EDA INTERROGATORY 7

Issue 3.1 Is the IESO's proposal for a proposed Operating Reserve of $15 million in the Forecast Variance Deferral Account (FVDA) appropriate?

Issue 3.2 Is the IESO's proposal to clear the amount of the 2022 year-end balance in the FVDA that exceeds the $15 million Operating Reserve appropriate?

Issue 3.3 Is the IESO's proposal for seeking OEB approval to adjust its previously approved expenditures, revenue requirement and fees in the event of a material unforeseen change appropriate?

3.0-EDA-7

INTERROGATORY

Reference: ExA-T1-S5 / Exhibit F-T1-S1

Preamble: The IESO is requesting an increase of $5 million to retain an operating reserve of $15 million over the three-year planning and approval period. This proposed increase recognizes the potential for additional unplanned events that may be material in scope and cost, given the scope and complexity of IESO's mandate, and the expected transformation of the sector over the 2023- 2025 Business Plan. As the IESO looks forward to the 2023-2025 planning period, the IESO believes that a $15 million FVDA balance will be a reasonable and adequate reserve against the uncertainties and impacts referred to above (See Exhibit F-1-1 – Forecast Variance Deferral Account).

Questions:

a) Proposal for Adjustment Due to Material Unforeseen Change: Please provide an analysis including volumes projected and realized to assess the risk of material unforeseen revenue change exceeding the operating reserve. Please explain the variances between historically forecasted revenues collected, and the actual revenues collected from domestic and export customers.

Revenue Side Risk Calculation		Actual	Actual	Actual	Actual	Budget	Budget	Budget
Revenues		2019	2020	2021	2022	2023	2024	2025
Forecasted:	Domestic TWh							
	Domestic $							
Forecasted:	Export TWh							
	Export $							
Total Revenue Requirement	IESO Usage Fee:							
		Actual	Actual	Actual	Actual	Budget	Budget	Budget
Revenues		2019	2020	2021	2022	2023	2024	2025
Actual:	Domestic TWh							
	Domestic $							
Actual:	Export TWh							
	Export $							
Total Revenue Requirement	IESO Usage Fee:							
		Actual	Actual	Actual	Actual	Budget	Budget	Budget
Variance		2019	2020	2021	2022	2023	2024	2025
Variance	Domestic TWh							
	Domestic $							
Variance	Export TWh							
	Export $							
Total Revenue Requirement Variance	IESO Usage Fee:							

b) **Proposal for Adjustment Due to Material Unforeseen Change**: Please provide an analysis of material unforeseen expense change exceeding the operating reserve. Please explain the variances between historically forecasted requirement and total adjusted expenses.

Expense Side Risk Calculation	Actual	Actual	Actual	Actual	Budget	Budget	Budget
	2019	2020	2021	2022	2023	2024	2025
Forecasted Revenue Requirement							
Total Adjusted Expenses							
Variance:							

c) Please explain the financial protocols that are in place to mitigate material unforeseen variances from occurring on the expense side exceeding board approvals. What is the

IESO's internal materiality threshold for review?

d) **Surplus Threshold**: The IESO proposes if the balance of its operative reserve reaches above $30 million during the interim year period after the conclusion of the OEB proceeding the IESO will refund the surplus over $30 million within a month of the annual publication of its Annual report on March 31st. Please confirm that the IESO is proposing a $30M threshold, two times its operating reserve, 15% of approved revenue requirement for the refund **<u>or charge</u>** to customers during the interim period between rate applications. Explain the rationale for a $30M threshold which triggers the settlement of the FVDA.

<u>RESPONSE</u>

a) Please see Table 1 below for historically forecasted revenues compared to the actual revenues collected. The variances are driven primarily by overall changes in volumes associated with extreme weather patterns and economy performance (e.g., pandemic slow down). The risk of volumes variances would have an impact on revenues between 1% to 3% +/- annually. Please see response to 2.0 OEB Staff Interrogatory 13 a) for demand and revenue variance between Forecast and Actual.

Table 1 - Forecasted Revenues Compared to Actual

Revenue ($ Millions)	2019	2020	2021	2022
Budget	190.8	188.6	191.8	201.5
Actual	191.0	188.6	195.0	206.6
Variance $	**0.2**	**-**	**3.2**	**5.0**
Variance %	**0.1%**	**0.0%**	**1.7%**	**2.5%**

b) Please refer to Exhibit D Tab 1 Schedule 1 Appendix 2-JA for historical forecasted OM&A and Total Expenses requirements compared to Actual (2019 – 2025). The 2019-2022 historical variances to the approved budget on the OM&A expenses have been immaterial (less than 1%), and up until 2021 they have been lower than the projected requirements; however, in 2017 the IESO received a recommendation from the Auditor General that required a $12 million adjustment to the expenses in that year which far exceeded the available funding from the approved revenue requirement and the Operating Reserve of $6 million, and created a deficit balance in the Operating Reserve which was not replenished until 2022.

c) The IESO conducts a forecast for the year at reasonable intervals that is presented to the Executive Leadership Team for approval before it is submitted to the IESO Board for review and discussion. In this forecast process the IESO conducts reprioritization discussions to ensure actions are taken to mitigate material unforeseen variances as much as possible. The IESO's internal materiality threshold for review is any variance +/- 2%.

d) Please see the response to 3.0 OEB Staff Interrogatory 18.

EP INTERROGATORY 10

3.0 Operating Reserve

3.0-EP-10

INTERROGATORY

Reference: Exhibit A-1-3, Page 2

Preamble: Approval to retain $15 million as an operating reserve in the Forecast Variance Deferral Account (FVDA).

Questions:

a) Please provide the opening and closing balances of the FDA for 2018-2022 and 2023 (estimate).

b) please provide FDA dispositions:

   i) Refunds to rate payers,
   ii) Retention,
   iii) Forward to next year,
   iv) Interest earned in year.
   v) Please reconcile to FDA opening and closing balances.

RESPONSE

a) In 2018, the FVDA had an opening balance of $6.0 million and closed at a $4.7 million deficit. The balances for 2019-2022 are provided in Exhibit F-1-1. The IESO is unable to provide an FVDA estimate balance as of December 2023, since it is dependent on decision and order on the market rebate to be issued by the OEB.

b) Please see Table 1 in Exhibit F-1-1. Please note interest earned exclusively on the operating reserve isn't available.

OEB STAFF INTERROGATORY 16

ISSUE 3: Operating Reserve

3.0-OEB STAFF-16

INTERROGATORY

Reference:

a. EB-2019-0002, Decision and Order, December 5, 2019, p. 13
b. Exhibit F / Tab 1/ Schedule 1 / p. 1 & 2

Preamble:

In the OEB's 2019 decision on the IESO's 2019 revenue requirement submission (EB-2019-0002), the IESO received approval to retain an operating reserve of $10 million.

However, OEB staff notes that in the above-noted decision, the OEB stated its expectations that this operating reserve will not be reviewed again for five years unless there is a material change to the operations of the IESO.

In the current application, the IESO is requesting to increase the FVDA balance to $15 million effective January 1, 2023, to manage cost or revenue variances that may arise over the planning horizon with the approval of all three years of the 2023-2025 Business Plan. This proposed increase recognizes the potential for additional unplanned events that may be material in scope and cost, given the scope and complexity of IESO's mandate and the expected transformation of the sector over the 2023-2025 Business Plan.

In the scenario where costs exceed the current level of the operating reserve, the IESO stated that it must fund these costs by either reducing invested funds or increasing borrowings because the IESO is a not-for-profit, non-taxable corporation. The IESO stated that these actions have net interest impacts that increase costs.

The IESO also noted that these expenditures would need to be restored in the next Business Plan and revenue requirement submission, and would therefore have a future impact on the IESO's revenue requirement and usage fees. The IESO believes that a $15 million FVDA balance will be a reasonable and adequate reserve against the uncertainties and impacts referred to above within the 2023-2025 planning horizon.

Questions:

a) Given the OEB's expectations in its decision for the IESO's 2019 revenue requirement that the operating reserve of $10 million was not to be reviewed again for five years unless there was "a material change to the operations of the IESO", please explain why the IESO is of the view that a change to a $15 million reserve should be made effective for its January 1, 2023 revenue requirement.

b) Please describe whether there was "a material change to the operations of the IESO, as outlined in the OEB's 2019 revenue requirement decision as a pre-requisite to changing the IESO's operating reserve level.

c) Please list any material changes to the operations of the IESO that the IESO is anticipating may happen from 2023 to 2025.

d) If there was not an anticipated material change to the operations of the IESO, please provide reasons as to why the OEB should deviate from its findings in the 2019 revenue requirement decision (i.e., not to revisit the operating reserve for five years).

e) Please list any OEB precedents for such an increase in operating reserve, including the EB# and date.

<u>RESPONSE</u>

a) The five-year period identified in the OEB's decision in EB-2019-0002 will expire on December 31, 2023. While the review of the operating reserve is occurring a year earlier than was expected in EB-2019-0002, the IESO's preference is to have a uniform operating reserve for all three years covered by this application and to address the dispensation of any surplus or deficits at the time of the next application. The IESO's rationale for increasing the operating reserve to $15 million for the 2023-2025 period is discussed in Exhibit F, Tab 1, Schedule 1.

b) Please see a) above. The IESO does not agree that "a material change to the operations of the IESO" should be treated as a pre-requisite to reviewing the IESO's operating reserve in the context of a three-year application.

c) The IESO does not anticipate any material changes in its operations in the 2023 to 2025 period that would require a further review of the operating reserve for those years.

d) Please see a) above.

e) In the OEB's Decision on the IESO's 2019 Revenue Requirement Submission (EB-2019-0002), dated December 5, 2019, the IESO's operating reserve was increased from $6 million to its current $10 million level. In the IESO's 2015 Revenue Requirement Submission, as part of the Package Settlement on September 7, 2016, (EB-2015-0275), the IESO was approved by the OEB to retain an operating reserve of $10 million, an increase of $5 million from its previous $5 million operating reserve.

OEB STAFF INTERROGATORY 17

ISSUE 3: Operating Reserve

3.0-OEB STAFF-17

INTERROGATORY

Reference:

a. Exhibit F / Tab 1 / Schedule 1 / p. 1-2
b. Exhibit C / Tab 2 / Schedule 1 / p. 2
c. Exhibit B / Tab 1 / Schedule 2 / p.23-26 (Appendix 2 of the 2023-2025 Business Plan)

Preamble:

In Exhibit F-1-1, the IESO outlines its request for an increase in its operating reserve, recognizing the potential for additional unplanned events that may be material in scope and cost. In Exhibit C-2-1, the IESO identifies some risks associated with forecast uncertainty: exchange rate, interest rates, change in demand, etcetera. The IESO further provides strategic and operational risks to achieving the IESO's strategic objectives with Appendix 2 of the 2023-2025 Business Plan: the undersupply of energy, maintaining credibility with the stakeholder community, cybersecurity risks, impairments to the IESO's efficiency mandate, and readiness to address transformation.

Questions:

a) Please articulate how the operating reserve could or would be used to mitigate the impact of each of the risks identified in references b. and c. should they materialize over the 2023-2025 period.

b) Please explain how the quantum of additional operating reserve, i.e. an increase of $5 million or 50%, was derived based on the identified risks. Including, if available, the relative or absolute contribution of each of the above risks to determining the quantum.

c) Is the IESO concerned about any risks that are not identified in the filed evidence? If yes, what is the nature of the risk(s) and what are the potential impact(s)? How would the operating reserve that the IESO carries in the FVDA be used to mitigate to impact of these risk(s) if they materialize?

d) How would the IESO manage the increase in risk if the request to increase operating reserve was denied?

RESPONSE

a) The operating reserve would be used to offset unplanned shortfalls in revenues and/or unforeseen expenses over the 2023-2025 period. With the operating reserve, the IESO is able to avoid borrowing to manage the unplanned and unforeseen variances, as well as the accrued interest from the borrowed amounts. The IESO is of the view that the requested $15 million operating reserve is a reasonable amount to fund operations in the event of unplanned shortfalls in revenues or unforeseen expenses.

b) In determining the appropriate level of operating reserve, the IESO is guided by a balance of considerations, including the potential for unplanned variances to accumulate over a three-year period and exceed the reserve level, the opportunity to create regulatory efficiency over a three-year period by limiting the need to return before the OEB for revised fees in only exceptional circumstances, the historical use of the operating reserve, and ratepayer impact. The $15 million operating reserve represents 2% of the IESO’s total revenue requirements for 2023-2025.

c) The IESO’s operating reserve is meant to offset revenue and/or expense variances, irrespective of their cause, so long as they are unplanned and unforeseen. See also the response to b) above.

d) The IESO would have to fund these unplanned and unforeseen variances by borrowing from its credit facility.

OEB STAFF INTERROGATORY 18

ISSUE 3: Operating Reserve

3.0-OEB STAFF-18

INTERROGATORY

Reference:

a. Exhibit F / Tab 1/ Schedule 1 / p. 4 & 6

Preamble:

The IESO proposes that if the balance of its operating reserve reaches above $30 million during the interim year period after the conclusion of the OEB proceeding, the IESO will refund this surplus over $30 million within a month of the publication of its Annual Report on March 31st.

However, the IESO also stated that it expects to carry surplus or deficits for the three-year period (2023 to 2025 revenue requirements) for dispensation at the next application.

Questions:

a) Please explain whether the IESO made a typographical error and meant a surplus of $15 million instead of $30 million as described in the preamble to this interrogatory.

b) If this was not a typographical error, please explain why the IESO is proposing a $30 million surplus in only this one instance, as opposed to a $15 million surplus discussed in the remainder of the current application.

c) Please explain why the IESO has referred to disposing the balance in the FDVA both on an annual basis and in its next revenue requirement application (i.e., expected for its 2026 revenue requirement). Please clarify the IESO's proposal regarding the timing of the disposition of the balance in the FVDA.

d) Please explain whether the IESO would be supportive of an annual rebate to market participants within a month of the publication of its Annual Report on March 31st. A proposed rebate would occur in the event that the FVDA balance exceeds the OEB-approved operating reserve threshold for this account in any interim year (i.e., any year before its next application expected for the IESO's 2026 revenue requirement).

e) If the IESO executes an annual rebate to market participants within a month of the publication of its Annual Report on March 31st (i.e., before its next application expected for its 2026 revenue requirement), please explain what type of approval process the IESO would seek from the OEB.

f) Please provide the FVDA actual balance as at May 31, 2023 and the forecasted balance as at December 31, 2023.

g) Please explain the drivers of any material FVDA actual balance as at May 31, 2023 and the forecasted balance as at December 31, 2023.

RESPONSE

a) The IESO did not make a typographical error. However, the IESO clarifies that the $30 million surplus is the threshold at which the IESO would file a rebate with the OEB for the amounts exceeding $15 million.

b) The IESO is proposing to carry surplus or deficits in the FVDA for the three-year period (2023 to 2025 revenue requirements) for dispensation at the next application. This approach takes advantage of the regulatory efficiencies offered by a three-year filing period by (i) avoiding the need for an annual cycle of regulatory filings by the IESO, and (ii) providing the IESO with the ability to manage the potential for offsetting annual revenue surpluses and deficits over a three-year period. At the time of the next application, the IESO would seek to refund any balance in the FVDA beyond the requested $15 million operating reserve threshold. The IESO is also proposing that if the surplus in the FVDA exceeds $30 million during the interim period, then the IESO will refund the amount of the surplus exceeding $15 million within a month of the publication of its Annual Report on March 31st.

c) Please see b) above. The IESO is only proposing to dispose of its FVDA surplus on an annual basis if it reaches over $30 million. If surplus does not reach $30 million, then the IESO would dispose of any surplus in the subsequent application.

d) The IESO would not support an annual rebate. As discussed in b) above, the IESO's proposed approach takes advantage of the regulatory efficiencies offered by a three-year filing period. An annual rebate mechanism would not offer these advantages.

e) The IESO is seeking OEB approval of the rebate mechanism as part of this proceeding. The IESO does not expect that any OEB approval would be needed at the time of the rebate if the mechanism is triggered.

f) The interim balance of the FVDA as of March 31, 2023, is $32.5 million prior to any potential market participant rebate ordered by the OEB. Note that the balance has been provided as of March 31, 2023 and not May 31, 2023 as requested as quarter- end processes for accruals are ongoing. The FVDA balance as of December 31, 2023 is forecasted to be $16.7 million without any rebate to market participants.

g) The variance between March 31st interim FVDA balance ($32.5 million) and the December 31st forecast ($16.7 million) of $15.8 million, is primarily driven by the present value of benefit enhancements included in the collective agreement that was settled in Q1 2023, in addition to actions taken to mitigate elevated attrition rates experienced at the IESO as a result of rising salaries in the market. See also response to f) above regarding the March 31st balance date.

OEB STAFF INTERROGATORY 19

ISSUE 3: Operating Reserve

3.0-OEB STAFF-19

INTERROGATORY

Reference:

a. Exhibit F / Tab 1/ Schedule 1 / p. 3
b. Exhibit A / Tab 1/ Schedule 2 / p. 2
c. EB-2020-0230, Response to OEB Staff Interrogatory #11, September 9, 2021
d. Exhibit B / Tab 2 / Schedule 1 / p. 33 & 35 (2022 Annual Report)

Preamble:

The IESO proposes that the increase to a $15 million operating reserve be funded by $5 million of the $13.7 million surplus and the remaining $8.7 million be refunded to market participants.

A credit of $8.7 million is shown in Exhibit F "Table 1: 2019 -2025 Balances and Transactions in the FVDA" in the column "2022 Actual".

The IESO stated that it will rebate the surplus to market participants proportionate to the fees collected in 2022. The rebates will be provided in the next billing cycle following the month in which OEB approval is received.

As noted in the response to an interrogatory in the IESO's 2020 and 2021 revenue requirements proceeding, the IESO rebated $9.6 million and $12.6 million to market participants in 2015 and 2016, respectively.

In its 2022 audited financial statements, Note 6, the IESO has shown an accumulated surplus of $10 million as at December 31, 2022 for its Regulatory Deferral Account. However, in its current application, the IESO has shown a surplus of $23.7 million in the FVDA as at December 31, 2022.

In its 2022 audited financial statements, Note 7, the IESO stated that in 2022 it recognized $13.7 million in rebates due to market participants regarding system fees.

Questions:

a) Regarding the FVDA, please explain why the IESO's 2022 audited financial statements show a surplus of $10 million as at December 31, 2022, but the current application shows a surplus of $23.7 million.

b) Please explain why it is appropriate to use the prior-period operating surplus from 2022 to fund the requested increase in operating reserve.

c) Please explain why a credit of $8.7 million is shown in Exhibit F "Table 1: 2019 -2025 Balances and Transactions in the FVDA" in the column "2022 Actual", instead of the column "2023 Budget", as it appears that this amount has not yet been refunded to market participants.

d) Please describe the rate design in the current application of refunding the $8.7 million surplus (in excess of a $15 million operating reserve) to market participants, as OEB staff is not clear whether this will be refunded in 2023 or has already been refunded in 2022.

e) Please describe the rate design in the current application of instead refunding the $13.7 million surplus (in excess of a $10 million operating reserve) to market participants, instead of a $8.7 million surplus (in excess of a $15 million operating reserve).

f) Please describe the rate design that the IESO plans to use for the interim rate period, in the event of a surplus or deficit.

g) Please explain why an accrual to rebate market participants of $13.7 million was made as at December 31, 2022 in the IESO's audited financial statements (and not yet rebated), but in the current application the IESO suggested to only rebate market participants $8.7 million.

h) Please explain how the IESO rebated its market participants $9.6 million and $12.6 million in 2015 and 2016 respectively. Please also explain whether the IESO proposes to use the same methodology to refund either $8.7 million or $13.7 million, as noted in the current proceeding.

RESPONSE

a) In accordance with Public Sector Accounting Standards (PSAS), the IESO was required in its 2022 audited financial statements to accrue the potential rebate of the FVDA surplus to rate payers based on the current operating reserve level of $10 million approved by the OEB.

b) Using surplus to fund the operating reserve is easy to implement and has minimal impact on rate payers.

c) The $8.7 million credit represents the surplus in excess of the proposed $15 million operating reserve threshold. The credit is applied to the period when it was incurred and not when it is paid.

d) The $8.7 million surplus will be rebated to rate payers in the next available market settlement process following the issuance of an OEB decision and order in this proceeding. The rebate would be applied as a one-time adjustment using the mechanism discussed in h) below and would not impact the IESO's usage fees.

e) As described in d) above, the IESO's usage fees will not be impacted by the rebate to rate payers regardless of the amount of the rebate.

f) For treatment of surpluses, please see d) and e) above in addition to the response provided in 3.0 OEB Staff Interrogatory 18 b). Regarding the treatment of deficits, please see the response provided in 3.0 OEB Staff Interrogatory 22 c).

g) In accordance to the applicable accounting principles, the IESO made an accrual of $13.7 million as at December 31, 2022 in its audited financial statements based upon the current operating reserve threshold approved by the OEB. In the current application, the IESO proposed to refund $8.7 million surplus to allow the IESO to increase the operating reserve from $10 million to $15 million.

h) In 2015 and 2016, the rebate was pro-rated to the rate payers that paid the administration fees (charge type 9990 "IESO Administration Charge" and charge type 754 "OPA Administrative Charge") in the respective years. The same mechanism will be used for any rebate paid after the issuance of an OEB decision and order in this proceeding.

OEB STAFF INTERROGATORY 20

ISSUE 3: Operating Reserve

3.0-OEB STAFF-20

INTERROGATORY

Reference:

a. Exhibit F / Tab 1/ Schedule 1 / p. 4
b. Exhibit B / Tab 2 / Schedule 1 / p. 35 (2022 Annual Report)

Preamble:

The IESO's proposal to increase the operating reserve to $15 million is expected to decrease the risk of unforeseen expenses or revenues exceeding the operating reserve. However, if unforeseen expenses or change in revenues cause the IESO's proposed operating reserve, and the balance of the FVDA, to reduce below zero in Year 1 of the three-year cycle (i.e., in 2023), the IESO proposes that the IESO may choose to re-apply to adjust its fees. The IESO proposed that any material unforeseen expenses in Year 2 or Year 3 would likely be reviewed in the next application.

If the $15 million threshold is exceeded, the IESO would review whether it is appropriate and feasible to apply for revised usage fees with the OEB.

The IESO's review would take into account items such as the availability of the IESO's letter of credit with the Ontario Electricity Financial Corporation (OEFC). The IESO currently has a $160 million unsecured credit facility agreement with the OEFC, with a $nil amount drawn down as at December 31, 2022.

OEB staff is seeking clarity on whether it is reasonable for the IESO to adjust its usage fees if the balance in the FDVA is a surplus greater than the OEB-approved operating reserve amount. This clarity is being sought given that the IESO is also proposing a different mechanism in the Application to refund such surpluses (i.e., rebates to market participants, rather than adjusting usage fees.

Questions:

a) Please explain the different refund mechanisms that are being proposed (i.e., revise usage fees or issue rebates to market participants) in the event of a surplus in the context of the following:

   i. Different amounts may actually be returned to customers based on the refund mechanism approved by the OEB
   ii. Different timing of the two potential refund mechanisms
   iii. Due to the differing timing, intergenerational equity issues may be incurred (i.e., different customers may benefit depending on the refund mechanism approved by the OEB)

b) Regarding the OEFC credit facility, please explain whether the IESO is in essence proposing that it be granted discretion to access an additional $160 million without OEB scrutiny on the reasonableness of that spend, if it deems necessary. This is because any over-spending of expenses would flow into the FVDA balance to be requested for clearance in a future application.

RESPONSE

a) i., ii., iii. The IESO is not proposing to revise its usage fees if there is a surplus in the FVDA. Please see the responses to OEB Staff Interrogatory 18 b), and 19 d) and h) for further details about the mechanism that the IESO would utilize to rebate surpluses to market participants.

b) The credit facility is not in addition to business plan revenue requirements submitted within the approved three-year business plan and currently under OEB review. The credit facility is an agreement to access money for temporary shortages in liquidity (cashflow). This is expected as actual spending does not necessarily align with business plan recovery i.e. recovery of the IESO fee to meet revenue requirements happens once a month, but capital and operational costs happen throughout a month.

OEB STAFF INTERROGATORY 21

ISSUE 3: Operating Reserve

3.0-OEB STAFF-21

INTERROGATORY

Reference:

a. Exhibit F / Tab 1/ Schedule 1 / p. 4

Preamble:

The IESO defines the material change threshold as follows:

- A change in revenue or expenses that results in an operating reserve deficit
- Occurs in Year 1 after receiving three-year approval of IESO usage fees
- A change that has a significant impact on the operation of the IESO

Questions:

a) Please explain whether the material change threshold is intended to address both operating reserve deficits and surpluses.

b) If the material change threshold is not intended to also address surpluses, please explain.

c) Please define what is meant by the word "significant" in terms of the IESO's reference to a "significant impact on the operation of the IESO."

RESPONSE

a) The material change threshold is intended to address operating reserve deficits.

b) The material change threshold is not intended to address surpluses. The threshold is focused on material changes that could result in costs or revenue deficits that would affect the IESO's ability to continue operations and carry out its mandate. See responses to 3.0 OEB Staff Interrogatories 18 b), 19 d) and h) and 20a) for the proposed treatment of surpluses.

c) A significant impact on the operation of the IESO in the context of the material change threshold means that the IESO can no longer work within its revenue requirements to carry out its business plan. For example, an unplanned event occurs in the first year and has a cascading impact that also compromises the IESO's ability to work within future years' revenue requirement and carry out the activities in its business plan.

OEB STAFF INTERROGATORY 22

ISSUE 3: Operating Reserve

3.0-OEB STAFF-22

INTERROGATORY

Reference:

a. Exhibit F / Tab 1/ Schedule 1 / p. 5 & 6

Preamble:

The IESO stated that if the material change threshold is reached, and the IESO decides the best course of action is to revise its usage fees, then the IESO would file a revised Business Plan with the Minister of Energy (The Minister) and following the Minister's approval of the revised Business Plan, file a revised revenue requirement submission to the OEB for revised usage fees.

The IESO would request approval of revised usage fees necessary to recover some or all of the IESO's $15 million operating reserve as appropriate at the judgment of the IESO based on business needs, economic factors, and impact on market participants.

The IESO has listed the benefits of its adjustment proposal, but has been silent on the cons and risks.

Questions:

a) In the absence of a material change, please explain whether the IESO plans to annually update its business plan in the interim period and seek the Minister's approval on the revised business plan.

b) Please explain how any revised business plan in the interim period would impact 2024 Budget and 2025 Budget and if the IESO plans to revise such revenue requirement requests, even in the absence of a material change.

c) Please describe the reasonableness of the IESO's proposal to revisit usage fees in the event of either a deficit or surplus in the interim period (i.e., 2023 to 2025), before the filing of its next application expected for its 2026 revenue requirement.

d) Please confirm that if the IESO applies to revise its usage fees in the interim period, in the event of either a deficit or surplus, it would be seeking OEB approval to also adjust its previously approved expenditures and revenue requirement(s). If this is not the case, please explain why the IESO's proposal is asymmetric.

e) If the IESO's usage fees are proposed to be revised in the event of a FVDA deficit or surplus, please explain why a revised revenue requirement submission would be required in the interim period (i.e., 2023 to 2025), rather than the IESO waiting to be made whole at the filing of its next application expected for its 2026 revenue requirement.

f) Please explain why the revised usage fees would be required to recover "some or all of the IESO's $15 million operating reserve", as opposed to bringing the IESO to a break-even level.

g) Please describe the cons and risks of the IESO's adjustment proposal.

RESPONSE

a) The IESO does not plan to annually revise its business plan and seek Minister approval during the interim years after OEB approval.

b) Please see the response to a) above.

c) The IESO is of the view that it is reasonable to revisit usage fees if there is a material change to its revenue or expenses that exceeds the $15 million operating reserve, on a combined basis, within the first year after receiving OEB approval, with revised rates being effective in the third year of the application. This is not applicable in the second and third year of the application because there is insufficient time to revise and implement rates in advance of the next revenue requirement submission. As per the responses to 3.0 OEB Staff Interrogatories 18 b), 19 d) and h) and 20a), the IESO does not propose to revise usage fees in the event of a surplus.

d) The IESO is not proposing to adjust its usage fees in the event of a surplus. If the material change threshold for a deficit is met, and the IESO decides to file a revised business plan with the Minister, followed by a revised application with the OEB, it would request approval for revised expenditures, revenue requirement and usage fees for the previously approved third year of its filing.

e) Refer to the response for d). The IESO understands that any such application to the OEB for revised expenditures, revenue requirement and usage fees would need to explain why the IESO could not wait to be made whole at the filing of its next application.

f) The IESO designed the proposal with the flexibility to recover some or all of the reserve to reduce any negative impacts based on business needs, economic factors and the impact on market participants. Whether the IESO would seek to recover amounts above a "break-even" level would be determined at the time of any such application.

g) The IESO believes its adjustment proposal is reasonable as it balances regulatory efficiency associated with a multi-year process with the prudency of interim review should material change thresholds be met.

OEB STAFF INTERROGATORY 23

ISSUE 3: Operating Reserve

3.0-OEB STAFF-23

INTERROGATORY

Reference:

a. Exhibit F / Tab 1/ Schedule 1 / p. 5
b. Filing Requirements For Electricity Distribution Rate Applications - 2022 Edition for 2023 Rate Applications - Chapter 3 Incentive Rate-Setting Applications May 24, 2022, p. 21 & 22
c. Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, July 14, 2008

Preamble:

For the revised revenue requirement submission, the IESO proposes a limited scope of review focused on the unforeseen expense and its direct impact on the IESO's budget in order to maintain the regulatory efficiency of a multi-year approach. A limited scope of review would be requested to achieve the approval of revised usage fees prior to January 1st of Year 3.

The IESO would specify the costs that impacted the IESO's operating reserve in detail and demonstrate that these impacts could not be accommodated within the approved IESO budget.

OEB staff notes that the IESO's limited scope of the review focused on the unforeseen expense is similar to a Z-factor request.

In the OEB's filing requirements for electricity distribution rate applications, distributors may request to recover costs associated with unforeseen events that are outside the control of a distributor's ability to manage. This is referred to as a claim for a "Z-factor" event. The cost to a distributor must be material and its causation clear.

To recover these amounts, a distributor must follow the guidelines discussed in the OEB's Report on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors. The materiality thresholds, described in the above noted OEB report, must be met on an individual event basis for the distributor to apply for recovery of the relevant costs.

To be eligible for a Z-factor claim, a distributor must demonstrate that its achieved regulatory return on equity (ROE), during its most recently completed fiscal year, does not exceed 300 basis points above its deemed ROE embedded in its base rates.

Questions:

a) Given that the IESO does not have a ROE built into its rate structure, please explain how the IESO would satisfy the OEB's requirements for a Z-factor. Specifically what would the IESO propose to satisfy the OEB's requirement that its achieved ROE, during its most recently completed fiscal year, does not exceed 300 basis points above its deemed ROE embedded in its base rates?

   For example, if the IESO incurs any profit at all in any given year from 2023 and forward (i.e., a profit incurred before its true-up to break-even with the offset recorded in the FVDA), would the IESO be agreeable to zero recovery of its "unforeseen expense"?

b) Rather than using the IESO's proposed approach for unforeseen amounts, please explain whether the IESO would be amenable to applying for a Z-factor claim under the OEB's filing requirements for electricity distributors (including the requirements set out in the Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors). This would include satisfying such requirements rather than filing a revised revenue requirement submission.

<u>RESPONSE</u>

a) The IESO is not proposing to satisfy the Z-factor requirements applicable to electricity distributors and does not view it as an appropriate tool for managing deficits that meet the material threshold. The IESO is a not-for-profit statutory corporation with objects that include important electricity system matters such as planning, reliability and security. As a non-profit corporation, the IESO has no ROE (or any comparable metric) and its investments and activities cannot necessarily be evaluated on the basis of financial and economic measures that might apply in respect of regulated utilities. The IESO's proposed revenue requirement and capital expenditure envelope are included in the Business Plan that is approved by the Minister before the IESO files its submission for review with the OEB, which is distinct from the process electricity distributors follow in their incentive regulation mechanisms.

b) See the response to a) above. Given the IESO's mandate and objects under legislation, the IESO is not amenable to applying for claims under the OEB's filing requirements for electricity distributors.

SUP INTERROGATORY 6

3.0 Operating Revenue

3.0-SUP-6

INTERROGATORY

Preamble: In the OEB's Notice of Hearing and Procedural Order No.1 dated March 22, 2023 in EB-2023-0098 it is stated:

Ontario Power Generation Inc. (OPG) filed an application with the Ontario Energy Board (OEB) on March 1, 2023, under section 78.1 of the Ontario Energy Board Act, 1998 seeking approval to establish a variance account to record the nuclear revenue requirement impacts resulting from the Ontario Superior Court overturning the Protecting a Sustainable Public Sector for Future Generations Act, 2019 (Bill 124).

Effective November 8, 2019, Bill 124 set a 1% maximum for annual increases in both wages and total compensation for unionized and non-unionized employees in the Ontario public sector for a three-year period. Bill 124 also applied to employees at OPG. The bill was legally challenged by unions and other organizations. On November 29, 2022 the Ontario Superior Court overturned Bill 124 and declared it to be "void and of no effect."

OPG has proposed that a new variance account be approved to record the nuclear revenue requirement impact effective March 1, 2023 until the effective date of the OEB's next nuclear payment amounts order. The proposed variance account would record the difference between the forecast compensation costs included in OPG's last nuclear payment amounts order and the compensation costs for the nuclear facilities resulting from the overturning of Bill 124.

OPG has also requested that the OEB issue an interim order effective March 1, 2023, approving the establishment of the requested variance account on an interim basis. On March 22, 2023, the OEB approved the establishment of the new variance account on an interim basis effective March 1, 2023.

IESO was also subject to Bill 124 and is currently in the same situation as OPG

Questions:

Please clarify:

a) Why IESO has not included a request for a variance account similar to OPG's in this application?

b) Is it IESO's intent to capture any such resulting variance in its operating reserve?

RESPONSE

a) On November 29, 2022, Bill 124 was overturned by the Ontario Superior Court of Justice. The Ontario government filed an appeal in response, and Bill 124 will stay in effect until the outcome of the appeal is known. For these reasons, the IESO has not made any requests to the OEB regarding Bill 124.

b) The IESO will consider all options available, as appropriate, once the outcome of the appeal is known and the financial impact is determined, including an application to the OEB as necessary as per the adjustment mechanism described in in Exhibit F, Tab 1, Schedule 1.

SUP INTERROGATORY 7

3.0 Operating Revenue

3.0-SUP-7

INTERROGATORY

Preamble: In its EB-2023-0098 submission, OPG states the following on p9,10:

The impact of overturning Bill 124 on OPG's forecast compensation costs for the nuclear facilities for the 2022-2026 period is expected to be in excess of OPG's accounting order materiality threshold of $10M per year. While the exact impact cannot be determined until the outcome of current and future processes to establish the compensation provisions of collective agreements that were or would have been covered by a moderation period is known, it is very likely that wage increases will exceed 1% in certain years. In this regard, a directional approximation of the impact can be observed from a response to an interrogatory submitted in EB-2020-0290 (Ex. L-F4-03-PWU-023), which asked OPG to "quantify the impact on the test period revenue requirement had wage escalation been set at inflation beginning in 2021". In response, OPG stated:

> *OPG understands the question to refer to future collective agreements that will* be subject to the Bill 124 moderation periods. If the wage escalation were to be set at an assumed inflation rate of 2% per year for April 1, 2021 to March 31, 2024 for the PWU and 2% per year for January 1, 2022 to December 31, 2024 for the Society, estimated revenue requirement impact would [be] an increase of approximately ***$33M in 2022, $39M in 2023, $42M in 2024, $36M in* 2025 and $28M in 2026***, for impacts on wages and resulting impacts on* pension costs. As in EB-2016-0152, Ex. L-6.6-13 PWU-015, these estimates were determined on the basis of compensation costs reflected in OM&A expenses and are inclusive of associated income tax impacts (calculated at 25% tax rate /(1- 25% tax rate)).

Questions:

IESO is requested to estimate the impact on its compensation costs of Bill 124 being withdrawn in a manner similar to that applied by OPG in its response to the above referenced interrogatory response. Please breakdown the annual impact by non-represented, SUP and PWU staff for both regular and non-regular staff.

RESPONSE

a) To respect good faith bargaining outcomes as part of the ongoing arbitration with the Society on the reopening provision for wages for 2022, 2023 and 2024, the IESO will await the outcomes of the Ontario government's appeal of the Ontario Superior Court of Justice decision to overturn Bill 124 before quantifying the financial impact.

VECC INTERROGATORY 12

Issue 3.0 Operating Reserve

3.0-VECC-12

INTERROGATORY

Reference: Exhibit F, Tab 1, Schedule 1

Preamble: "*The IESO is requesting to increase the FVDA balance to $15 million effective January 1, 2023, 20 to manage cost or revenue variances that may arise over the planning horizon with the 21 approval of all three years of the 2023-2025 Business Plan*."

Questions:

a) Please explain how the amount of $15 million was determined to be an appropriate amount to cushion against unplanned events.

b) Some capital projects, like the Backup Operating Centre, have large contingencies that are not reflected in the Business Plan (Exhibit E, Tab 2, Schedule 1, Attachment 6, page 1). In light of this and given the longer horizon under the 3-year review proposal of this application why would a larger contingency not be a more prudent course of action?

c) How is interest earned on unutilized contingency amounts accounted for in the budgeting process of the IESO?

RESPONSE

a) Please see the response to 3.0 OEB Staff Interrogatory 17 b).

b) For contingency of capital projects, the IESO leverages credit facilities to fund the capital expenditures and recovers the interest and debt costs of capital expenditures through the IESO usage fee once the capital asset is in service and amortized. The IESO views the requested operating reserve level as appropriate based on a balance of considerations. Please see the response to 3.0 OEB Staff Interrogatory 17 b).

c) Unutilized contingency amounts of capital projects do not have an impact on interest since this does not represent cash items that would require financing or that would earn interest.

VECC INTERROGATORY 13

Issue 3.0 Operating Reserve

3.0-VECC-13

INTERROGATORY

Reference: Exhibit F, Tab 1, Schedule 1

Preamble:

Questions:

a) What is the dollar variance from the proposed annual budget that would trigger the process for usage fee adjustment under the "Material Change Threshold" provisions described in Appendix F?

RESPONSE

a) Please refer to the response to 3.0 OEB Staff Interrogatory 22 c).

CME INTERROGATORY 6

Issue 3.1 Is the IESO's proposal to retain an Operating Reserve of $15 million in the Forecast Variance Deferral Account (FVDA) appropriate?

3.0-CME-6

INTERROGATORY

Reference: Exhibit F, Tab 1, Schedule 1, p. 1.

Preamble:

At page 1, the IESO outlines its proposal to increase its operating reserve to $15 million.

Questions:

a) Please indicate all of the instances where the IESO has run a deficit and was required to resort to use of the operating reserve in the previous 5 years.

b) To the extent that the IESO is required to expend funds over and above its revenue requirement and operational reserve, please outline its impact on the IESO and its ability to achieve its mandate.

c) Please confirm that any expenditure of the operating reserve or amounts in excess of the operating reserve would be collected in future higher usage fees.

d) Please advise on what analysis the IESO performed to determine that $5 million additional in the operating reserve was a reasonable and appropriate figure to defray the risks it identified.

RESPONSE

a) The IESO last used its operating reserve in 2018 to offset an increase in pension and OPEB expenses because of a discount rate change recommended by the Auditor General. The restatement of the pension and OPEB expenses resulted in an additional $13.4 million in expenses and an operating reserve deficit of $4.7 million.

b) To the extent that the IESO is required to expend funds over and above its revenue requirement and approved operating reserve, the IESO would access debt to finance its operation to achieve its mandate within the expected timelines and address the transformation of the energy sector. The impact to the IESO of any expenditure of the operating reserve or amounts more than the operating reserve including interest on borrowed amounts is that the collection of these amounts would need to be addressed in a future Business Plan.

c) See the response to b) above.

d) See the response to 3.0 OEB Staff Interrogatory 17 b).

SEC INTERROGATORY 21

Issue 3.1 Is the IESO's proposal to retain an Operating Reserve of $15 million in the Forecast Variance Deferral Account (FVDA) appropriate?

3.0-SEC-21

INTERROGATORY

Reference: [F-1-1, p.6]

Preamble: The IESO states that: "The IESO proposes that if the balance of its operating reserve reaches above $30 million during the interim year period after the conclusion of the OEB proceeding, the IESO will refund this surplus over $30 million within a month of the publication of its Annual Report on March 31st.":

Questions:

a) Please confirm that the IESO would not bring forward an application to the OEB for specific approval to refund the surplus in such a situation.

b) Please explain why the IESO would not agree to refund a balance over $15 million over the interim period.

RESPONSE

a) and b) please see the response to 3.0 OEB Staff Interrogatory 18.

AMPCO INTERROGATORY 19

Issue 3.3 Is the IESO's proposal for seeking OEB approval to adjust its previously approved expenditures, revenue requirement and fees in the event of a material unforeseen change appropriate?

3.0-AMPCO-19

INTERROGATORY

Reference: F-1-1 p.4

Preamble: The IESO defines the material change threshold as follows:

- A change in revenue or expenses that results in an operating reserve deficit
- Occurs in Year 1 after receiving three-year approval of IESO usage fees
- A change that has significant impact on the operation of the IESO

Questions:

a) Please discuss if the IESO is currently aware of any potential events that could result in the proposed operating reserve, and the balance of the FVDA, to reduce below zero in Year 1 of the three-year cycle.

RESPONSE

a) As noted in the response to 3.0 SUP Interrogatory 6, while the outcome of the appeal of Bill 124 is not yet known, nor the financial impact, the IESO will consider all options available, as appropriate, once the outcome of the appeal is known.