply

³⁰ Presentation Day Transcript at pp. 96-97.

³¹ Presentation Day Transcript at pp. 100 and 109. See Day One Technical Conference Transcript at pp. 94 and 95 for a discussion of how the IESO calculated the avoided system costs.

stack is skinnier than it would have been, which means there is less resources to call upon before we have to take out of market control actions such as, you know, reducing voltage, curtailing exports, other undesirable out of market conditions that are both costly and operationally problematic.

...[W]e would advise against any decisions that could potentially put us in those types of situations in the future.³²

27. Although the IESO's primary concern is operability, a higher ETS rate will reduce export volumes, which will also result in increased system costs that are ultimately paid by consumers.³³ In the Market Implications Report, the IESO concluded that, in the absence of exports, an additional \$150-240 million per year of Avoided System Costs would have been incurred to pay for foregone energy from curtailing wind, spilling water at hydroelectric stations and maneuvering of nuclear units. The Avoided System Costs would have been recovered from domestic consumers through increased Global Adjustment charges.³⁴

28. From a purely operational perspective, the IESO would prefer an ETS rate of zero that would allow the export price to be set entirely by the ICP – a dynamic mechanism that varies by intertie and adjusts every hour to changing system conditions – and reduce the risk of having to take control measures.³⁵ However, the IESO recognizes there are other relevant considerations in setting the ETS rate and acknowledges that it has effectively managed the grid with an ETS rate within the historical range.³⁶ For this reason, while the IESO would prefer an ETS rate that is lower than the current rate of \$1.85/MWh, the risks are manageable at the current rate and the IESO is not “strongly advocating” for an ETS rate of zero in this proceeding.³⁷

29. Any increase in the current ETS rate above \$1.85/MWh would be a concern for the IESO.³⁸ Based on the IESO's operational experience, even a relatively small increase in the ETS rate could have a material impact on heavily traded interties such as New York where price margins are already small.³⁹ The relationship between a higher ETS and the increased operational risk is not linear in nature; as Mr. Chapman stated during the Presentation Day in

³² Presentation Day Transcript at pp. 89 to 91.

³³ Presentation Day Transcript at pp. 91 to 92. The IESO estimates that the cost of each three-day shutdown of a nuclear unit is at least \$4 to \$6 million: see Exhibit JP-1.04.

³⁴ Market Implications Report at p. 10 of 17; Exhibit I-8-3.

³⁵ Presentation Day Transcript at pp. 101 to 102.

³⁶ Presentation Day Transcript at p. 105.

³⁷ Presentation Day Transcript at pp. 91 to 92.

³⁸ IESO Presentation, slide 10.

³⁹ Market Implications Report at p. 16 of 17; Presentation Day Transcript at p. 92.

response to a question from Commissioner Anderson, the risk associated with a higher ETS rate is “a question of probabilities”:

[I]t is not really a linear relationship. It is not like if you increased [the ETS rate] by 20 percent there will be a 20 percent chance you might have to take a control action.

There are certain times when it comes like a step function, right? You hit a point where you now have to take a nuclear unit offline because of system conditions at the time, and it could be that that price point is \$1.87.

If we were in a period of significant excess during a -- shoulder seasons, for example, where we were flush with power and we need to export it, and Ontario demand is at 10,000 megawatts overnight because no one is using heating or cooling ... we have all the nuclear units operating, and market prices are low, it could be that the \$1.87 is the point where we actually have to take the control action.

Other times ... it might be a much higher number, but it really increases the probability that we will need to take one of these types of ... actions.⁴⁰

30. Evaluating the risk associated with an increase of the ETS rate is particularly difficult at the present time as the Ontario market is facing a time of transformative change and attendant uncertainty in the years ahead due to, amongst other things, the emerging capacity need in 2025 (documented in the IESO’s Annual Planning Outlook (the “**APO**”)), the roll out of MRP by the IESO, and volatile commodity prices. As noted above, exports have become increasingly important in recent years to ensure the reliable operation of the Ontario grid and any increase to the ETS would introduce additional uncertainty at a time when market participants are managing these changes. From the IESO’s perspective, there is a need for stability in the market where possible and a strong desire to avoid unnecessary additional changes to the market during this period.

31. In contrast to these operational and economic risks, the evidence in this proceeding has not demonstrated that consumers will derive significant benefits from a higher ETS rate. The IESO expects that any additional revenue gained from an increase in the ETS rate would be largely offset by a reduction in congestion rents due to the strong inverse relationship between

⁴⁰ Presentation Day Transcript pp. 96.

the ETS rate and the ICP.⁴¹ Both the ETS and ICP are components of the total charges on exporters and, while it is not a dollar-for-dollar relationship, any increase in revenue resulting from a higher ETS should result in a roughly equivalent reduction in revenue from the ICP as discussed in the Market Implications Report.⁴² Therefore, assuming the quantity of exports remains constant, any increase in the ETS rate is likely to result in a corresponding decrease in ICP and the total amount collected from exporters and disbursed to consumers would remain largely unchanged.⁴³ In addition, any reduction in export volumes due to a higher ETS rate will impact the amount of EST revenue, ICP revenue and uplift charges collected and increase system costs for consumers as noted above.⁴⁴

32. Considering the operational and economic risks associated with a higher ETS rate, along with lack of any corresponding benefit to Ontario consumers, it is the IESO's position that the ETS rate should be set at zero or no higher than its current level of \$1.85/MWh.

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

33. The IESO does not believe that the use of a solely cost-based approach to set the ETS rate would be an optimal solution⁴⁵ for four reasons.

34. First, as discussed above, the ETS was established as a compromise between two competing objectives – the recovery of a portion of the total transmission system costs from exporters while minimizing impediments to trade with other jurisdictions – and a solely cost-based approach would not provide any consideration to the role that the ETS rate has on export volumes. While a properly conducted cost allocation study may be a relevant consideration, it should not be the sole determinant of the ETS rate to the exclusion of the other considerations identified in the IESO's Market Implications Report. Electricity trading over the interties is a competitive marketplace driven by profit-seeking traders transacting based on the expected electricity price differences between jurisdictions. These factors make intertie capacity a scarce

⁴¹ Market Implications Report at p. 13 of 17.

⁴² Exhibit I-1-36.

⁴³ Market Implications Report at p. 13 of 17.

⁴⁴ As explained during the Presentation Day, the IESO views the work of Power Advisory in quantifying the costs and benefits of different ETS rates (and which has not been challenged with opposing expert evidence in this proceeding) as being based on "conservative assumptions which were flowing through to the potential cost and benefits [identified in the report]." See Presentation Day Transcript at pp. 103 and 104.

⁴⁵ Exhibit I-9-3.

resource resulting in traders competing for access to these resources.⁴⁶ For this reason, electricity intertie trading is unlike traditional cost-based utility rate-making and needs to be treated accordingly.

35. Second, any cost-based analysis must address the lack of clear cost causality related to exports. HONI's evidence in this proceeding is that it does not take exports into account when designing the transmission system.⁴⁷ Likewise, the IESO plans the system, in accordance with established planning standards, to ensure export capability (if needed) is sufficient to maintain system reliability and operability.⁴⁸ However, the needs and activities of competitive exporters (e.g., volume and profit opportunities) as a result of normal market conditions are not considered when planning the transmission system.⁴⁹ Consequently, while exporters utilize transmission infrastructure they are not a primary driver of investment in the system.⁵⁰

36. Third, as stated in the Market Implications Report, the IESO does not support the use of the OEB's pole attachment approach to set the ETS rate.⁵¹ While both exporters and pole attachers are seeking to use installed infrastructure – transmission lines for exports and telecom wires for pole attachers – there are important differences in usage that require alternative approaches to revenue collection. In the case of exporters, their marginal costs and willingness-to-pay varies hour-to-hour with market conditions; in contrast, pole attachers make infrastructure usage decisions based on multi-year, fixed investments. In this context, the dynamic approach of the ICP, which adjusts to reflect the changing marginal costs and willingness-to-pay of exports is more appropriate means to optimize value from exports than the fixed rate approach used for pole attachments.⁵²

37. Fourth, revenue from the ETS is only one component of the value that Ontario receives from exports and historically has been the smallest component of the economic benefits associated with exports.⁵³ Any consideration of cost allocation must be viewed holistically in conjunction with the other benefits that exports provide to Ontario, including any congestion

⁴⁶ Market Implications Report at pp. 6 and 7 of 17.

⁴⁷ 2021 Elenchus Report at pp. 8, 18, 31 and 36 of 44.

⁴⁸ Market Implications Report at p. 7 of 17.

⁴⁹ Market Implications Report at p. 7 of 17. In addition, the IESO recovers out-of-market costs from exporters through the use of volumetric uplift charges.

⁵⁰ Market Implications Report at p. 7 of 17. While exporters have the same access to the transmission system as other market participants they have lower priority than domestic load and this is reflected in the planning standards. See also Day One Technical Conference Transcript at pp. 179 and 180.

⁵¹ Market Implications Report at pp. 15 and 16 of 17.

⁵² Market Implications Report at pp. 15 and 16 of 17.

⁵³ Market Implications Report at pp. 9 and 10 of 17.

revenue that results from the ICP. A cost-based approach that fails to take account of these considerations could, for the reasons detailed above, actually result in increased costs for Ontario consumers in the form of reduced congestion rent, uplifts and higher system costs.

2.2 Should a settlement-based approach be permitted?

38. The IESO would not preclude the continued use of a settlement-based approach to set the ETS rate.

39. The history of the ETS and the evidence in this proceeding demonstrates that setting the ETS rate requires balancing different objectives. This balancing could be facilitated through settlement discussions (or, as occurred in this proceed, an untranscribed session). The IESO does not believe there is a mechanistic formula which can be utilized to set the ETS rate, particularly in the light of the dynamic nature of the electricity market and the anticipated changes to the Ontario grid that are coming in the near future.

2.3 What other methods for setting the ETS rate should be considered?

40. There has been some suggestion in this proceeding that the ETS rate could be set on a variable basis (i.e. a rate that varies by intertie and/or by the time of the export) or gradually increased over time.⁵⁴ At this time, no particular proposals have been made in this regard and no evidence has been tendered as to the efficacy or impact of such approaches.

41. Depending upon the design of the mechanism, the IESO could support a variable ETS rate in concept⁵⁵ but notes there is no evidentiary basis in this proceeding, either quantitative or qualitative in nature, upon which a variable ETS rate could be based. Further study of the issue is necessary and would need to include careful consideration of the complexity of designing, implementing and administering a variable ETS rate.⁵⁶ The ICP already generates revenue for the benefit of Ontario consumers by way of a dynamic pricing mechanism that automatically adjusts to changing market conditions every hour.⁵⁷ The IESO does not believe the dynamism of the ICP could be easily replicated in a regulated charge. The IESO also questions whether the attendant costs and complexity of a variable ETS would represent an improvement over the current structure of a fixed ETS with a dynamic ICP.

⁵⁴ Presentation Day Transcript at pp. 112 and 113.

⁵⁵ Presentation Day Transcript at pp. 117 and 118.

⁵⁶ Presentation Day Transcript at p. 118.

⁵⁷ Market Implications Report at p. 10 of 17.

42. The IESO would not support any approach that would see a gradual escalation of the ETS rate over time. As described above, the IESO is concerned that even a small increase in the ETS rate could have a material impact on export volumes and lead to operability challenges and higher costs for Ontario consumers. These conditions will persist as the challenges with the current supply mix will not be changing in the foreseeable future.⁵⁸ Further as noted above, there is value in stability as the Ontario market is facing a time of transformative change and the attendant uncertainty in the coming years. The concern that the IESO has articulated in this proceeding would not in any way be alleviated by a gradual escalation of the ETS rate.

2.4 How often should the ETS rate be set?

43. The IESO supports the setting of the ETS rate to coincide with the duration of HONI's current rate-setting period of 2023-2027 in its Custom Rate Application proceeding for two reasons.

44. First, an ETS rate that runs from 2023-2027 will provide Hydro One with a degree of revenue certainty for the purposes of its Custom Rate Application in which other changes will be set based, in part, on the level of anticipated revenue from the ETS.

45. Second, as set out in the APO, the Ontario system faces a number of near-term challenges, including a projected capacity need emerging in 2025, and decisions will need to be made by the sector on how to address these challenges.⁵⁹ As Mr. Chapman stated at the Technical Conference, these decisions will be "a big factor in influencing actual market outcomes, such as the volume of exports or imports, market prices, the level of ICP."⁶⁰ In addition, the implementation of MRP will result in changes to the Ontario market, including the introduction of locational marginal pricing to Ontario.⁶¹ There is value in stability as the Ontario market is facing a time of transformative change and the attendant uncertainty in the coming years.

46. Considering these factors, it would be appropriate to not reset the ETS rate until the end of 2027, at which time there should be greater certainty on how the sector is addressing the projected capacity need and MRP will have been implemented.

⁵⁸ Mr. Chapman defined the foreseeable future as "five to ten years": Presentation Day Transcript at p. 115.

⁵⁹ For further information, see IESO's Annual Planning Outlook, December 2021. Links to details about the IESO's current procurement mechanisms and activities can be found in Exhibit JT-1.12.

⁶⁰ Technical Conference Transcript at p. 104. See also Technical Conference Transcript at pp. 142 and 143.

⁶¹ Exhibit JP-1.03.

3. Are there other key issues the OEB should consider related to the ETS rate?

47. The IESO anticipates that other parties may request that the IESO undertake further studies with respect to the ETS or release additional market data so that other parties could undertake such analysis.

48. The IESO cautions the OEB against mandating further studies or ongoing monitoring by the IESO in pursuit of the “perfect” ETS rate. In the IESO’s view, the relevant considerations in setting the ETS rate have been well defined, albeit in a largely qualitative manner, in this proceeding. The IESO is skeptical that the results of any further study will provide greater clarity to parties than what is available at this time. Any further study of the ETS rate will, by necessity, be premised upon assumptions and forecasts that would likely be the subject of the same types of disputes that have arisen in this proceeding.⁶² As Mr. Chapman stated during the Technical Conference, the IESO does not engage in economic forecasting and “actual market conditions will result from a multitude of factors”.⁶³

49. Further, the IESO anticipates it would be required to retain a consultant to conduct any further study and that such work could be quite costly (as well as time consuming to manage for IESO staff). In the event the IESO is required to undertake a further study, it may need to seek an adjustment to its usage fees to ensure the necessary funds are available for the work.

50. With respect to the release of additional market data, the IESO agreed as part of the settlement in its fees case to “engage an independent third-party to conduct a jurisdictional review of the types of market and planning information and data that are made available in other comparable jurisdictions and how such information and data is made available.”⁶⁴ The results of the jurisdictional review will be made public by the end of Q2 2023.

⁶² In this proceeding, several interrogatories were directed to the IESO in which the intervenor requested the IESO undertake an analysis of a specific scenario. The IESO generally declined to respond to these requests given the level of work that would have been required and the limited value of the response. The IESO’s anticipates that any further study undertaken on the impact of the ETS rate would be subject to similar inquiries.

⁶³ Technical Conference Transcript at p. 154 to 155.

⁶⁴ Decision and Order, EB-2022-0002, Independent Electricity System Operator - Application for Approval of 2022 Expenditures, Revenue Requirement and Fees.

E ORDER REQUESTED

51. For the reasons set out above, the IESO requests that the OEB set the ETS rate at zero or no higher than its current level of \$1.85/MWh for the duration of the 2023-2027 rate period.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 6th day of September 2022.



Patrick Duffy
Stikeman Elliott LLP