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 an application by the Ontario Energy Board for Uniform Transmission Rates, Related Issues, and the Export Transmission Service Rate.

REPLY SUBMISSIONS OF THE INDEPENDENT ELECTRICITY SYSTEM OPERATOR

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A. INTRODUCTION

1. These are the written reply 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 intervened in this matter in its capacity as Ontario's electricity system operator because electricity exports, which are directly impacted by the ETS rate, play a vital role in ensuring efficient and reliable grid operations. The IESO's objective is to ensure that due consideration is given to maximizing the operational, reliability and economic benefits provided by exports when setting the ETS rate. In reviewing the written submissions, the IESO notes that parties have generally accepted its evidence on the importance of maintaining export volumes and considered the IESO's concerns in formulating their final positions on the appropriate ETS rate.

3. The IESO's position remains that the ETS should be maintained along with the Intertie Congestion Price ("**ICP**") and set at a rate between zero and $1.85/MWh. The IESO's reply points are as follows:

- *The Precautionary Principle Should be Applied in Setting the ETS Rate:* The IESO agrees with OEB Staff that the OEB should apply the precautionary principle considering the operability and economic risks associated with a higher ETS rate. In the IESO's view, the evidence in this proceeding has not demonstrated that consumers will derive significant benefits from an ETS rate set higher than the *status quo* of $1.85/MWh that would be commensurate with the countervailing risks.

- *The IESO has Proven the Operability and Economic Risks of a Higher ETS Rate:* The IESO disagrees with OEB Staff that it has not "proven" that a higher ETS rate will reduce exports and result in a greater need to curtail or shut down Ontario generation. While the IESO's concerns have, by necessity, been expressed in a largely qualitative manner throughout this proceeding, no party has seriously challenged this evidence and it has been broadly accepted by the intervenors.

- *The IESO Continues to Directionally Agree with the Power Advisory Analysis:* The IESO has reviewed the confidential arguments filed by the Schools Energy Coalition ("**SEC**") and the Vulnerable Energy Consumers Coalition ("**VECC**") related to the Power Advisory

analysis commissioned by the Association of Power Producers of Ontario ("**APPrO**"). After reviewing these arguments, the IESO maintains its position that it directionally agrees with the conclusions of the analysis and views Power Advisory's assessment of the costs of a higher ETS rate as conservative.

- *A Low ETS Rate Could Assist in Reducing Regional Greenhouse Gas Emissions*: The IESO agrees with the submissions of Anwaatin and Pollution Probe that a low ETS rate could assist in reducing regional greenhouse gas emissions ("**GHG**") by facilitating the export of low carbon electricity from Ontario to neighbouring U.S. jurisdictions and, by extension, a higher ETS could increase regional GHG emissions.

- *Surplus ICP Revenue is Utilized to Offset Transmission Services Charges*: SEC, VECC and APPrO made arguments as to the purpose of the ICP mechanism. The IESO reiterates that, under the Market Rules, ICP revenue is utilized to offset transmission services charges through the disbursement of surplus funds in the Transmission Rights Clearing Account ("**TRCA**"). The IESO does not agree with SEC and VECC's characterization of exporters, who must compete in a marketplace that maximizes the amount that they are willing to pay for any given transaction, as "free riders".

- *A Phased-In Increase in the ETS Rate Does Not Address the IESO's Concerns*: The phased-in increases in the ETS rate proposed by OEB Staff and the London Property Management Association ("**LPMA**") are not consistent with the precautionary principle and do not address the IESO's concerns about the operability and economic risks associated with a higher ETS rate. The IESO does not support these proposals.

- *The Effective Date of Any Increase in the ETS Rate Should be January 1, 2024:* If the OEB determines that an increase in the ETS rate is appropriate, the implementation of any change in the ETS rate should occur no earlier than January 1, 2024 assuming that the OEB issues a decision in this matter prior to the end of 2022. This will allow the ownership period of all existing transmission rights ("**TR**") (current as of the date of the decision) to expire before the new ETS rate takes effect.

- *The ETS Rate Should Not be Adjusted Annually:* The IESO does not support an annual adjustment in the ETS rate. Intertie trading is driven by price spreads between

jurisdictions and is not directly impacted by inflationary pressures. Introducing an annual adjustment that increases the ETS rate would make exports from Ontario more expensive, thereby reducing the price spread and rendering otherwise profitable trades uneconomic.

- *Proposals for Further Studies or Monitoring by the IESO:* Several parties have recommended that the IESO undertake or participate in further studies or monitoring of 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. As the IESO has expressed throughout this proceeding, it is skeptical the results of any further study will provide greater clarity to parties than what is available at this time.

- *The IESO Would Participate in an ETS Working Group:* SEC has proposed that an ETS Working Group be established. If this proposal is accepted by the OEB, the IESO would be willing to assist an ETS Working Group.

B. REPLY SUBMISSIONS

1. The Precautionary Principle Should be Applied in Setting the ETS Rate

4. OEB staff submit that the "precautionary principle" ought to guide the OEB when implementing changes to the ETS rate given the uncertainties and risks at hand. In words of OEB Staff, the precautionary principle here refers to the notion of "better be safe than sorry" amidst a lack of categorical proof of some potential future harm.[1]

5. The IESO agrees with staff that the OEB should employ the precautionary principle and adopt a cautious approach to setting the ETS rate considering the operability and economic risks associated with a higher ETS rate. However, the IESO disagrees with OEB staff's proposed application of the precautionary principle in this case, which would result in a substantial increase in the ETS rate phased-in between 2024 and 2029 with further increases to follow until 2035.

[1] OEB Staff Submissions at p. 18.

6. The *status quo* is an ETS rate of $1.85/MWh and historically, the ETS rate has ranged between $1.00/MWh and $2.00/MWh. The fixed ETS rate and variable ICP have worked well over the last twenty years to facilitate economically efficient exports and generate revenue for the benefit of transmission customers.[2] While the IESO has been able to manage the system with an ETS rate within the historical range,[3] it expects that exports will become increasingly important to ensure the reliable operation of the Ontario grid[4] and is concerned that any increase in the ETS rate will put current export volumes at risk.

7. Therefore, it is the IESO's view that, consistent with the precautionary principle, any party requesting that the OEB impose an ETS rate greater than the current rate of $1.85/MWh bears the onus of clearly demonstrating that the specified ETS rate will deliver benefits to consumers that are commensurate with the countervailing risks.

8. As the IESO stated in its written submissions, the evidence in this proceeding has not demonstrated that consumers will derive significant benefits from a higher ETS rate. A higher ETS rate will be offset by decreased ICP and increased system costs to consumers. Consistent with the precautionary principle, in the absence of compelling evidence that an increase in the ETS rate will benefit Ontario consumers, the OEB should refrain from making any change that would risk lowering export volumes and set the ETS rate at level between zero and $1.85/MWh.

2. The IESO has Proven the Operability and Economic Risks of a Higher ETS Rate

9. In their submission OEB Staff suggest that the IESO has not "substantiated that a higher ETS rate will reduce exports" nor "proven" that that an increase to the ETS rate will result in a greater need to curtail or shut down Ontario generation for reliability management purposes.[5]

10. The IESO disagrees with these suggestions from OEB Staff. While the IESO acknowledges there is uncertainty over the magnitude of any impact, there can be no reasonable disagreement that a higher ETS rate will reduce exports assuming all other factors

[2] Exhibit I-1-38.
[3] Presentation Day Transcript at p. 105.
[4] Exhibit KP-1.4, slide 3. See also Presentation Day Transcript p. 88.
[5] OEB Staff Submissions at p. 18.

are held constant.[6] Export transactions are based on price spreads between jurisdictions – any additional costs, such as higher ETS rate, will render some otherwise profitable trades uneconomic.[7] Mr. DesLauriers of Charles Rivers Associates ("**CRA**") echoed this point when he stated during the Presentation Day that the ETS rate "does have a very [real] effect on the economic viability of any particular transaction."[8]

11. OEB Staff justify their position by reference to the off-setting relationship of the ICP and ETS. OEB Staff overlook that the impact of a higher ETS rate will go beyond an offsetting decrease to ICP where there is a tight price spread between markets as described in the Market Implications Report:

> **Tight price spread between markets:** occurs when there is less price difference to buy electricity in Ontario and sell electricity in neighbouring jurisdictions. In this scenario the tighter price spread means there will be less demand to export, and therefore the ICP will be less to start with. As a result, there will be less or no ICP to offset an increase to the ETS. This means exports will become uneconomic on basis of a smaller increase in ETS compared to the wide price spread scenario. As an example, if the price spread was $5, ETS was $2, Uplift was $1 and the ICP was $1, then a $2 increase in ETS to $4 would stop the trade as even if ICP went to $0, there would still be no profit incentive for the exporter to transact. When exports do not flow, no ICP, ETS or Uplift revenues are collected to defray domestic consumer system costs. In this respect it can be understood that export flows are more sensitive to increases in ETS under a tight price spread than under a wide price spread. It also means more exports will be prevented under the tight price scenario, and so have a greater negative economic and operational impact.[9] [Emphasis added.]

12. As Mr. Chapman stated in this proceeding, the ICP would "naturally contract to … make sure it wasn't interfering with an efficient transaction" while "a fixed [ETS] charge would

[6] On this point, the Schools Energy Coalition ("**SEC**") made the following statement at para. 44 of its submissions with which the IESO agrees: "At a high-level, SEC does not dispute the contention that all else being equal, an increase in the ETS rate will reduce overall export volumes. The ETS rate is a cost to exporters, and so as with all but the most inelastic of costs, the higher it is, the less demand there will be. Reduced exports will have financial impacts besides reduced ETS revenue."
[7] Market Implications Report at p. 13 and 14 of 17.
[8] Presentation Day Transcript at p. 74.
[9] Market Implications Report at p. 12 and 13 of 17.

potentially interfere with what would otherwise be an efficient trade."[10] A fixed charge "would never be in tune precisely with market conditions" which means that "it would always be underutilizing the asset relative to [relying solely upon] the ICP."[11]

13. VECC argues, using data provided by the IESO, that a small increase in the ETS rate may not necessarily have a material impact on export volumes.[12] The IESO does not agree with VECC's analysis. The impact of the ETS rate on export volumes needs to be looked at on a tie-by-tie basis. On interties where there is frequently a large price spread between jurisdictions, an increase in the ETS rate would be expected to have the lowest impact on exports (such as Michigan).[13] However, on interties where congestion is less frequent (such as the large interties with New York and Quebec), the price spread between jurisdictions is likely to be small and traders will be highly sensitive to price increases. Consequently, even a slight increase in the ETS rate could substantially reduce export flows on these interties. The IESO notes that the combined affect across all interties may well be consistent with the approximately 50% reduction in total export volumes as described in the 2012 CRA analysis.[14]

14. The IESO has also provided evidence throughout this proceeding to support its concerns about the operational risks that will accompany a higher ETS rate. While there is inherent uncertainty about the extent of that risk, no party has seriously challenged the IESO's evidence on the operability risks of a higher ETS rate at any stage of this proceeding. Notably, in their written submissions, the intervenors have generally accepted the IESO's concerns about the operability risks associated with a higher ETS rate.[15] This is reflected in the positions of the intervenors on the appropriate ETS rate, which support the IESO's recommendation to lower or keep the ETS rate at $1.85/MWh[16] or seek to balance the findings of the Elenchus cost

[10] Presentation Day Transcript at pp. 96 to 97.
[11] Technical Conference Day One Transcript at p. 125.
[12] VECC Submissions at pp. 31 to 32.
[13] VECC states that a close to doubling of the ETS rate would "only impact less than 30% of the export volumes" on the Michigan tie. The IESO would view a 30% reduction of imports on the Michigan tie as a significant decrease in export volumes.
[14] Market Implications Report at p. 14 of 17. VECC's analysis of the New York tie shows a nearly 70% reduction in export volumes on that intertie under a scenario where the current ETS rate is nearly doubled.
[15] Association of Major Power Consumers in Ontario ("**AMPCO**") Submissions at p. 6; APPrO Submissions at para. 27; Canadian Manufacturers & Exporters ("**CME**") at para. 32; Pollution Probe Submissions at p. 8; SEC Submissions at para. 38; VECC Submissions at pp. 31.
[16] The intervenors that aligned with the IESO's position that the ETS rate should be at or less than the current rate of $1.85/MWh are AMPCO, APPrO, CME and Pollution Probe. In addition, Energy Probe proposed a moderate increase

allocation with the IESO's concerns.[17] As such, the IESO fails to understand on what basis OEB Staff can assert that the IESO's concerns have not been "proven" in this proceeding.

15. The IESO acknowledges that its concerns about reduced export volumes and operational impacts have, by necessity, been expressed in a largely qualitative manner throughout this proceeding. The type of quantitative precision that OEB Staff and others appear to be seeking is not feasible because, as Mr. Chapman testified, the price point at which these impacts occur is "very hard to pinpoint" and "will vary according to the time of year, supply and demand conditions"[18] as well as by intertie. Moreover, any analysis based on past conditions is specific to the market conditions at that time and is not necessarily indicative of future impacts, particularly given the transformative changes the Ontario system will be experiencing in the coming years. Despite these uncertainties, the risk of a decline in export volumes from a higher ETS rate presents "real costs, real challenges" that need to be factored into any decision-making on the ETS rate.[19]

16. The IESO reiterates that, from a purely operational perspective, its preference is 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 – so that trade volumes can be maximized for the benefit of the Ontario system. Nonetheless, as it has stated throughout this proceeding, the IESO understands that there may be other considerations the OEB determines are relevant in setting the ETS rate and therefore it remains acceptable to the IESO that the ETS rate be set between zero and $1.85/MWh.

3. The IESO Continues to Directionally Agree with the Power Advisory Analysis

17. In his evidence, Mr. Chapman indicated that the IESO "directionally" agreed with Power Advisory's analysis[20] but viewed the conclusions on the impact of a higher ETS rate as

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of the ETS rate to $2.00/MWh. Anwaatin did not identify a specific ETS rate but argued in favour of maximizing exports which implies a low ETS rate.

[17] The intervenors that proposed an ETS rate set at a midpoint ($3.00 to $3.66/MWh) between the current rate and Elenchus fully allocated cost-based methodology (80% scenario) are the Consumers Council of Canada ("**CCC**"), SEC and VECC. Naren Pattani also recommended an ETS rate of $3.66/MWh based on Elenchus' 50% scenario.

[18] Technical Conference Day One Transcript at p. 117.

[19] Technical Conference Day One Transcript at p. 118.

[20] Technical Conference Day One Transcript at p. 115.

conservative.[21] In their written submissions, SEC and VECC have expressed several concerns about the methodology adopted and resulting analysis undertaken by Power Advisory.[22] The details of these concerns are set out in the confidential submissions filed by each of SEC and VECC. SEC and VECC argument that the costs to Ontario consumers of a higher ETS are not as great as shown in Power Advisory's analysis.

18. The IESO has reviewed the Power Advisory model and the confidential arguments of SEC and VECC. The IESO maintains its position that, although it directionally agrees with Power Advisory's analysis, the modeled impacts of changes in intertie flows for a $4.56 increase in ETS rate are conservative. The IESO's view is based on the nature of the period assessed, a comparison of elasticities between the Power Advisory model and past analysis of the OEB's Market Surveillance Panel (the "**MSP**"), expected future market conditions and the exclusion of uplifts and fees from the analysis.

19. As a general comment, the IESO notes that the Power Advisory analysis would benefit from consideration of price spreads in addition to HOEP to accurately understand the impact on export volumes; as traders are primarily interested in price differentials and not absolute values of HOEP. By focusing on HOEP the analysis will tend to underestimate the impact on exports when HOEP is low relative to neighbouring prices and overestimate the impact when HOEP is high relative to neighbouring prices. The IESO notes that it found instances where grounding the analysis in absolute values the model led to counterintuitive results – such as increases in ETS rate leading to increases in exports volumes.

20. In its confidential submission, VECC proposes an alternative analysis using an "average approach".[23] VECC's average approach mutes the potential signal that can be drawn from the data for a change in exports from a change in the ETS rate. The effect of averaging across large amounts removes key information about the underlying distribution of data and makes it difficult to clearly distinguish changes in HOEP and corresponding changes in exports on a line-by-line basis.

[21] Presentation Day Transcript at pp. 103 to 104.
[22] SEC Submissions at paras 41 to 49; VECC Submissions at pp. 39 to 44.
[23] VECC Submission, Confidential Attachment at p. 5.

21. The IESO notes that not all market impacts were considered in the Power Advisory analysis. When the impact on uplift and other revenues are considered, the net impact on Ontario ratepayers is considerably higher, estimated to be over $40 million in additional losses. [24]

22. Furthermore, the Power Advisory analysis covers a time period when Ontario had considerable surplus power which is quite different from expected future market conditions detailed in the IESO's Annual Planning Outlook. Under tighter market conditions the IESO would expect the impact of a higher ETS on export volumes to be more sensitive and consistent with previously derived MSP estimates. [25]

23. For these reasons, the IESO continues to be of the view that Power Advisory's analysis represents a conservative estimate of the impact of prices changes on future export volumes and the associated cost to Ontario ratepayers.

4. A Low ETS Rate Could Assist in Reducing Regional Greenhouse Gas Emissions

24. Anwaatin and Pollution Probe submit that the ETS rate should be set to ensure that clean, low carbon Ontario electricity is exported to neighbouring U.S. jurisdictions at the lowest

[24] When there is a loss in exports, there is also a loss in the collection of a variety of uplifts and fees that exporters pay to recover separate system costs. The Power Advisory model does not account for other fees and uplifts in any of the calculations to date. For fees of approximately $2.42/MWh consisting of a combination of uplift and IESO fees, a loss of 17,004,726 MWh results in additional losses of $41,151,437 over and above those already stated, and these additional losses should also be attributed to the higher ETS fee.

[25] Monitoring Report on the IESO-Administered Electricity Markets for the period from November 2008 – April 2009. Online: https://www.oeb.ca/oeb/_Documents/MSP/msp_report_200907.pdf. In the Power Advisory model, a 1% change in the Hourly Ontario Energy Price ("**HOEP**") results in a slightly less than 1% change in exports. In 2009, the MSP developed a model that included price spreads and tested whether the average hourly volume of exports from. Ontario to New York and Michigan were decreasing functions of the HOEP and increasing functions of the neighbouring jurisdictions' prices, and to what degree. Looking at intertie data from January 2003 to April 2009 the MSP found that, for all hours for New York, a 1% increase of the HOEP led to a 4.55% decrease of export volumes. The MSP further found that in the case of Michigan, a 1% increase in the HOEP led to a 6.2% decrease in export volumes. The MSP model also looked at a longer time frame and controlled for factors such as month of the year, whether hours were on-peak or off-peak, and what the price was in neighboring jurisdictions to better clarify the long-term correlation between changes in HOEP and changes in exports. While the MSP assessment was done at a time when Ontario had a different supply mix the IESO expects that, consistent with the IESO's Annual Planning Outlooks, price spreads between jurisdictions will tighten and the elasticity of export demand should be expected to be significantly higher than that implied by the Power Advisory model and more in line with the MSP's estimates.

cost to the Ontario market.[26] They argue that exporting electricity generated using Ontario's low/no carbon emission fleet can result in lower GHG emissions.

25. The IESO agrees with the submissions of Anwaatin and Pollution Probe. Exports from Ontario into a neighboring jurisdiction displaces the energy produced by a domestic generator in that jurisdiction. The difference in the emissions rates between Ontario and its neighbors multiplied by the export represents the net carbon emissions reductions from the export. Ontario has one of the lowest GHG emitting electricity systems in the world. It produces substantially fewer carbon emissions per kilowatt-hour than our U.S. export markets. By exporting Ontario-generated electricity to be consumed in U.S. jurisdictions with significantly greater marginal GHG emissions rates, Ontario facilitates the reduction of global carbon emissions.

26. A lower ETS rate could assist in reducing regional greenhouse gas emissions by facilitating the export of low carbon electricity from Ontario to neighbouring U.S. jurisdictions and by extension, a higher ETS could increase regional GHG emissions. It is imperative, therefore, that in its decision the OEB be cognizant of the potential impact of the ETS rate on the reduction of GHG emissions.

5. Surplus ICP Revenue is Utilized to Offset Transmission Services Charges

27. SEC and VECC argue that the ICP should be viewed as a "cost of energy" or "as a function of [an exporter's] energy market bid".[27] On this basis, they argue an increase in the ETS rate is needed so that exporters bear a fair proportion of the costs for use of the transmission system. In contrast, APPrO argues that both the ETS and the ICP are payments for use of capacity on the transmission system and that, as a result, exporters are already required to pay twice for the same thing.[28]

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[26] Anwaatin Submission at paras. 12 to 15; Pollution Probe Submission at pp. 5 to 8.
[27] SEC Submissions at para. 14; VECC Submissions at pp. 23 to 25. ICP does not include the cost of energy as it represents the premium that exporters pay relative to the Ontario market price: Exhibit 1-2-5 and Exhibit KP-1.4, slide 9. In making this argument, SEC and VECC appear to be comparing the payment of ICP by an exporter with the payment of Global Adjustment by domestic load as, in the words of VECC (at p. 28), a "fundamental part of Ontario's hybrid electricity market." The IESO would not agree with this comparison. Global Adjustment covers the fixed costs of providing generation capacity in Ontario and as such is not charged to exporters. Further, surplus ICP revenue is paid to Ontario consumers through TRCA disbursements (as described below) and the proceeds of Global Adjustment payments go to generators. The IESO would not view the two as equivalents.
[28] APPrO Submissions at para. 45.

28. The IESO reiterates that, in its view, any consideration of cost allocation must be viewed holistically in conjunction with the other benefits that exports provide to Ontario, including any congestion revenue that results from the ICP. The purpose of the ICP mechanism was, and remains, to efficiently and fairly allocate access to interties and utilize any surplus generated by that mechanism to offset costs for Ontario consumers.[29] The Market Design Committee recommended that revenue from what became the TRCA be utilized "to offset revenue requirements for Basic Use Service" and that basic structure was implemented in the Market Rules.[30]

29. SEC argues that the purpose of the ICP mechanism has evolved;[31] however, the provisions that govern the handling of ICP revenues established at market opening remain part of the Market Rules today. Sections 4.18.1.5 and 4.18.2 of Chapter 8 of the Market Rules provide that surplus funds debited from the TRCA are to be utilized to "offset *transmission services charges*", which are defined in the Market Rules as "all charges administered by the IESO to recover the costs of *transmission services*". The Market Rules in turn define *transmission service* by reference to various transmission charges set by the OEB:

> *transmission service* means any one or more of *network service*, *export transmission service*, *line connection service*, *transformation connection service* and such other service as may be approved by the OEB and in respect of which charges are required to be collected by the IESO pursuant to section 6A.1.1 of Chapter 10*;*

30. As discussed in the Market Implications Report, the IESO implemented changes to the TRCA disbursement methodology in 2021 so that the allocation of disbursements better aligns with the proportion of transmission service charges paid by domestic consumers and exporters.[32] The IESO's decision to revise the allocation methodology was based on a recommendation from the MSP, which characterized thee TRCA disbursements as "a rebate on costs paid":

[29] Exhibit I-01-34; Exhibit JT-1.11.
[30] Exhibit JT-1.11.
[31] SEC Submissions at para. 16.
[32] Market Implications Report at p. 11 of 17.

> As stated in Chapter 8, Section 4.18.2 of the Market Rules, the purpose of disbursements from the TR Clearing Account is to offset transmission service charges; the disbursement is a rebate on costs paid. Accordingly, the Panel believes that a fair allocation would have each customer receive a rebate proportionate to its share of costs paid. For instance, a transmission customer that paid 1% of the total transmission service charges over the accrual period would receive 1% of the disbursements at the end of that period.

31. SEC and VECC attempt to distinguish ICP from the ETS on the basis that surplus revenue from the TRCA is disbursed to consumers through Account 1588 (Wholesale Market Service Charges) rather than being remitted directly to HONI.[33] While there are differences in the allocation of revenue collected from the ETS and ICP, the ultimate objective is the same – to transfer funds to transmissions customers to lower their costs.[34] The TRCA disbursement mechanism achieves this end by dispersing funds directly to transmission customers. The Brattle Group discussed this point when it reviewed the TRCA disbursement methodology:

> [S]ome jurisdictions would lower charges by providing surplus congestion funds directly to [Transmission Operators] in the region. This does not make sense in Ontario, in which Uniform Transmission Rates (UTRs) are set by the OEB and would not include a process for including TRCA surplus funds. By comparison, 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. The IESO cannot directly influence transmission rates through [Transmission Operators], but can achieve the same end through direct transfers of surplus TRCA funds to partly offset the [Provincial Transmission Service] charges paid by internal load and ETS charges paid by exporters.[35] [Emphasis added.]

32. SEC and VECC also rely upon the related principles of "no free riders" and fairness in support of their position.[36] The IESO does not believe it is accurate to characterize exporters as

[33] SEC Submissions at para. 16; VECC Submissions at p. 28.
[34] See Exhibit JT-1.3 for details on the disbursement methodology of the TRCA and its differences from the treatment of ETS revenue.
[35] Exhibit JT-1.6, Attachment 1 at p. 18.
[36] SEC Submissions at paras. 23 to 25; VECC Submissions at pp. 12 to 17; LPMA and Naren Pattani also cited these principles in their submissions.

"free riders"[37] – to the contrary, exporters must compete in a marketplace that maximizes the amount that they are willing to pay for any given transaction.[38] As Mr. Chapman noted during the Technical Conference, the margins on export transactions are generally small because the traders "compete those margins away for the benefit of ratepayers, because we collect that premium in the congestion rents."[39] Mr. Chapman added that it is "hard to think of another mechanism that could derive the same amount of benefits, since the existing one extracts everything that the traders are willing to pay on an hour by hour basis."[40]

33. In his submissions, Naren Pattani argues that, in the absence of the ETS, exporters would get a "free ride" in hours where an intertie is not congested and no ICP is paid for that hour.[41] The IESO disagrees with Mr. Pattani's hour-by-hour approach to the issue. Due to ICP's dynamic nature, exporters will pay high rates of ICP in some hours and no or low rates of ICP in other hours. Rather than focus on this variability, the overall contribution of exporters made through the ICP should be viewed over time. The evidence in the proceeding demonstrates that, on an annual basis, the ICP generates significant surplus revenues that ultimately flow offset the transmission service charges of Ontario consumers through TRCA disbursements.[42]

6. A Phased-In Increase in the ETS Rate Does Not Address the IESO's Concerns

34. LPMA[43] and OEB Staff[44] have advocated for substantial increases of the ETS rate that would be phased-in over time. The rationale of OEB Staff for a phased-in approach is that it will allow time "to mitigate rate impacts to the export class, to allow for continued assessment of electricity market and operability implications of an ETS rate increase, and to recognize uncertainties around market participant behavior change, market renewal implementation, and

[37] In Order No. 1000-A at para. 578, the Federal Energy Regulatory Commission defined free riders as "entities who are being subsidized by those who pay the costs of the benefits that free riders receive for nothing." Online: https://www.ferc.gov/sites/default/files/2020-04/OrderNo.1000-A.pdf
[38] Market Implications Report at pp. 5 and 6 of 17. Exporters are different than pole attachers in this respect as their marginal costs and willingness-to-pay varies hour-to-hour with market conditions.
[39] Technical Conference Day One Transcript at p. 171.
[40] Technical Conference Day One Transcript at p. 172.
[41] Naren Pattani Submissions at p. 8 to 9 and 12.
[42] Exhibit I-1-1, Table 5; Exhibit JP-1.05.
[43] LPMA proposes that the ETS rate be increased to $2.50/MWh for 2023 and then increased by $0.50/MWh in each subsequent year until it reaches $5.03/MWh in 2028: LPMA Submissions at p. 8.
[44] OEB Staff propose the ETS rate be set at $2.15/MWh starting in 2024 and increased annually by approximately $0.30/MWh until it reaches $3.66/MWh in 2029; if appropriate, after 2029 the ETS rate could continue to increase at the $0.30/MWh annual rate to reach the proposed rate of $5.42/MWh by 2035: OEB Staff Submissions at p. 22.

technology change." [45] OEB Staff view a phased-in approach as consistent with the precautionary principle.

35. The IESO does not support a phased-in increase of the ETS rate. These proposals – which consist of incremental and seemingly arbitrary annual increases to the ETS rate – do not address the IESO's concerns about the operational and economic impacts of an increased ETS rate. As Mr. Chapman stated during the Presentation Day, even a relatively small increase in the ETS rate could have a material impact on export volumes and the relationship between a higher ETS and the increased operational risk is not linear in nature.[46] This concern is in no way alleviated by a system of predetermined annual increases in the ETS rate.

36. The IESO does not find any of the three rationales presented by OEB Staff in favour of a phased-in approach to be persuasive:

- *To mitigate rate impacts to the export class*: The IESO does not view the concept of rate impact mitigation as having any application to the export market. Electricity trading over the interties is a competitive marketplace driven by profit-seeking traders transacting based on the expected electricity price differences between jurisdictions.[47] Exporters are not a captive consumer-base – if an increase to the ETS rate makes a trade uneconomic, then the exporter does not need to make the trade and export volumes will reduce – and do not require protection in the form of phased-in rate increase.

- *To allow for continued assessment of electricity market and operability implications of an ETS rate increase*: OEB Staff have proposed an export monitoring and analysis program that would be utilized to determine if the phased-in increases would continue after 2029. The IESO does not support this approach for two reasons. First, as stated above, the Ontario electricity market is complex and dynamic, and it is unlikely the results of the proposed monitoring program will provide greater clarity to parties than what is available at this time. The inherent complexity of this task would be magnified if the variable that is the focus of the study – the ETS rate – is not being held constant during the term of the

[45] OEB Staff Submissions at p. 19.
[46] Presentation Day Transcript pp. 96.
[47] Market Implications Report at pp. 6 and 7 of 17

monitoring as proposed by OEB Staff. Second, any monitoring of the ETS rate will, by necessity, be backward-looking in orientation which means it will subject to the same types of disputes that have arisen in this proceeding when parties attempt to apply any findings to unknown future market conditions.

- *To recognize uncertainties around market participant behavior change, market renewal implementation, and technology change*: The IESO agrees with OEB Staff that the Ontario market is facing a time of transformative change and attendant uncertainty in the years ahead. However, in the IESO's view, the appropriate approach to this uncertainty is to promote stability in the market where possible and avoid unnecessary additional changes to the market that introduce risk and cost to traders – such as repeated increases to the ETS rate – during this period. This factor militates against any increase in the current ETS rate of $1.85/MWh. This approach would be more consistent with the precautionary approach than a pre-determined phased-in increase of the ETS rate.

37. Further, the IESO notes that (as SEC and VECC have recognized) an increase in the ETS rate can interfere with the value of TRs, which are sold in advance for periods of one-month and one-year respectively. Traders purchasing export TRs will have to factor in not only their own changes in trading behavior due to an increasing ETS, but also estimates of changes in the behavior of the larger trader community, as this larger group determines total exports and congestion prices. As no trader would have historical data to draw from for the impact of a higher ETS, the IESO expects traders as a whole will manage this risk by submitting more conservative bids for TRs, leading to difficult-to-estimate but potentially significant losses in TR auction revenue as the ETS rate rises.

38. As discussed below, the impact of a one-time increase in the ETS rate can be mitigated to an extent by timing the increase to coincide with the expiry of the current periods for TRs that have been purchased. However, a series of annual increases introduces ongoing risk and uncertainty to traders resulting in adverse impacts on auction revenue on an ongoing basis. Lower auction revenues will directly impact the financial disbursements from the TRCA that are disbursed to Ontario ratepayers on a semi-annual basis. In proposing phased-in increases, LPMA and OEB staff do not appear to have given any consideration to the impact of annual increases on the operation of the TR market.

7. The Effective Date of Any Increase in the ETS Rate Should be January 1, 2024

39. SEC and VECC requested that the IESO comment on whether it is preferable to postpone the effective date of any change in the ETS rate until after the expiry of any current TRs have lapsed.[48]

40. If the OEB determines that an increase in the ETS rate is appropriate, the IESO requests that the effective date of the new rate be delayed until the ownership period of all TRs (current as of the date of the decision) have expired.[49] The IESO's most recent auction of one-year TRs occurred in August 2022 for the period of October 1, 2022 to September 30, 2023.[50] The first round of the next auction for year-long TRs (for the period of January 1, 2023 to December 31, 2023) will occur in November 2022. The first step in the upcoming auction process is the issuance of a pre-auction publication by the IESO on October 14, 2022.

41. Given these dates, the IESO's preference is that the implementation of any change in the ETS rate occur no earlier than January 1, 2024 assuming that the OEB issues a decision in this matter prior to the end of 2022. This will allow participants in the upcoming TR auction to prepare their bids on the basis that the current ETS rate will remain in place for the duration of the ownership term of January 1, 2023 to December 31, 2023.

8. The ETS Rate Should Not be Adjusted Annually

42. SEC, VECC and CME have proposed the ETS rate be adjusted annually using Revenue Cap Index ("**RCI**") employed by HONI to adjust its revenue requirement or the percentage annual increase in the Network Service Rate component of the UTR.[51]

43. The IESO does not support an annual adjustment in the ETS rate using either the RCI or the percentage annual increase in the Network Service Rate component of the UTR. Intertie trading is driven by price spreads between jurisdictions and is not directly impacted by

[48] SEC Submissions at para. 59; VECC Submissions at p. 49.
[49] This would align with the approach taken by the IESO when it changed the TRCA disbursement methodology to provide a greater proportionate of the surplus to domestic load. The implementation of these changes was timed to allow for the expiry of all TRs purchased before the change was announced.
[50] IESO 2022 Transmission Rights Auction Schedule, Online at: https://www.ieso.ca/en/Sector-Participants/Calendars/Market-Calendars/2022-Transmission-Rights-Auction-Schedule
[51] SEC Submissions at paras. 63 and 64; VECC Submissions at pp. 49 to 50; CME Submissions at para. 39.

inflationary pressures. Introducing an annual adjustment that increases the ETS rate would make exports from Ontario more expensive, thereby reducing the price spread and rendering otherwise profitable trades uneconomic.[52] Any increase it the ETS rate would, in any event, likely be matched by an off-setting reduction in ICP revenue.

9. Proposals for Further Studies or Monitoring by the IESO

44. Several parties have recommended that the IESO undertake or participate in further studies or monitoring of the ETS rate. As stated in its written submissions, the IESO cautions the OEB against mandating further studies or ongoing monitoring by the IESO in pursuit of the "perfect" ETS rate. As the IESO has expressed throughout this proceeding, it is skeptical that the results of any further study will provide greater clarity to parties than what is available at this time.

45. Pollution Probe recommends that the OEB request that the IESO undertake a comprehensive study on the benefits, costs and risks of an updated ETS rate on key stakeholders.[53] As stated in the IESO's written submissions, the IESO believes that the considerations relevant to setting the ETS rate have been well defined in this proceeding and questions the value of a further comprehensive study. The IESO reiterates that, in the event it is required to undertake such a study, it may need to seek an adjustment to its revenue requirement to ensure the necessary funds are available for the work.

46. OEB Staff have recommended that the IESO oversee and conduct an export monitoring and analysis program to support future reviews of the ETS rate.[54] The recommended program would consider factors relevant to understanding the performance of Ontario's export markets and the performance of the ETS rate in relation to electricity markets and reliability. As stated above, the IESO does not support OEB Staff's phased-in increase and is not willing to take on responsibility for the associated proposed monitoring program. Further, as the evidence in this proceeding has made clear, electricity export markets are influenced by a multitude of factors. The IESO believes the analysis associated with the monitoring program would be complex,

[52] Market Implications Report at p. 13 of 17.
[53] Pollution Probe Submissions at p. 10.
[54] OEB Staff Submissions at p. 22 to 23.

introduce additional market risk and costs, require a significant amount of work and provide limited insight for the setting of the ETS rate in the future.

47. APPrO has requested that the IESO comment on whether, should the OEB decide not to set an ETS rate, the IESO would be willing to undertake (i) to monitor developments and associated benefits as they change over time; and (ii) report back to the OEB if the IESO is no longer of 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.[55] For the reasons set out above, the IESO is reluctant to engage in monitoring of the market for the specific purpose of discerning the impact of a specific ETS rate. Moreover, it is the IESO's view that reducing the ETS rate to zero – and relying instead solely on a market-based dynamic ICP – will be the mostly economically efficient solution. From the IESO's perspective, the decision to re-introduce an ETS rate (assuming it is set to zero by the OEB) would not be based on economic efficiency but instead on other relevant considerations as noted in the IESO's written submissions.

10. The IESO Would Participate in an ETS Working Group

48. SEC has suggested that the OEB create an ETS Working Group of interested parties to meet over the next couple years to determine what, if any, further study of the ETS rate can reasonably be undertaken, and what data the IESO would need to provide.[56]

49. If the OEB desires ongoing review or study of the ETS rate, the IESO would be willing to participate in an ETS Working Group if one were established by the OEB. At this stage, SEC's proposal is high level and further details as to the composition and objective of the ETS Working Group would need to be sorted out. Once established, the ETS Working Group would need to clearly define the parameters of any further study and assess what, if any, value it would provide to setting the ETS rate. Given the complexity of the task and as noted above, the IESO reiterates its reluctance to engage in any study that would introduce additional market risk, require a significant amount of work, and provide limited insight for the setting of the ETS rate in the future.

[55] APPrO Submissions at para. 40.
[56] SEC Submissions at para. 68.

50. With respect to the provision of further market data, as stated in the IESO's written submissions, it has retained 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. The results of the jurisdictional review will be made public by the end of Q2 2023.

C. ORDER REQUESTED

51. For the reasons set out above, the IESO reiterates its request 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 26th day of September 2022.

Patrick Duffy
Stikeman Elliott LLP