ONTARIO ENERGY BOARD

FILE NO.: **EB-2010-0046**

VOLUME: **1**

DATE: **April 25, 2011**

BEFORE:	**Karen Taylor**	**Presiding Member**
	Marika Hare	**Member**

EB-2010-0046

THE ONTARIO ENERGY BOARD

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

AND IN THE MATTER OF the Independent Electricity System Operator Fiscal 2011 Fees Submission for Review.

Hearing held at 2300 Yonge Street,
25th Floor, Toronto, Ontario,
on Monday, April 25th, 2011,
commencing at 10:04 a.m.

VOLUME 1

BEFORE:

KAREN TAYLOR	Presiding Member
MARIKA HARE	Member

A P P E A R A N C E S

KRISTI SEBALJ	Board Counsel
ROBERT CAPUTO LEILA AZAIEZ DAVID RICHMOND	Board Staff
GLENN ZACHER PATRICK DUFFY	Independent Electricity System Operator (IESO)
MICHAEL BUONAGURO	Vulnerable Energy Consumers Coalition (VECC)
SHELLEY GRICE	Association of Major Power Consumers of Ontario (AMPCO)
VINCE DeROSE	Canadian Manufacturers & Exporters (CME)
DAVID BARR	Ontario Power Generation (OPA)

ALSO PRESENT:

SUSAN NICHOLSON BRIAN RIVARD TERRY YOUNG BIJU GOPI	Independent Electricity System Operator (IESO)

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NO EXHIBITS WERE FILED IN THIS PROCEEDING

U N D E R T A K I N G S

Monday, April 25, 2011

--- On commencing at 10:04 a.m.

MS. TAYLOR: Please be seated.

Good morning. My name is Karen Taylor, and sitting with me today is Marika Hare. The Board has convened today on the matter of an application filed on November 2nd, 2010 by the Independent Electricity System Operator, the IESO, for review by the Board pursuant to sections 18 and 19 of the Electricity Act with respect to the IESO's fiscal 2011 fees. The Board has assigned docket EB-2010-0046 to this review.

The Board issued a notice of application on December 3rd, 2010 and issued Procedural Order No. 1 on January 18th, 2011, which included a draft issues list.

On February 11th, 2011, the Board issued a decision and order that included a Board-approved issues list, and a technical conference relating to the application was held on February 18th.

A settlement conference was held on March 8th, and on March 16th, 2011 the IESO filed a settlement proposal based on the agreements reached at the settlement conference.

The parties to the settlement proposal are the IESO, the Association of Major Power Consumers in Ontario, or AMPCO, Energy Probe Research Foundation or Energy Probe, the Canadian Manufacturers & Exporters, or CME, and the Vulnerable Energy Consumers Coalition, or VECC.

The settlement proposal indicates that parties have agreed to a settlement on all issues, with the exception of issue 3.3 which reads:

"Is the IESO's proposal for the treatment of its 2010 accumulated operating surplus appropriate and reasonable?"

The Board issued a procedural order on April 5th setting down today as the date on which the Board would hear parties present the settlement proposal, with a specific focus on issue 5.3 and to hear submissions from parties regarding issue 3.3.

With respect to the logistics of this hearing, we will first hear parties present on the settlement proposal and answer the questions on the settlement proposal the Panel may have.

We will then take a short break, during which the Panel will consider whether or not to accept the settlement proposal.

We will then return to hear any settled issues of concern to the Board, and hear submissions from parties on issue 3.3.

Please be aware that depending on the nature of submissions, the Panel may choose to render an oral decision on issue 3.3 after an appropriate break today.

May I have appearances, please?

APPEARANCES:

MR. ZACHER: Good morning, Madam Chair, Ms. Hare. My name is Glenn Zacher and I am appearing as counsel for the IESO. With me is my colleague Patrick Duffy, and as well from the IESO to my left is Susan Nicholson, who is the

IESO's corporate controller, and to the right of Mr. Duffy is Brian Rivard, who is the IESO's manager of regulatory affairs.

I should just note, as well, that behind me is Terry Young. Mr. Young is the IESO's VP of corporate relations, along with Biju Gopi, who is a senior regulatory analyst. Thank you.

MS. SEBALJ: Good morning, Panel. Kristi Sebalj for Board Staff, and with me is the Board Staff team, which is made up of Robert Caputo, Laila Azaiez and David Richmond.

MS. TAYLOR: Thank you.

MR. DeROSE: Good morning, Panel. Vince DeRose on behalf of CME.

MR. BUONAGURO: Good morning. Michael Buonaguro for VECC.

MS. GRICE: Good morning. Shelley Grice for AMPCO.

MS. TAYLOR: Ms. Grice.

MR. BARR: Good morning. David Barr with Ontario Power Generation.

MS. TAYLOR: Okay. I think we have covered the bases. Are there any preliminary matters? If not, then, Mr. Zacher, would you like to begin?

PRESENTATION OF SETTLEMENT AGREEMENT

SUBMISSIONS BY MR. ZACHER:

MR. ZACHER: Thank you, Madam Chair.

So as I understand it, you would like us to walk through the settlement proposal first, deal with that.

Let me first off say I will walk through some of the background with regards to the settlement proposal. My colleague, Mr. Duffy, has acted for the IESO with respect to smart metering issues with respect to the recent licence application and so I am not trying to duck any tough questions, but he will be more adept at answering any questions you have on that.

MS. TAYLOR: Okay.

MR. ZACHER: So by way of background, Madam Chair, there was of course the Board's initial procedural order in January. That established an issues list. That issues list was then the subject matter of a technical conference, which occurred in February.

At the technical conference, all of the intervenors, I think, save for Ontario Power Generation, appeared. In advance of that technical conference, a number of the intervenors submitted questions on the issues list to the IESO. Those questions were addressed at the technical conference, in addition to other follow-up questions and other inquiries that parties had about the issues.

The IESO had several panels of witnesses. In addition to Ms. Nicholson and Mr. Rivard, there was also Mark Wilson, who is the IESO's director of corporate planning; Darren Finkbeiner, the IESO's manager of market development; Bill Van Veghel, the IESO's manager of compensation and benefits; and Rhonda Wright Hilbig, who is the IESO's manager and responsible for the enhanced day-ahead commitment project.

Following that technical conference that took the better part of half a day, there was then a settlement conference which occurred on March 8. Again, most of the intervenors were present at that settlement conference. The facilitator was Gail Morrison, and with Ms. Morrison's assistance the parties succeeded in coming to a resolution on all of the issues, with the exception of issue 3.3, concerning the IESO's proposed treatment of the operating surplus.

So the settlement was then documented in the settlement proposal which was filed with the Board. That is appended as Exhibit A -- or appendix A, rather, to the written submissions we filed this past Thursday.

In my submission, it accords with the usual requirements required of a settlement proposal, in that it identifies all of the issues that the parties reached a settlement on, and it provides a reference in the evidence either to the IESO's business plan or to evidence from the technical conference that supports the settlement of that issue.

So I believe the IESO speaks for all of the intervenors here in asking that the Board approve that partial settlement proposal, subject to any questions you may have on any parts of it, in particular the issue of smart metering expenditures, which I understand you may have some questions with respect to.

MS. TAYLOR: So why don't we proceed to looking at issue 5.3 in the settlement as it relates to that issue?

MR. ZACHER: Okay. As I indicated, I will turn that over to my colleague, Mr. Duffy.

SUBMISSIONS BY MR. DUFFY:

MR. DUFFY: Good morning, Panel. I understand you have before you some materials that we filed in the SME licence application. I know, Ms. Taylor, you presided at that application, and so we wanted to give you a little bit more background on what is happening with the SME.

And really it comes down to three points that I think are of importance, the first one being that the SME costs are tracked separately, and the time spent on SME matters are tracked separately from IESO costs. So, therefore, none of the expenditures that are at issue in this proceeding relate to the SME.

The second is that the SME-related costs will be recovered at a future date through a separate regulatory charge, and its preliminary nickname at this point is the smart metering charge, or SMC.

There has been some discussion, I know, in past IESO fees cases about when the IESO will be seeking recovery of those costs. It is important to understand that the IESO's role as an SME is transitional in nature and that there have been discussions over the past couple of years about what the long-term governance of the SME role will look like.

And in the past year, there has been an agreement that eventually that role will transition to LDC control through the EDA, and we expect that that transition will take place when the IESO's role, which is effectively setting up the

MDM/R and bringing LDCs on to the MDM/R, is substantially complete, which is expected to occur sometime around the end of 2011.

Then at that point, about four million of the 4.6 million customers will eventually have smart meters, will be enrolled and receiving service from the MDM/R.

And the third point is that the operations of the MDM/R and the operations of the SME have been underway and have been continuing separate from the governance discussions over the past few years. And at this point, as I mentioned, they are expecting to have four million of the 4.6 million customers on line by the end of the year.

And the SME is filing regular monthly reports with the Board, detailing progress on getting to time-of-use rates and getting -- I mean, an essential part of that is getting LDCs on to the MDM/R.

So if there are any questions on any of that, I am happy to take them. I have been involved, as I mentioned, on council for the SME for the last few years, so I have some -- I have kind of lived it through the years.

MS. TAYLOR: I believe Ms. Hare has questions.

MS. HARE: I think our concern in asking about this is to ensure that there are adequate resources being devoted to the SME, so that we don't later find out that if there are any issues with the functionality and ability to meet obligations, that it isn't because additional funds weren't put in.

But if these costs are tracked separately, then it would appear to me this may not be the case to actually review that.

Is that -- I see lots of heads agreeing.

MR. DUFFY: Yes. That would be the -- the basic point being that there will be a future proceeding at some date down the road.

MS. HARE: But wouldn't that be after the fact?

MR. DUFFY: That's true. I mean, that will be -- we anticipate that that will be, like I said, sometime around the end of this year when the IESO's role is substantially complete, and the IESO's cost, that it has incurred, getting the MDM/R up and running and getting LDCs on board will form part of that, and then there will be a rate going forward as well.

In respect to your question about adequacy, at this time the IESO feels it has adequate resources.

What you are seeing is -- I know there are a number of exemption applications from time-of-use rates coming forward before the Board. Each one of those -- you have 80 different LDCs -- each one is kind of an individual circumstance, but at this time the IESO feels it has adequate resources.

They anticipate that they will be able to deal with the coming enrolment in the next few months, and they don't anticipate having to turn anybody away. So if an LDC is ready to come on board the MDM/R, at this time the IESO has the resources and is ready to accommodate them.

MS. HARE: Thank you. That is the assurance that at least I was looking for.

MS. TAYLOR: My question, I think, was a little bit different.

You said the IESO feels that it has adequate resources, and I see there are certain references in the settlement agreement to transcript and pieces of the business plan.

Does that substantially form the basis of the settlement? And precisely what did the parties settle on that, that the IESO, in its belief it has adequate resources, as opposed to -- is that what parties settled?

It wasn't immediately clear to me when I read the settlement agreement what the parties had actually agreed as to that point.

MR. DUFFY: Well, if you read the issue, the issue is linked to the IESO's expenditures, and as my first point was, the fees being spent in this case have no relationship to the SME.

So I think that is probably how I would read the first point, which is that the parties have settled on the understanding -- I don't want to speak for the other parties, but on the understanding that none of the fees that are the subject of this proceeding relate to the SME.

I mean, I would add to that that I am not sure that in this proceeding we have the appropriate parties at the table who would even be in a position to know whether or not the SME is operating effectively, and those would primarily be the LDCs. And that at the moment, as I mentioned, there is an oversight mechanism for that; that is a regular monthly reporting that is happening. The SME reports to that. And then the Board obviously produces its own report coming out of that, as well.

MS. TAYLOR: Do you have any further questions?

So I think at this point the Panel will break, if there is no other questions from any other party.

I have no further questions, and we will decide on the settlement agreement.

So we will reconvene in 15 minutes.

--- Recess taken at 10:19 a.m.

--- On resuming at 10:34 a.m.

DECISION:

MS. TAYLOR: Please be seated.

The Panel has determined that it will accept the proposed settlement agreement as filed. The additional context provided by counsel for the IESO has been useful to the Board with respect to the settlement of issue 5.3.

Although parties had agreed that we would only hear submissions on the remaining issue, which is issue 3.3, the Panel does have a couple of questions that we would like to ask, so it is appropriate at this time that we would swear Ms. Nicholson in so that we can ask the questions under oath.

INDEPENDENT ELECTRICITY SYSTEM OPERATOR - PANEL

Susan Nicholson, Sworn.

MR. ZACHER: Madam Chair, is it all right for Ms. Nicholson to stay here?

MS. TAYLOR: Yes.

MR. ZACHER: Okay.

QUESTIONS BY THE BOARD:

MS. TAYLOR: We only have two questions.

The Panel, in looking at the material that was filed and the submissions that have been filed, really just has two questions, the first of which is why the 5 million is not sufficient for 2011.

MS. NICHOLSON: At the time we prepared our business plan, we put together a three-year business plan and we looked out over the three years and looked at the implications to the business over that three-year period.

The 5 million would be sufficient for 2011, but when we look out over the entire planning period, we are looking at increasing costs and decreasing demand in 2012 and 2013.

At the time of the business plan, the IESO had projected an operating surplus for 2010 of $8.1 million, which, when we use that over the three-year planning period, helped to rate-stabilize over the three-year period.

So the increase of the 8.1 million to the 5 million is not an impact for 2011. It is really for rate stabilization in 2012 and 2013.

Our actual costs in 2010 were lower than what we had projected in the business plan, leaving us with an additional operating surplus of 10.2 million, and that we are proposing to rebate to market participants as part of this rate case application.

MS. TAYLOR: The second question that the Panel has - and you have addressed it somewhat in the answer here - is you will be returning to the Board and you will be filing a new budget with the Minister in 2012 for 2012 fees.

Why is it not appropriate to consider the monies retained in the context of the overall cost structure as it relates to that overall filing?

MS. NICHOLSON: It is correct we do come back every year with an annual rate submission, both to yourself and to the Minister. But the planning period is over three years, and we thought it was financially prudent to use the money over the planning period as opposed to having rate stable in 2011 and see dramatic rate increases in the future years.

Without the use of the surplus, we are looking at a 12 percent increase by 2013 to our rates, but by using the 8.1 million that was the accumulated surplus for 2010, as in the business plan, we're actually able to maintain our rates at an increase of only 2 percent in 2011 and -- or, sorry, 2012 and 2013, and to keep the rate flat in 2011 from the 2010 fee.

MS. HARE: Just one question. If in 2012 when you come forward you see a significant increase, wouldn't another solution be to decrease your budget for 2012?

MS. NICHOLSON: Yes. We've looked through our budget. We think we are very financially prudent in our budgeting. With the annual submission in front of the Board, the IESO has a history of not spending out what its budget is. If we don't spend the money, the money gets rebated to market participants. If there were any changes in our 2012 application, we would be back again next year to present those changes to the Board, either in the form of a rebate or other deficit.

MS. HARE: Thank you.

MS. TAYLOR: The Panel has no further questions.

So at this point, I think we would like to hear submissions from parties regarding issue 3.3, beginning with the IESO.

The Panel has received a written version of the IESO's submission dated April 21 of 2011, pages 6 through 10, and I am assuming, Mr. Zacher, you would like to walk us through that submission?

MR. ZACHER: If I might, thank you.

MS. TAYLOR: Proceed.

CLOSING ARGUMENT BY MR. ZACHER:

MR. ZACHER: So if I might structure my submissions to, first off, just address and be clear exactly what the IESO is seeking.

Second, Panel Members, I would like to just put in historical context exactly what's being sought here, and, third, address why, in my submission, the proposal before you is a reasonable and appropriate one.

So as Ms. Nicholson indicated, what the IESO is seeking to do is to retain a portion of its operating surplus from 2010, coupled with $5 million remaining as its accumulated surplus from the previous year, and to apply that, if necessary, over the three-year planning horizon.

So it is a total of $13.1 million which the IESO is seeking to retain, 8.1 million from 2010, $5 million which was the accumulated surplus from the previous year.

And the one clarification or the one change that was made to the IESO's submission - again, I just want to be clear about this - is that initially when the IESO filed its business plan in its application in the fall, it was projecting a 2010 operating surplus of $8.1 million, and so it was seeking to hang on to that entire amount as a surplus to apply for rate stabilization purposes.

Since that time, the IESO has projected a larger surplus, and so the IESO amended its notice of application. That was filed I believe in February, before the technical conference, and what that makes clear is that notwithstanding that the 2010 surplus is higher, the IESO is still only seeking to retain $8.1 million of that.

So the balance, $10.2 million, the IESO is proposing to rebate to market participants based on last year's consumption.

So subject to your approval, the IESO would be proposing to do that immediately.

MS. TAYLOR: So just to be clear with the numbers, then, Mr. Zacher, so the surplus for this year is $18.3. Add that to the additional surplus from last year of five, which gives me 23.3, deduct 10.2, leaves a net retained surplus for 2010 or 2011 of 13.1; is that correct?

MR. ZACHER: That's correct. That's correct.

MS. TAYLOR: Okay.

MR. ZACHER: So that is what the IESO is proposing to do, and the reasons, which I will touch on in a little bit more detail, are to counteract what the IESO forecasts are increased costs over the planning period, and, as well, a reduction in demand, which has the effect of reducing usage fee revenue.

To just put this in historical context, because I want to be clear that what the IESO is proposing to do this year is not different than what it has proposed to do in the past; rather, what the IESO is asking is simply to retain a slightly higher portion of the surplus than it has in the past.

Initially, the IESO filed an initial rate application in 2000 following the deregulation. At that time, it was recognized that the IESO was a slightly different animal than other utilities. It does not have a rate -- rather, a shareholder to absorb deficits or surpluses.

But on the other hand, there invariably will be forecasts -- or, rather, variances from forecast that will be reflected as deficits or surpluses.

And so the Board approved in that inaugural fees case the establishment of a deferral account to record those amounts, and the intention was that the IESO would come forward at each of its annual fees cases, explain the reason for the deficit or the surplus, and then propose how that account, deferral account, was to be disposed of through rates or what have you.

So what -- at the same time as the IESO has filed its annual fees cases, it's espoused as a very important objective of its business that it maintain fee stability for its customers.

And so what the IESO has proposed in appropriate cases where there have been surpluses is that those surpluses be applied in a way to maintain fee stability, or in some cases to reduce, incrementally reduce the usage fee.

So in the written submissions that we filed this past week, I gave at least a couple of examples. If you look at paragraph 17, there is referenced the IESO's 2002 fee submission, where the Board approved the use of an $8.8 million surplus, including $1.2 million carried over from the previous year to apply against the 2002 revenue requirement.

In the 2004 proceeding, the Board approved similar treatment. And there, what I would suggest is important to note is that the Board approved the use of the surplus to offset the revenue requirement over not just the ensuing year, but over the planning period. Okay? So not just -- even though the IESO, of course, comes before this Board every year to have its revenue requirement approved and to have its fee approved, it does use a three-year planning horizon.

Since 2005, what the IESO has adopted almost every year is that -- and this was subject to agreement amongst intervenors in that case, again, approved by the Board -- was that the IESO would hold on to $5 million of any surplus, and any amount in addition to that would be rebated to market participants.

That has been the treatment since 2005. But on no occasion since then has the IESO faced a fee increase.

In fact, what the IESO has -- is proud to have achieved over the past six or eight years is that in every year the IESO's fee has been flat, or declined, or increased by a very, very marginal amount.

So the objective of maintaining fee stability for its customers has been something the IESO's been able to achieve through prudent management of its business, including the way in which the IESO has proposed that any surplus be treated, and that the Board has approved.

And the difference this year is that the IESO is forecasting or is projecting a relatively significant increase in costs and reduction in demand, due largely to Green Energy impact initiatives, and as well, in part, due to the -- still the effects of the 2008 recession.

So the IESO is forecasting a reduction, a reduction in demand. It's forecasting an increase in conservation and embedded generation, which has a downward effect on revenues. And it is also forecasting a relatively significant increase in costs over the planning period, largely in order to increase staffing and other resources in order to implement Green Energy Act work.

If I might just -- if you have the IESO's application record in front of you, if I could just -- there is one exhibit that helps to illustrate this.

If you turn to -- it is Exhibit B, tab 3, schedule 1, which is the methodology for calculating the usage fee.

If you turn over to page 2 of 3, you will see a couple of tables. In the top table, which is identified as "Revenue requirement calculation for IESO usage fee," you will see there that from 2011 through 2013, that there is a relatively significant increase in costs; so from 128.3 million to 139.5 million.

And then if you go to the second table below, you will see a chart which references market demand over the planning period. In the far-right column, you will see that there is a reduction in market demand of -- from 153.3 terawatt-hours to 145.6 terawatt-hours.

So it is the revenue requirement divided by the market demand that gives you the usage fee, and if you turn over on to the next page, you will see how the usage fee is calculated.

So what the IESO calculates is that the usage fee in 2011 will stay at 0.822 cents, and that even applying the surplus in the manner recommended, the fee will still increase by two percent in each year, to 0.838 in 2012 and to 0.855 in 2013.

And the impact of not applying the surplus in that manner would be a 12 percent increase over that period.

So the reason, Madam Chair and Ms. Hare, that the IESO is recommending this is that, first off, it believes it is incumbent on it in the circumstances to come forward with this sort of plan.

The IESO has over the past 10 years had a fee that has declined or remained relatively flat. It has declined 14 percent since 2002 or 2003, and what the IESO is forecasting is an increase of 12 percent over a couple of years.

And that, coupled with the increase in electricity costs generally, is in the IESO's view cause to come forward and to propose some sort of plan that mitigates or softens the impact of that rate increase.

The other important point is that this is not something that is set in stone. So while the IESO is proposing that the surplus be retained so that it can be used to offset any rate increases in subsequent years, the IESO does have to come back before this Board next year. And if circumstances were to change, so if at that point in time, there was a revised forecast and the IESO projected that costs would not be increasing as substantially, or that demand would not be dropping as much, there is the opportunity to adjust and true up for that in the next -- in next year's fees case.

The danger is that if the money is all rebated now, then it is gone. And so if the IESO's projections do come to fruition and there is this increase, forecast increase in costs, there is this forecast reduction in demand, that money will not be there in order to soften that impact.

And then the option is to phase in the rate increase.

Lastly, I want to just address the issue of any concerns about intergenerational inequity, which are always something that has to be considered whenever any kind of rate deferral plan is being proposed.

And really, the potential impacts in this case are marginal. The rate deferral plan is not a plan that is being proposed over five, six or seven years. It is over a very short period of time. So three years at most, with the opportunity, as I said, to make adjustments annually, and there is very little turnover in the IESO's effective rate base.

So the market participants that pay for -- pay the IESO's fees, it is just the load side. And the evidence in the technical conference is that there is very marginal turnover in those loads.

So those sorts of concerns that might prevail in other cases are not, I submit, as significant in this case.

So, in short, my submission is the IESO is proposing to do something which strikes a very, very reasonable balance. It rebates to market participants now a little over $10 million of the surplus, but it proposes to prudently hang on to the balance of the surplus in order to mitigate the impacts of rate increases which are forecast over the planning period.

Subject to any questions you may have, those are my submissions.

MS. HARE: I do have a question. You have provided transcript references where -- sorry, technical conference transcript references where some of this was discussed.

But I didn't see, in the technical conference materials - but maybe you could take me to that - where the costs for 2012 and the decreased load was examined for 2012 and 2013.

MR. ZACHER: Ms. Hare, it might be easier to look at the actual business plan.

So if I could ask you to turn up the IESO's business plan, which is marked as Exhibit B, tab 1, schedule 1, and to go to page 9 of that, which is marked as the financial outlook, there is the IESO's evidence with regards to the forecast increase in costs over the planning period.

On the subsequent pages, some of those costs are broken out with regards to OM&A program costs, staffing, pension expense, but the -- in the table at the top, under -- three-quarters of the way down the table, there is the line "Total Costs", and you will see that projected at $119.4 million for 2010, which I think the actuals are -- the actuals are a little less than that. Then the projected increases over the planning period are identified.

MS. HARE: I did see that in your evidence. What I was really wondering was: Was there very much testing of that evidence at the technical conference, or was it accepted as filed?

MS. SEBALJ: I think if it assists, I have in my technical conference transcript -- I am not sure, Mr. Zacher, if you will agree with me, but around pages 79 and 80, there was a discussion about your table at that same exhibit, page 14, which is appendix 1, IESO usage fee financial statements.

I did ask some questions of Ms. Nicholson about what happens over the planning period. There were some answers, starting at about line 19 of page 80, about eating through the surplus until you end up at a deficit of -- I think it was $700,000. So it is page 80, and then the top of page 81.

I don't know if that is what you are looking for.

MS. HARE: Yes, it is, Ms. Sebalj. Thank you.

MR. ZACHER: Also at roughly page 22 to 40 in the technical conference transcript, there are questions about staff compensation, staff increases, about the amortization expense.

MS. TAYLOR: The question that I would have following the discussion in the transcript and the financial outlook - and you can point me to this - the largest expense growth on page 9 of your financial outlook is depreciation, which goes from 14.3 million in 2011 to 18.7.

Your total revenue line increases modestly in '12 versus 2011, and basically flat 2013 versus '12. The other cost lines are, you know, largely flat, with a very slight -- so the largest growth in your expense is, per this table, depreciation, which is non-cash.

So based on this, one would expect to see an increase in your overall net cash position, and I didn't see a cash flow statement for those years, as well, which would govern the growth of the cash balance, unless there is one and I just missed it.

MR. ZACHER: Ms. Taylor, at page 25 of the business plan is an actual pro forma statement of cash flows.

MS. TAYLOR: So your cash from operations increases from 5 million in the 2011 budget to 34.1 million by the end of 2013.

It is partially offset by increases in investing activities, and you are in fact, by 2013, retiring a substantial portion of your outstanding debt, 13.8 million.

So how does that tie back into, then, the requirement to have a higher cash balance on hand to offset -- so this speaks to an improved liquidity position over the forecast period as opposed to a notional decline in, arguably speaking, net income, which again is being driven by non-cash expenses.

So if you could just reconcile the two for me, please?

MR. ZACHER: Ms. Nicholson will address this.

MS. NICHOLSON: The financial planning of the IESO is not done on a cash basis with the accumulated surplus kept in cash.

Our position is that we maintain the least amount of debt as possible and, therefore, that reduces the amount of interest expense that goes through our books.

So as you can see from that cash flow statement, we actually plan to hold no more than $2 million of cash at any given time, and the offset is always in terms of retirement of debt.

MS. TAYLOR: Thank you. Do you have any additional questions?

MS. HARE: No.

MS. TAYLOR: I understand that there is an order and that we will hear from Mr. DeRose, then Mr. Buonaguro, and we will follow up with Staff, Ms. Sebalj.

CLOSING ARGUMENT BY MR. DEROSE:

MR. DeROSE: Thank you, Madam Chair, Ms. Hare.

First of all, let me thank the IESO for their written submissions on Thursday. I know that they weren't required by the procedural order, but I think setting out the facts on this issue has been helpful I hope to the Board. It certainly was helpful to us, because, from our perspective, this issue is really not one that is fact driven. It is an issue of principle to be decided by this Board.

I would -- I have tried to simplify the issue in my own mind, and this is what I have - what I would present to you. The issue to be decided by the Board is: When should the operating surplus from years prior to 2011 be credited to market participants?

The IESO's position is that it should be entitled to retain 13.1 million to mitigate rates, if necessary, in future years beyond 2011.

Keep in mind that 2011 is the only year that you are deciding -- that is the only year that is subject to this application. And so as Mr. Zacher pointed out this morning, it will be applied in 2012 and 2013, if necessary. It may not be applied for 2012, 2013.

CME's position - which is contrary to the IESO - is that the entire operating surplus should be cleared to market participants, either in 2011 or alternatively in the same manner as the Board has done in other utilities, where you actually pick a time period. It is like the clearing of a deferral account, where you will set out over a one-year or a two-year period that it will be cleared, if you feel that it should go beyond 2011.

Now, I have divided my submissions into two sections. First of all, I just want to provide some context on a couple of discrete points. It won't take long.

Then secondly, I would propose four principles that I would urge you to consider when making your determination of this issue.

So turning to the context, as, Madam Chair, you pointed out this morning, just to get the numbers straight -- because I think it is important, when we look at -- the operating surplus from 2010 was 18.3 million. The accumulated surplus is 23.3 million, because 5 million is retained from prior to 2010. So you actually have -- part of the accumulated surplus is already going back over 24 months. We are going back to 2009.

When we -- I recognize that in the world of electricity rates, 18.3 million and 23.3 million might not seem like that much. If we were in an OPG case or a Hydro One case, those are on the smaller side of many of the numbers.

But I think you need to keep in mind that the 2011 revenue requirement that the IESO has –- well, that all of the parties have asked that you approve through the settlement agreement is 126 million. So the accumulated surplus of 23.3 million represents 18 and a half percent of their total revenue requirement.

The IESO's proposal to retain 13.1 million represents over 10 percent of their entire revenue requirement; on my math it is 10.4 percent.

And so when we relate it to their revenue requirement for 2011, this is, by percentage, a very large portion of funds to be retained.

Now, in determining how to clear the surplus, there are a couple of additional facts I would like to just reiterate to you.

First of all, the 13.1 million will not be used to mitigate fees in 2011. For a reference to that, it is technical conference, page 96.

So the decision on this operating surplus, I submit to you, has no impact on the 2011 fees which you are being asked to approve in this case.

Rather, the proposal is to use the 13.1 million, if necessary, to mitigate fee increases in 2012 and 2013. Those two years are not subject to this fees application. They're included in the financial outlook, they provide context, but you are not approving any fees for those two years.

So when, Ms. Hare, you asked whether the 2012 and 2013 years were scrutinized in the technical conference, I submit they weren't, and it is because they aren't subject to this application.

The evidence -- with the exception of the business plan -- the evidence is focussed on 2011, because those are the issues set out in the issues list. Because you are being asked to approve fees for 2011; you are not being asked to approve fees for 2012 or 2013.

Now, in terms of the assessment of 2012 and 2013, there were some additional questions, and they were more, I think -- they were not scrutinizing 2012 and 2013 in the context that, Ms. Hare, you were asking, but one of the issues that we did ask about was whether any analysis has been undertaken to assess whether the 6 percent increase in 2012 and 2013 that's projected, or the 12 percent by 2013, has any analysis been undertaken to determine whether that would create rate shock.

And the answer was no. For reference, that is technical conference, page 93.

And again, keep -- I think you need to keep in mind that the projected increases for 2012 and 2013, they might be higher; they might be lower than what is being projected now. And that will be subject to an application, presumably next year.

The other technical conference -- the last piece of evidence from the technical conference I just want to bring your attention to, and it was at page 93. Again, I don't think you need to turn it up, but it was consistent with what was presented to you this morning by the IESO, and it was confirmation that the IESO's strategy has been to try and make sure that its costs escalate at rate of inflation.

This is consistent with the submissions of my friend from the IESO, that has pointed out that over the past decade, rates have generally been stable or minor declines.

Now, as you will both be aware, CME, I think, has consistently applauded those market participants or utilities whose goal is to ensure that its costs escalate at the rate of inflation. If everyone's rates increased at the rate of inflation because of cost controls, that would be, I think, a positive outcome, particularly in the current environment.

But our submission is that it should not be achieved by retaining operating surpluses from prior years, because that is not achieving it through cost control. That is being achieved by asking market participants to pay more in prior years than it actually cost to serve them, and rather than crediting it, using it in the future to mitigate rates.

So we would submit that when you look over the past decade at the IESO's fees, and the fact that they've declined or remained flat, it leads to the question: Why?

And in part, I think it is because of their effective management and their cost containment. But in part, it is also because they have used an operating surplus. They have used and maintained. They have charged more in prior years and kept the operating surplus to help in later years.

So let me turn to the question that set out the principles that I would submit, and just to reiterate the issue as we see it.

Should the IESO be entitled to retain 13.1 million, which represents over ten percent of its 2011 revenue requirement, which was collected in 2010 and 2009 for the purpose of reducing rates, if necessary, in future years, beyond 2011?

CME submits that when you look at the four principles, the answer is no.

Principle number one, operating surpluses, in particular, but even more generally, deferral accounts where credits are owing to ratepayers should be reimbursed sooner rather than later.

In our submission, when over-collection occurs, the credit should be applied against the revenue requirement or reimbursed in a form of a rider in the next rate year. That is principle number one.

Principle number two, the Board should not approve the creation of what I refer to as a rainy-day fund. Surpluses should not be retained to be used, if necessary, to mitigate fees in future years that are not subject to the application, if and when necessary.

This is, in effect, asking to -- in our submission, if approved -- the IESO will be entitled to keep this 13.1 million as a cushion, and if and when in the future rates start to increase, they can fall back on that cushion to reduce the fees.

And it is, in our submission, not proper to simply allow this to go into the future to be dealt with in future applications, if and when necessary.

And I think we also need to separate this. I am aware that both of you would be familiar with deferral account clearances in traditional utilities, and there are times that the Board has found that it is appropriate to clear a deferral account over a period outside of the application year that they're dealing with. It might be 12 months, 16 months, 24 months.

And at times, the Board has found that an extended period of time to clear a deferral account is appropriate because it does, in fact, mitigate costs. But the point is the Board starts the clearance process in the very year that it is dealing with it.

So to apply that to this context, you would order that the amount be cleared -- rather than over 2011 and over a 12-month period, you would order that it be cleared over, for instance, a 24-month period or whatever you feel is an appropriate amount of time.

That is very different than this situation that we are facing where the IESO -- the IESO is not even telling you that it shall apply it in 2012 and 2013. It is saying, We want to retain it to have the option to apply it, if we feel it is necessary, in 2012 and 2013.

So that is a very different situation than what we have seen in other cases.

Principle number 3 is that the Board should avoid intergenerational inequity. And I take Mr. Zacher's submissions this morning that the IESO is -- when it comes to intergenerational subsidies or inequities, it is a different beast than your traditional utility that would have ratepayers coming and going.

That said, even though it may be minimal, I think you need to take into consideration that the gap in the number of years is getting larger. The accumulated surplus that is going to be retained, if you approve what they're asking for, starts in 2009, and it might be applied in 2012 or 2013.

So if it were to be applied -- and let's just assume it is applied in 2013. Some of that was collected in 2009. You have a four-year gap. And, in our submission, the larger the gap, the greater the chances of intergenerational subsidies, even in a pool of market participants that the IESO deals with.

Finally, we submit that the Board should continue to promote transparency of actual costs. Now, the IESO's strategy is to ensure that its costs escalate at the rate of inflation. And if you just look at the way that it's being phrased to you today, its fees have remained stable or declined over the past decade.

I have no doubt that if the operating surplus -- if you allow the operating surplus to be retained, and if 2012 and 2013 do unfold exactly as it is set out in the financial outlook and so the fees increase by, let's say, 2 percent a year, the perception of most market participants, specifically, and ratepayers more broadly in Ontario, will be that the IESO's fees have only increased by 2 percent per year.

There will not be the appreciation that it increased by 2 percent per year, because amounts that were overpaid in 2009 and 2010 were retained to mitigate those fees and ensure that they stay at 2 percent.

Now, I suspect the question may come up that: Is 2 percent preferable to a 6 percent increase in 2012 and 2013? Isn't a 12 percent increase unwanted? Two percent would be preferred, absolutely. Two percent is -- a 2 percent increase is better than 6 percent.

But, in our submission, it is important that there be transparency of what the actual costs are. And the inclusion of the operating surplus does have the risk of masking what the IESO's actual cost increases are.

And if the IESO's rates increase by 6 percent or more in 2012 or 2013, we submit that they would have to justify those increases in a future application. And if the increases are of such significance that they create rate shock, it would be at that time that the Board and the IESO would have to address whether they require a mitigation strategy or not.

The time to assess rate shock and mitigation strategies, if required, are when the actual costs are known and the Board is approving the fees. This is the way it's been done in other utilities. And by example Hydro One Distribution, when they were moving down from just over 90 rate classes to a limited set of rate classes, some of those rate classes were facing rate increases of 25, 30, 40, 50 percent. I believe there was one over 100.

And it was at that time that rate shock was assessed and there was a time period, a phase-in, that allowed for a mitigation strategy. That is always available to the IESO, but that can be done with all of the information before the Board in a well-thought-out and transparent manner, because it would be done through the use of deferral accounts, which would include interest -- and there is a cost of that, and the cost is borne by the ratepayers or by the market participants ultimately over time.

So in conclusion, it is our submission that the Board should not maintain the illusion of costs increasing at the rate of inflation by allowing the use of prior year surpluses to be used to mitigate the actual costs in future years, if necessary.

Subject to any questions, those are our submissions on this issue.

MS. TAYLOR: Mr. DeRose, I do have one question.

The Board's mandate with respect to the IESO fee is more of a review function, and, in fact, the budget is in fact submitted and potentially approved by the Minister prior to the receipt by the Board, and then the process that we're now going through.

How does that get reflected in what you have said, because most -- a large portion of what you said seems to track a conventional utility model where the Board, in fact, will review the costs.

Does any of your -- or would any of your principles change, if you backed up a second and said the Board's function here is to review something that has already notionally at least been approved?

MR. DeROSE: I don't think it would, and it is for this reason. The fees that you are being asked to approve, which the Ministry has already approved, will not change regardless of what your decision is on the operating surplus.

The issue of the operating surplus will have an effect on future years that have not yet been approved by the Ministry. The operating surplus will have absolutely -- your decision on this issue will have no issue on the 2011 fees. The IESO has made that crystal clear at the technical conference and in their testimony today.

It will only have an impact on 2012 and 2013, if necessary, and those years have not yet been approved by the Ministry, and, quite frankly, you aren't approving those years today.

So this issue is really -- I submit is something that is fully within your mandate and will not have any negative impact on the IESO's ability to operate in 2011.

MS. HARE: Just so I understand, if, in fact, this Board decides to return all of the surplus, what you're saying is the fee for 2011 remains as filed for and as agreed to, and that the surplus would be returned by way of a rider or some other mechanism, but -- so what the market pays is actually lower, but the fee is still the same? Is that what you're saying?

MR. DeROSE: Correct.

MS. HARE: Thank you.

MR. DeROSE: Just on that point, the IESO already has a mechanism in place to return the 10.2 million, I believe, all of the amount above the 13.1.

So the 10.2, the mechanism is already there. It is just a question of how much it should be.

MS. HARE: Thank you.

MS. TAYLOR: The Panel has no other questions.

So Mr. Buonaguro?

CLOSING ARGUMENT BY MR. BUONAGURO:

MR. BUONAGURO: Thank you. I generally agree with the concerns raised by Mr. DeRose in terms of the appropriateness of the proposal by the IESO.

I think where we may differ slightly is in the concept of any kind of appropriateness for a rate stability mechanism, like retaining excess revenue and going forward to provide some rate stability.

I can tell you that -- my understanding of Mr. DeRose's arguments on behalf of CME is that the entire amount of the excess revenue should be returned, either on a schedule or immediately as a rebate, whereas as a participant in the previous years' settlements, VECC has endorsed, as part of an overall settlement agreement, the idea of an amount of retention by the IESO in the order of $5 million, in order to allow them to provide some rate stability going forward.

The issue, I think, in this case, from our perspective is: Is that what is going on here, in this proposal? Or is something different happening?

I think I would suggest that something different is happening. To illustrate the point, I would take you to the 2008 business plan, which actually sets out in one paragraph sort of the justification for the retention of the funds going forward at that time, which is one of the settlement agreements that we agreed to, the proposal in that case.

So this is from the IESO 2008 fees business plan, 2008 to 2010, dated September 27th, 2007, and it is from page 10 of the business plan. I am just going to read the one paragraph, which in a nutshell, explains why at that time this particular fund was being proposed.

> "It is important to note that forecasts, by their nature, rarely reflect actual results. Certain factors that contribute to the IESO's forecasted revenues and costs are beyond management's control. For example, fluctuations in long-term interest rates and equity market returns can either positively or negatively impact IESO revenues and costs. Similarly, deviations in actual energy demand from forecasted energy demand has a direct impact on IESO revenues. To better manage these fluctuations, the IESO maintains a surplus account of up to $5 million, refunding any excess to ratepayers in the form of a market rebate. The surplus account allows the

IESO to provide customers with a higher degree of rate stability".

Now, our understanding of that paragraph as justification for this type of fund and the use of that fund in future years is as a tool to react in a modest way to these fluctuations that are beyond the IESO's control. And the quote referred to long-term interest rate changes, equity market changes, and deviations in actual energy demand from forecasted energy demand.

I think what is happening here, though, in terms of increasing the request beyond a $5 million amount to almost triple that amount, has to do with their actual forecast demand going forward and their actual forecast cost increases going forward, which is very different, I think, than accounting for what you might almost call Z-factor-type changes in the future, and the ability to react to maintain rate stability in the face of those types of changes in the future.

If rates are actually -- sorry, if costs are forecast to go up in the future and demand is forecast to go down in the future, that should to some extent be reflected in rates, which I think is the thrust of at least part of Mr. DeRose's argument.

We are not talking about blips in rates or -- in interest rates, or blips in differences between actual demands versus the forecast demand that the rates are based on; we're talking about an actual forecast of increased costs over the next three years, culminating in a

12 percent increase over -- by 2013.

That is different, I would suggest, than the type of mitigation or rate stability that was contemplated by some of the parties, and certainly VECC, when the original $5 million amount -- based on their relative revenue requirement -- was agreed to over and over again in the settlement agreements.

So I would put that to the Board as a consideration, in terms of whether or not something like the $5 million amount, which has historical backing with respect to the IESO, should be retained, versus the new proposal - I would call it - which seeks to actually take forecast significant material increases in the revenue requirement versus demand -- versus the revenues going forward as being something -- being a different animal in this case.

The last thing I would point out - and I think it was implicit in what Mr. DeRose was saying, and following along with the IESO's logic - if allowed to do the mitigation in precisely the way they're asking, assuming everything progresses in the future as they're suggesting it would progress, you are looking at a perceived 2 percent increase per year for 2012 and 2013.

But then that begs the question of what happens in 2014, when actual costs and actual demand, if their forecasts are correct, have -- would have resulted in a 12 percent increase over those two years, which hasn't actually been realized. Assuming that trend continues into 2014, what you are looking at, I would expect, is a massive jump in rates in excess of 12 percent relative to what has actually been experienced by consumers, or experienced by market participants, over the interim.

So it may have an effect of mitigating the increases over the next two years, but then it could have a very unintended effect in 2014.

I would suggest those as considerations the Board might have in terms of evaluating the relief.

I think in the end it is a judgment call. I think everybody agrees the money is there, and it is going to go to market participants either in a rebate or over a number of years, or paid out at the discretion of the Board depending on what happens in the next two years or so.

But I think it would be nice to do so on a principled basis, and for that reason, we tend to support maintaining some kind of fund in the order of the $5 million, to allow for a reaction to these real fluctuations or what I would almost call Z-factor-type changes over the years, but shy away from allowing this sort of contingency fund to exist to offset actual planned forecast increases in the future.

Subject to any questions, those are our submissions. Thank you.

MS. TAYLOR: Thank you. We have no questions.

Ms. Sebalj?

CLOSING ARGUMENT BY MS. SEBALJ:

MS. SEBALJ: Thank you. Our submissions don't completely echo what Mr. DeRose has said, but they're in that general direction, as well.

Board Staff went through the transcript from the technical conference to pull out the reasons that were cited by the IESO for retaining the surplus, both the accumulated surplus, the 5 million, and the additional surplus, the 8.1 that they're asking to retain.

And the three reasons that I was able to pull out were just to assist in rate stabilization, to address the higher-than-normal risk that energy volumes will be lower than assumed, and to apply it to contingencies and future revenue requirements over the three-year planning period.

And really, I think all of those, except perhaps the contingencies and future revenue requirements, amount to rate stabilization. And so this goes to the point that I think both of my colleagues have made with respect to rate stabilization, and whether it is and when is it appropriate.

Board Staff agrees that it is a matter of principle, but of course, Mr. Zacher has pointed you to the fact that as a matter of principle, this Board has allowed the retention of at least $5 million in surplus on previous occasions.

I will talk about that in a little bit more detail.

So Board Staff has three general points related to rate stabilization. Who should bear the risk of the types of events that the IESO is forecasting, and then of course this concept of we are in a 2011 fees case and really this surplus is being projected to be used over a period that this fees case does not -- has not examined.

In general, this Board, in Board Staff's submission, supports the concept of rate smoothing and rate mitigation. I think everyone in this room has seen several examples of this in the context of utility rate-setting, and we certainly have a statement -- this Board has a statement about it in its Electricity Distributor Deferral and Variance Account Review report, which is commonly known as the EDDVAR report.

Board Staff is of the view, however, that it is not appropriate to stabilize rates unless there is a compelling reason to do so.

In general, in electricity rate-setting contexts for utilities, the concept of mitigation is usually only allowed when the impact of rate changes approach or are greater than about 10 percent on the total bill.

And as the parties have pointed out, there hasn't been a thorough examination of whether the increases that the IESO is projecting for 2012 and 2013 would constitute rate shock or somewhere in the range of 10 percent on the total bill.

I think intuitively, because we all know that the IESO's fees are part of the wholesale market service charge and that the wholesale market service charge is a percentage of the total bill - and probably in the range of 12 percent - that it is unlikely that a 12 percent increase over a two-year period would cause rate shock or require rate mitigation in the traditional sense that the Board uses that tool.

In the absence of rate shock, the principle of true cost pricing or rate transparency that Mr. DeRose referred to should, in Board Staff's view, prevail. In other words, fee increases is not inherently bad to the extent that it reflects increased costs.

Board Staff takes this view as it considers that part of the Board's objective to protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service requires that the Board set just and reasonable rates, which, in turn, requires the Board, to the extent possible, and without creating rate shock, to set rates that reflect the costs to provide the service.

In this case, the IESO can do this, in Board Staff's submission, without having to rate mitigate. So, in Board Staff's view, it should do so.

The biggest mitigating factor for Board Staff, of course, is that the IESO is a not-for-profit, and so it doesn't have a shareholder from whom to borrow funds when operating deficiencies occur.

As Mr. Zacher has indicated, the Board has approved the retention of surpluses, and even though these have largely been approved by the Board in the context of settlement proposals, the general gist of those, in Board Staff's opinion, was to deal with contingencies.

The evidence in this case, from a rate mitigation perspective, however, is that the IESO could simply seek to recover the deficiencies in the funds required in the next fee's case.

Our second point is this concept of the risk of lower demand and increased costs in future years. Board Staff is of the view that while the IESO is clearly best positioned to forecast these risks, the question becomes whether and to what extent market participants should be funding a contingency account which may or may not be needed, or whether those consumers should get the benefit of these funds now and be asked on ex post basis to fund past revenue shortfalls by way of a subsequent fee increase.

Said in another way: To what extent should market participants be bearing the risk premium on an upfront basis by funding a contingency account that may or may not be needed in future years, depending on whether the risks identified by the IESO materialize?

In approving settlement proposals where the parties agree that the IESO would retain $5 million of any realized surplus revenues, the Board has accepted on multiple occasions the proposition that it is appropriate for the IESO to retain a $5 million surplus to fund these contingencies.

Mr. Buonaguro has aptly pointed you to the fact that, at least in Board Staff's perception, the types of contingencies we thought that this 5 million was meant to address were a, quote/unquote, "different animal"; not forward-looking rate stability, but, rather, contingencies of the sort that frankly the IESO has used it for. One example is the $4.3 million that is in evidence that was used when there was a loss as a result of the losses on asset-backed commercial paper.

Board Staff is of the view that it is appropriate to continue this practice, meaning the approximately $5 million surplus, as it achieves a balance between providing the IESO with the funds it needs to address contingencies that may arise, against the need for market participants to have some indication of the actual costs that are associated with the operations of the IESO.

Our third and final point is concerned -- Board Staff is concerned with the concept that the Board would allow the IESO to retain monies accumulated in 2010 for the period for which this fees case covers, which of course is 2011, even though the IESO has no intention - and Mr. DeRose has pointed you to the transcript reference - to use the surplus in 2011. In other words, the fee remains stable in 2011, without having to use any of the 13.1 million that the IESO proposes to retain.

Board Staff is of the view that this Board Panel is constituted to review the 2011 fees case, and that it is not appropriate or necessary for you to authorize the retention of funds in 2011 to cover risks of increased costs or lower demand in subsequent years.

I would point out just one additional point in relation to a question you asked, Member Hare, with respect to the Minister's -- or it may have been Member Taylor, I'm not sure, but with respect to the Minister's approval of the IESO's proposed fees, and that is that by my review of the evidence, and I am subject to be corrected on this, but the additional 8.1 million was something that was requested once they realized that there was a greater surplus than they had originally projected, and that request was made some time in February.

So they amended their application in February, and the Minister's approval of the plan had been some time in 2010, I believe in November 2010.

So whether or not it is relevant, I am not sure that the Minister was aware of this additional request for $8.1 million.

Subject to any questions, those are Board Staff's submissions.

MS. TAYLOR: The Panel has no questions. Mr. Zacher, would you like a few minutes to organize your thoughts for reply or...

MR. ZACHER: Sure. Thank you very much.

MS. TAYLOR: So perhaps we will reconvene at noon sharp.

--- Recess taken at 11:43 a.m.

--- On resuming at 12:02 p.m.

MS. TAYLOR: Mr. Zacher, are you ready?

MR. ZACHER: I am. Thank you. I appreciate the break.

REPLY ARGUMENT BY MR. ZACHER:

MR. ZACHER: What is clear, Madam Chair and Ms. Hare, in my friends' submissions, is that the IESO can't be viewed through the lens of an ordinary utility. It really is, in many ways, different.

And that is reflected in the past treatment that the Board has accorded to it, including with regards to the particular deferral account we're talking about.

It does, as a precondition to applying to this Board for approval of its fees case, have to have its business plan approved by the Minister, and that is a three-year business plan.

Just to correct one comment that my friend Ms. Sebalj made, the business plan in this case did make explicit reference to the projected increase in costs, decline in demand and the request that would be made of the Board in this fees case to use surplus for rate stabilization purposes over the planning period. So that was very explicit in the business plan that went to the Minister and was approved.

What is also unique is that the IESO, while it plans on a three-year planning horizon, really, anything shorter than that wouldn't be prudent. It wouldn't make sense to just plan your business out over a year, and then start over again the next year.

The IESO plans for three -- every three years, but then every year before it becomes before this Board, it updates its business plan, so it is almost like a three-year rolling business plan.

What my friends suggested to you, Mr. DeRose in particular, is that what the IESO is effectively asking for in this fees case -- which I agree is only for the purpose of setting 2011 rates -- is to effectively ask to use monies for the purposes of 2012 and 2013, which is not the subject of this fees case.

But with all due respect, that is not what the IESO is asking for.

It is a necessary -- because of the three-year horizon, the IESO necessarily looks ahead, but the IESO is not effectively asking for this Board's approval to take the money retained and to use it in 2012 and 2013. And the reason for that is because the IESO will be back before you next year.

And so if circumstances change, if next year the forecast for demand is higher and/or if the forecast for costs is lower, then the IESO will certainly be proposing different treatment for the surplus that it continues to hang on to, and intervenors will have an opportunity to make submissions on that.

What you are approving today doesn't make the use of these monies in 2012 and 2013 a foregone conclusion. And what the IESO has demonstrated each and every year that it has come before this Board, is, as Ms. Nicholson said, just because its budget is approved and it has money to spend, it spends it. It doesn't do that.

It has been extremely prudent in how it's managed the budget that's been approved by this Board.

Why we're asking in this case for the particular amount of the surplus to be approved and retained in this way is because the IESO does forecast an increase in costs and a decrease in demand, because of what are absolutely unprecedented and unique circumstances surrounding the unfolding of the Green Energy Act.

It really is a step change in Ontario, and it is a step change if you compare Ontario to any other jurisdiction in North America.

On the other hand, to respond to one of my friend -- Mr. Buonaguro's point, the IESO is not suggesting that these -- this increase in costs or this reduction in demand is a forever scenario.

To the contrary, the IESO has identified the effects of the Green Energy Act over the next three years. That is principally when a lot of this new feed-in tariff renewable generation is coming on line. And it is over that period of time that the IESO requires additional resources to deal with renewable integration.

So it is not a case where this is -- where the IESO is forecasting this to go on forever. But what the IESO is saying is if today we see out in the horizon two or three years hence that we've got a balloon in costs and a reduction in demand that is going to cause an unprecedented increase in our fee, and we have money today, why not set that money aside -- not all of it, part of it -- in order to be there for the purposes of rate mitigation?

And if the IESO is right in its forecast or if, in fact, demand goes lower and costs are even higher than forecast, at least that money will be there in order to defray costs, in order to soften the impact on customers.

But if the IESO is wrong, that money is there to be subject to disposition and approval by this Board next year.

I want to address one other point that Mr. DeRose made and I believe Ms. Sebalj made, and that has to do with transparency of costs.

In my submission, the IESO is being very transparent in its costs. It is highlighting the fact, in its business plan, that it sees -- foresees an increase in costs, and what it is simply proposing is measures that will soften the impact of those costs on customers, which I submit is an accepted ratemaking principle, accepted by this Board.

So in summary, there is no perfect treatment, but what the IESO is proposing in this case -- to reiterate what I said earlier -- is to try and strike a reasonable and appropriate balance. It is to put some money, earmark some money that is available now, to be there to guard against and mitigate rate increases in the future, albeit subject to what intervenors have to say next year and subject to approval of this Board next year, and to take the balance of the monies that are in the accumulated surplus account, $10.2 million, and to refund that amount immediately.

Subject to any further questions you may have, those are my submissions.

MS. TAYLOR: The Panel has no questions.

So based on the submissions, we would like to issue an oral decision this afternoon. We are proposing to break for an hour and a half, so I believe that would bring us back at quarter to 2:00, at which time we will give you our decision as it relates to issue 3.3.

MR. ZACHER: Thank you very much.

MS. TAYLOR: Thank you.

--- Luncheon recess taken at 12:12 p.m.

--- On resuming at 2:00 p.m.

MS. TAYLOR: Please be seated.

DECISION:

MS. TAYLOR: The Board has been asked to approve a proposal by the IESO to retain 13.1 million in operating surpluses from years prior to 2011 to stabilize potential future increases in IESO fees in 2012 and 2013. Although this is a new concept from the point of view of the use of the operating surplus, rate stabilization is an acceptable and known regulatory tool.

However, rate stabilization is normally done once the rate impact is known and after analysis and testing of costs has occurred. It is also normally done when the anticipated rate increase is likely to trigger a threshold pursuant to which mitigation or smoothing is required.

Were the Board to accept this proposal as filed by the IESO, it would be doing so without benefit of evidence that costs in 2012 and 2013 will increase, that demand will decline in a manner put forth by the IESO, and that the IESO will not be able to manage its affairs to mitigate anticipated increases in costs.

The IESO is thus asking the Board to approve a rate mitigation plan with limited and untested evidence that one will be required or that other options are unavailable to address the increase in fees.

The Board also notes that although the IESO did file its three-year business plan for the years 2011 to 2013, the sole purpose of this proceeding is to approve the proposed revenue requirement and the proposed fees for 2011.

All parties agreed that the 2011 fees are not affected by the magnitude of the amount rebated to market participants.

The Board agrees with the submissions of parties and of Board Staff that transparency of the true costs is an important principle, and that using a portion of the operating surplus from previous years to reduce future fees has the effect of masking the true cost pressures faced by the IESO.

Doing so would also potentially create intergenerational inequity, the avoidance of which is also an important regulatory principle.

Even if the effect were small, as suggested by the IESO, it remains an important regulatory principle.

If the IESO was like any other distributor, the Board would order the return of the entire surplus. However, the Board acknowledges that the IESO is not like a distributor and that the retention of some of the surplus is appropriate to enable the IESO to respond to revenue and cost variances from forecasts, uncertainties that are unforeseeable and beyond the control of IESO management, such as ABCP and debt costs.

Since 2005, the IESO has retained a surplus for this purpose of 5 million. The Board is of the view that surpluses should be used -- or, rather, should not be used primarily to mitigate future increases in fees that may or may not occur.

Accordingly, the Board finds that it is appropriate for the IESO to maintain a surplus of 5 million, which is consistent with practice since 2005, and return 18.3 million to market participants via the existing mechanism that would otherwise have been used to refund the proposed 10.2 million to market participants.

Are there any questions?

MR. ZACHER: Other than I just -- the proposal would be to rebate the money, the $18.1 million, in the next billing period, which I understand practically speaking would be the May settlement statement. So even though we're in April, to do it in the next few days might logistically -- would be too difficult.

MS. TAYLOR: Are you suggesting that is a May or June?

MR. ZACHER: May.

MS. TAYLOR: May? That's fine.

MS. HARE: Can I understand? Can you do it in May logistically or does that create a problem?

MR. ZACHER: It can be done in May, for the May settlement statement.

I don't have my -- the application right in front of me, but I believe we propose to do the rebate in the next billing period.

So I just want to be clear that that wouldn't be April, because it can't be done in the next couple of days. So May is doable. Thank you.

MS. TAYLOR: If there are no further questions, this proceeding is adjourned. Thank you.

--- Whereupon the hearing concluded at 2:06 p.m.