



EB-2005-0499

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 2006 Fees
Submission for Review

BEFORE: Paul Sommerville
Presiding Member

Pamela Nowina
Member

Ken Quesnelle
Member

DECISION AND ORDER

1.0 BACKGROUND

Section 19 of the *Electricity Act, 1998* provides that the Independent Electricity System Operator (IESO) shall, at least 60 days before the beginning of each fiscal year, submit its proposed expenditures and revenue requirements for the fiscal year and the fees it proposes to charge during the fiscal year to the Board for review, but shall not do so until after the Minister of Energy approves or is deemed to have approved the IESO's proposed business plan for the year.

By letter dated September 30, 2005, the IESO informed the Minister of Energy of its proposed expenditure and revenue requirements for 2006 and the fees it

proposed to charge during 2006. By letter dated October 21, 2005, the Minister of Energy gave approval for the IESO to submit its proposed expenditure and revenue requirements for 2006 and the fees the IESO proposed to charge to the Ontario Energy Board for review.

On October 28, 2005, the IESO filed its proposed Fiscal 2006 Fees Submission for Review with the Ontario Energy Board in accordance with sections 18 and 19 of the *Electricity Act, 1998*. The Board assigned file number EB-2005-0499 to this matter.

The IESO sought Board approval for:

- a revenue requirement of \$147.8 million;
- capital expenditures of \$25.0 million;
- a reduction of the usage fee from the 2005 rate of \$0.959/MWh to \$0.909/MWh commencing January 1, 2006; and
- a continuation of the \$1000 application fee

The Board issued a Notice of Application dated November 11, 2005 with respect to this matter. It was published on November 15, 2005.

An intervenor list and an observer list are attached as Appendix "B" and Appendix "C" respectively, to this Decision and Order.

On December 13, 2005, the IESO filed amended evidence as described below:

- In the IESO's original October 28, 2005 submission, the proposed 2006 capital expenditure of \$25m included \$9m for Day-Ahead Market (DAM). According to the amended December 13, 2005 submission, the DAM initiative will likely be delayed until 2007 and the funds (\$9m) have been reallocated as follows:
 - Day-Ahead Commitment Process (DACP): \$6.9m
 - Other related reliability initiatives: \$2.1m
- The accumulated forecast operating surplus at the end of 2005 was increased from \$13.9m to \$16.3m. Based on this, the expected rebate to market participants in 2006 was increased from \$8.9m to \$11.3m. This represents the amount of the accumulated surplus in excess of \$5m pursuant to an agreement reached as part of the IESO's 2005 Fees Submission (EB-2004-0477).

An Issues Conference was held on December 14, 2005. At the conference, the Participants and Board Staff agreed on an issues list which was approved by the Board and is attached as Appendix "D".

Responses to the interrogatories were received on January 23, 2006 and on January 26, 2006.

A Settlement Conference was held on January 30 and 31, 2006. The following parties participated in the settlement discussions:

- The IESO
- Vulnerable Energy Consumer's Coalition ("VECC")
- Canadian Manufacturers & Exporters ("CME")
- The Society of Energy Professionals ("SEP")
- Energy Probe Research Foundation
- The Association of Power Producers of Ontario ("APPPrO")
- Ontario Power Generation Inc. ("OPG")
- Power Worker's Union

The Board Staff attended the conference but took no position on any issue. At the Settlement Conference, the parties settled all issues from the Board approved issues list. The settlement proposal was filed by the Applicant with the Board on February 1, 2006 and is included, along with a cover letter, as Appendix "D".

In its cover letter for the settlement proposal, the IESO noted that, if the Board can approve the agreed-to usage fee of \$0.909 / MWh by February 3, 2006, the IESO would be able to incorporate the reduced usage fee in its first 2006 bill to market participants. The IESO therefore requested that that the Board approve the usage fee by February 3, 2006, if possible.

The Board considered the IESO's request and concluded that it would be in the public interest to make an Interim Order regarding the usage fees by February 3, 2006, pending its final decision on the application as a whole.

The Board, therefore issued an Interim Decision and Order (EB-2005-0499), dated February 3, 2006, approving the IESO's proposed 2006 usage fee of \$0.909 / MWh on an interim basis.

2.0 THE EVIDENCE

2.1 Operating Cost

2.1.1 Compensation

Regarding the appropriateness of IESO's Operating Cost in light of responsibilities assigned to the OPA, the IESO submitted that the role of the IESO remains largely unchanged with the introduction of the OPA (see Section 2.5)

The IESO's evidence also indicates that it has a large workload related to ongoing changes to Ontario's electricity sector, e.g., substantial workload related to Request for Proposals (RFP) process, the government's coal replacement policy and IESO's role in the IPSP.

The IESO provided evidence comparing its salary structure position to the market for various employee groupings (study done by the Hay Group). The results show that for total compensation, the IESO's union represented staff are on average about 1.5% above the 75th percentile of the market. For the IESO's management staff the total compensation is on average about 6% below the 75th percentile of the market.

The IESO submitted that the expected salary escalation in the period 2006-2008 contributes to increased staff costs. Compensation increases are primarily the result of collective agreements.

Costs for contract services and consultants (approx \$7m annually from 2006-2008) are mainly due to recurring annual expenses, e.g., insurance, director and panels remuneration, audit, accounting and legal fees. These costs were higher during the start-up years, averaging \$13.9m annually from 1999 – 2002.

At the January 30-31 Settlement Conference, the parties agreed to the following:

- As part of its 2007 Fees Case filing, the IESO will provide its views on whether or not it is appropriate to set targets for the IESO's compensation levels on a quartile or some other basis.

2.1.2 Pension Costs

The IESO submitted that its pension plan is a defined benefit and as such, the expenses are actuarially estimated to provide the required benefits. They considered the possibility of a defined contribution plan in the past but decided against it because it would lead to higher pension administration costs due to the need to retain a defined benefit plan for current employees. Also, it would require negotiation with two unions.

The IESO's evidence indicates that significant increases in pension costs in 2006-2008 are due to the low long term interest rates over the last number of years and also poor equity market returns. The IESO also submitted that virtually all corporations with a pension plan are experiencing similar results.

Some intervenors expressed concerns regarding the high cost of the IESO's pension plan. At the Settlement Conference, the parties agreed to settle these concerns on the following basis:

- The IESO has agreed to report to the Human Resources and Governance Committee of the IESO's Board of Directors the following:
 - (i) that some intervenors wish the IESO to design and conduct a study which will explore the advantages and disadvantages of Defined Benefit Programs vs. Defined Contribution Programs for all employee categories of the Applicant;
 - (ii) that intervenors wish to have input into the selection of the consultant doing the study and the terms of reference; and
 - (iii) that intervenors desire that these concerns be reported to the full Board of Directors of the IESO.

- The IESO has further agreed to provide to intervenors:
 - (i) Documentation demonstrating that the Human Resources and Governance Committee of the IESO Board has received and considered the intervenors' request; and
 - (ii) The response from the Human Resources and Governance Committee of the IESO Board of Directors to the intervenors' request. The IESO will also file such documentation and response with the OEB as part of this undertaking.

2.1.3 Performance measures

The IESO submitted that there are several changes to the performance measures but the balanced scorecard approach is retained. The aim is to:

- ensure management focus on overall cost to stakeholders and fee levels and direction
- encourage reliable supply and economic efficiency

The IESO's evidence indicates that the following metrics are designed to measure the accuracy of demand forecasts:

Day-Ahead Hourly Demand Forecast

- Annual average absolute error
- Annual average bias range

Day-at-Hand Hourly Demand Forecast – 3 Hours Ahead of Dispatch Hour

- Annual average absolute error
- Annual average bias range

Day-at-Hand Hourly Demand Forecast – 1 Hour Ahead of Dispatch Hour

- Annual average absolute error
- Annual average bias range

The IESO expressed the view that either the Stakeholder Advisory Committee (SAC) or one of its Committees would be the most appropriate forum in which to consider this issue. The IESO also advised that issues around deviations from forecasts, especially deviations from day-ahead forecasts, are currently under review by the IESO.

Some intervenors expressed a desire to have the day-ahead and the day-at-hand performance metrics reported on an on-peak seasonal basis in lieu of the current annual basis, and further requested that the processes and tools be reviewed to seek improvement in the accuracy of these forecasts.

With regard to demand forecast performance metrics, some intervenors and the IESO agreed on the following:

- The IESO will publish on its public website on a monthly basis (1) the bias calculations for on peak and off peak hours for both day-ahead and one and three hour out day-at-hand measures, and to be shown

separately for on and off peak periods, and (2) the number of days in which the absolute value of error in any hour exceeds 3%, for both day-ahead and one and three hour out day-at-hand measures, including the maximum absolute error in which any hour exceeds the 3% value.

- Some intervenors will recommend to the SAC that a task force (1) be established to examine ways to narrow the range of forecasting deviations, (for day-ahead as well as day-at-hand) and (2) commence its work and report back to the SAC with its recommendations as soon as possible. The IESO will not oppose a recommendation to establish a task force, however, should the IESO believe that there is another more appropriate means to address this issue, the IESO reserves the right to make such recommendation to the SAC and will work constructively under the approach adopted.

2.1.4 Reliability Initiatives for 2006

Based on the IESO's evidence, they have proposed four initiatives to increase reliability during the summer of 2006:

- (i) Day-Ahead Commitment Process (DACP)
 - Provides greater assurance that sufficient resources are committed day-ahead to meet forecast reliability needs in real time, similar to the markets surrounding Ontario.
- (ii) Emergency Load Reduction Program (ELRP)
 - Will be one of the initial emergency actions in order to reduce the use of other emergency control actions such as voltage reductions and emergency energy purchases from neighbouring markets.
- (iii) Resolution of internal resource dispatch issues
 - Improve the IESO resource dispatch process to avoid erratic dispatch of generators that can put additional stress on generators and impact on reliability.
- (iv) Improvements to the scheduling protocol for intertie transactions
 - Changes that will improve reliability by providing greater assurance that import transactions materialize in real time as expected.

The estimated capital costs for the above initiatives are:

Initiative (i):	\$6.9m
Initiatives (ii) – (iv)	\$2.1m

The above estimates are for capital costs and do not include OM&A costs associated with the initiatives.

At the January 30-31 Settlement Conference, the parties agreed to the following:

- On a trial basis for the 2006 forecast year, the IESO will provide, as part of its 2007 Fees Case filing, an informed estimate of the actual OM&A costs incurred in 2006 for each identified current market initiative in the event that such OM&A costs for any initiative exceed \$500,000, to be updated once final 2006 costs are known.

2.1.5 Funding for IESO Stakeholder Processes

The IESO submits that their stakeholder processes are designed to ensure that stakeholder views and requirements are identified and factored into decisions that are made.

The IESO advised that IESO management plans to bring to the IESO's Board of Directors in the near future a proposal for a pilot project for intervenor funding for IESO stakeholdering processes.

2.2 Capital Spending

2.2.1 Capital Expenditures

The IESO's evidence indicates that their capital program consists of the following three components:

Applications: This includes improvements, upgrades or replacement of existing systems and software.

IT Infrastructure: This is required to maintain and enhance the technology backbone of the IESO.

Facility Improvements: This includes Improvements to physical assets, heating, ventilation AC etc.

IESO's estimated capital costs for 2006 are:

Applications:	\$16.4m
IT Infrastructure:	\$7.1m
Facility Improvements:	\$1.5m
Total	\$25m

The estimated costs for reliability improvements listed in Section 2.1.4 are included in the Applications estimate above.

At the January 30-31 Settlement Conference, some intervenors expressed a desire to be provided with information comparing actual capital expenditures on capital projects in a year against forecast expenditures for such projects.

All parties agreed to settle this issue on the following basis:

- In its 2007 fees application, the IESO will file a Capital Project List similar in form to Appendix 3 in the 2006- 2008 Business Plan that includes additional information showing the actual 2005 expenditures for the capital projects forecast for 2005 and year to date 2006 expenditures for the capital projects forecast in 2006.

2.2.2 Timelines for Current Market Issues and Initiatives

In its pre-filed evidence, the IESO identified the following priority current market issues:

- (a) Reliability Issues and Initiatives
- (i) the DACP;
 - (ii) Demand Response (the ELRP);
 - (iii) Internal resource dispatch; and
 - (iv) Intertie scheduling

These are the initiatives described in Section 2.1.4.

- The IESO is committed to implementing these initiatives prior to summer of 2006 subject to the General Understanding of the Parties set out below.

(b) Market Pricing Issues and Initiatives

- (i) The appropriate ramp rate multiplier to be employed in the Market Schedule;
- (ii) Whether intertie transactions should be considered in the calculation of the Ontario Market Clearing Price; and
- The IESO is committed to implementing these initiatives in 2006 in parallel with the implementation of the DACP, to the extent feasible without jeopardizing the June 1, 2006 DACP in-service date and subject to the General Understanding of the Parties set out below.

(c) Market Evolution Programs including resuming and advancing work with stakeholders on the Day-Ahead Market.

- The IESO is committed to resuming and advancing this work with stakeholders in accordance with the Resolution of the Board of Directors dated December 7, 2005, subject to the General Understanding of the Parties set out below.

General Understanding of the Parties

The parties understand that the IESO's ability to fulfill its commitments set out above under this 2.0 series of issues relating to "Timelines" is subject to: (i) the completion and results of any required stakeholdering processes, which may involve discussions and resolutions on the timing of implementing the above mentioned initiatives; (ii) the IESO's ability to access required resources such as outsider vendors to implement the agreed upon solutions; and (iii) the availability of human resources in the event of extraordinary circumstances impacting the IESO.

2.3 Operating Surplus

The IESO's evidence indicates that the IESO's annual revenue requirements are based on the annual forecast of expenditures. In past years, in order to support a fixed fee structure, the IESO has used the accumulated surplus in the deferral account balance to offset annual operating deficits budgeted to occur over the planning period.

In the IESO's 2005 Fees Submission (EB-2004-0477), agreement was reached (and accepted by the Board) that any surplus in excess of \$5m should be returned to the market participants as a rebate in the following year based on each market participant's allocated quantity of energy withdrawn during the prior year.

At the Settlement Conference on January 30-31, 2006, the parties agreed to the continuation of the treatment of deferral account balances as agreed upon in the IESO's 2005 Fees Submission proceeding.

2.4 Benchmarking

The IESO submitted that on June 2, 2005, FERC issued its Notice of Proposed Rulemaking (NOPR) to amend the accounting and financial reporting requirements for public utilities and licensees, including independent system operators and regional transmission organizations (collectively ISOs/RTOs). The NOPR responded to comments filed in reply to a September 26, 2004, Notice of Inquiry (NOI), which invited comments on accounting, financial reporting, and cost management practices of ISOs/RTOs.

On December 16, 2005, FERC approved the Final Rule on Accounting and Financial Reporting for Public Utilities Including RTOs (Order No. 668) by revising its Uniform System of Accounts (USofA) and financial reporting requirements in order to improve the transparency of financial information and to better understand the costs of RTOs. These accounting and financial changes and updates identified in the Final Rule were scheduled to become effective on January 1, 2006, but FERC extended the effective date of Order

No. 668 until April 1, 2006, to give affected public utilities and licensees time to meet the requirements of Order No. 668.

Order No. 668 establishes the following new accounting categories to capture the costs of:

- (i) assets owned and used by ISOs/RTOs, which are primarily information technology (computer hardware, software and communication equipment);
 - (ii) market-related services performed by ISOs/RTOs such as the facilitation of day-ahead and real-time energy markets, ancillary services markets, transmission rights, and market monitoring and compliance;
 - (iii) transmission-related services performed by ISOs/RTOs such as system control, scheduling, dispatching, monitoring and operating the transmission system for reliability, system studies and long-term planning and standards development.
- The IESO has submitted that it will track and report costs consistent with FERC's Order No. 668 cost categories, and will include in its 2007 fees case such comparative information as is available at that time.

2.5 Coordination between IESO and OPA

The IESO submitted that the role of the IESO remains largely unchanged with the introduction of the OPA.

The IESO is responsible for overseeing the IESO-administered markets and ensuring reliability of the power system. They submit that the OPA responsibilities are new responsibilities that had not been provided for several years including:

- determination of future supply mix;
- procurement of future capacity;
- integrated power system plan;
- conservation; and
- ensuring appropriate medium and long term investment takes place.

The IESO submitted that preparation of medium and longer term forecasts only required a relatively small extension of the effort used to prepare more frequent shorter term forecasts.

The IESO and OPA continue to work together to identify areas where the co-ordinated use of resources would be practical and efficient. To this end, OPA and the IESO have established a Memorandum of Understanding (M.O.U.) – “Principles to Govern Coordination of Activities between the OPA and the IESO” (Exhibit 8, Tab 1, Schedule 1) that identifies areas where coordination is required and outlines the delineation of responsibilities between the two parties

The IESO’s evidence discloses that in 2006 the IESO anticipates providing services to the OPA and charging the OPA for such services on a cost recovery basis. The IESO has filed the Memorandum of Understanding (Ex. B, Tab 8, Schedule 1) entered into between the IESO and the OPA.

- At the January 30-31, 2006 Settlement Conference, the IESO committed to filing as part of its 2007 fees case:
 - (i) a copy of the OPA/IESO Master Service Agreement to be executed by the IESO and OPA, subject to any confidentiality concerns;
 - (ii) any schedules negotiated thereunder, subject to any confidentiality concerns; and,
 - (iii) the actual costs incurred and charged by the IESO to the OPA for services provided in 2006.

3.0 BOARD FINDINGS

Under Section 19 of the *Electricity Act, 1998*, the Board may approve the IESO’s proposed expenditures and revenue requirements and the proposed fees or may refer them back to the IESO for further consideration with the Board’s recommendations.

In the context of this Application, the main issues for the Board are as follows:

- (1) Validity of the Settlement Agreement
- (2) Are the IESO’s proposed operating costs for 2006 reasonable?
- (3) Are the IESO’s proposed capital expenditures for 2006 appropriate and reasonable?

- (4) Is the IESO's current mechanism for disposition of their accumulated operating surplus appropriate and reasonable?
- (5) Is there any overlap or duplication of activities between the IESO and the OPA? If so, are appropriate processes in place to eliminate this?
- (6) If the IESO's proposed expenditures, revenue requirements and Fees are approved, what are the conditions of approval?

3.1 VALIDITY OF THE SETTLEMENT AGREEMENT

The Board is of the opinion that the Settlement Conference that yielded the Proposed Settlement Agreement attached as Appendix "E" was validly constituted and attracted the interest and participation of a cross section of intervenors. All of the intervenors were in attendance at the Issues Conference held on December 14, 2005.

3.2 ISSUE (1) – OPERATING COSTS

3.2.1 Compensation and Pension Costs

The Board Acknowledges the IESO's evidence that:

- the role of the IESO remains largely unchanged with the introduction of the OPA (see Section 2.5, above)
- The IESO has a large workload related to ongoing changes to Ontario's electricity sector e.g., substantial workload related to Request for Proposals (RFP) process, the government's coal replacement policy and IESO's role in the Integrated Power System Plan (IPSP).
- Significant increases in the IESO's pension costs in 2006-2008 are due to the low long term interest rates over the last number of years and also poor equity market returns. Also, other corporations with a pension plan are experiencing similar results.

The Board notes that staff costs and pension costs are key components of the IESO's operating costs and accepts the Parties' agreement regarding compensation and pension costs outlined above in Sections 2.1.1 and 2.1.2.

3.2.2 Performance Measures

The Board acknowledges the IESO's efforts to monitor its performance to ensure it is on track to achieve its corporate objectives and its ongoing efforts to review its corporate performance measures.

The Board accepts the Parties' agreement to seek improvement in the IESO's accuracy of demand forecasts and the proposed measures relating to forecast performance metrics outlined above in Section 2.1.3.

3.2.3 Reliability Initiatives for 2006

The Board accepts the IESO's evidence that the proposed reliability initiatives for 2006 are needed to maintain adequate reliability.

The Board also accepts the Parties' agreement that the IESO monitor its OM&A costs for any initiative that exceeds \$500,000 as outlined above in Section 2.1.4.

3.3 ISSUE (2) – CAPITAL EXPENDITURES

The Board accepts the IESO's proposed 2006 capital expenditures.

The Board also accepts:

- the Parties' agreement that the IESO provide, in its 2007 Fees Submission, information comparing actual capital expenditures with forecast expenditures for capital projects as outlined above in Section 2.2.1; and
- the Parties' agreement regarding the timing of the IESO's 2006 priority initiatives as outlined above in Section 2.2.2.

3.4 ISSUE (3) - ACCUMULATED OPERATING SURPLUS

The Board acknowledges the IESO's rationale that an accumulated operating surplus is required in order to deal with cost or revenue variances from forecasts. The intent is to recognize uncertainties within the IESO's sphere of activity and that there are items that are not always within the control of management nor reasonably foreseeable.

The Board accepts the Parties' agreement to a continuation of the treatment of accumulated operating surplus balances as agreed to in the IESO's 2005 Fees Submission proceeding (EB-2004-0477). This requires that any surplus in excess of \$5m be returned to the market participants as a rebate in the following year, based on each market participant's allocated quantity of energy withdrawn during the prior year.

3.5 ISSUE (4) - BENCHMARKING

The issue of comparability of IESO costs with other system operators was discussed in some detail during the 2005 Fee Submission Review. In that proceeding, the Board directed the IESO to file the information compiled in accordance with the Federal Energy Regulatory Commission (FERC) process, when that process is complete.

The Board acknowledges the IESO's evidence that FERC has issued its Final Rule (Order No. 668) on this subject which is effective April 1, 2006. The Board agrees with the IESO's proposal to track and report costs consistent with FERC's Order No. 668 cost categories, and to include in its 2007 Fees Submission, such comparative information as is available at that time.

3.6 ISSUE (5) – COORDINATION BETWEEN IESO AND OPA

The Board acknowledges the IESO's evidence that the role of the IESO remains largely unchanged with the introduction of the OPA as outlined in Section 6.0.

The Board also acknowledges the IESO's evidence that the IESO and OPA continue to work together to identify areas where their efforts can be coordinated to achieve greater efficiency.

The Board accepts the Parties' agreement that the IESO will file additional information as part of its 2007 Fees Submission related to coordination of activities as outlined above in Section 2.5.

BOARD ORDER

The Board Orders that:

- The IESO's proposed 2006 revenue requirement of \$147.8 million is approved;
- The IESO's proposed 2006 capital expenditure of \$25.0 million is approved;
- The IESO's usage fee for 2006 of \$0.909 / MWh is approved;
- The IESO's proposed application fee of \$1000.00 is approved.

This approval is granted subject to the conditions of approval attached as Appendix A. These conditions are based on agreements reached at the January 30-31 Settlement conference. The Board's previous Order, approving Interim Rates for the IESO is supplanted and replaced by this final Decision and Order.

COST AWARDS

A Decision regarding cost awards will be issued at a later date when the Board receives claims for costs from the eligible parties.

DATED at Toronto on February 14, 2006.

ONTARIO ENERGY BOARD



John Zych
Board Secretary

**APPENDIX "A" TO
DECISION AND ORDER
BOARD FILE No. EB-2005-0499
DATED February 14, 2006

CONDITIONS OF APPROVAL**

CONDITIONS OF APPROVAL

1.0 OPERATING COSTS

1.1 As part of its 2007 Fees Case filing, the IESO will provide its views on whether or not it is appropriate to set targets for the IESO's compensation levels on a quartile or some other basis.

1.2 The IESO shall report to the Human Resources and Governance Committee of the IESO's Board of Directors the following:

- that some intervenors wish the IESO to design and conduct a study which will explore the advantages and disadvantages of Defined Benefit Programs vs. Defined Contribution Programs for all employee categories of the Applicant;
- that intervenors wish to have input into the selection of the consultant doing the study and the terms of reference; and
- that intervenors desire that these concerns be reported to the full Board of Directors of the IESO.

1.3 The IESO shall provide the following to intervenors:

- Documentation demonstrating that the Human Resources and Governance Committee of the IESO Board has received and considered the intervenors' request; and
- The response from the Human Resources and Governance Committee of the IESO Board of Directors to the intervenors' request. The IESO will also file such documentation and response with the OEB as part of this undertaking.

1.4 The IESO will publish on its public website on a monthly basis (1) the bias calculations for on peak and off peak hours for both day-ahead and one and three hour out day-at-hand measures, and to be shown separately for on and offpeak periods, and (2) the number of days in which the absolute value of error in any hour exceeds 3%, for both day-ahead and one and three hour out day-at-hand measures, including the maximum absolute

error in which any hour exceeds the 3% value.

- 1.5** Some intervenors will recommend to the SAC that a task force (1) be established to examine ways to narrow the range of forecasting deviations, (for day-ahead as well as day-at-hand) and (2) commence its work and report back to the SAC with its recommendations as soon as possible. The IESO will not oppose a recommendation to establish a task force, however, should the IESO believe that there is another more appropriate means to address this issue, the IESO reserves the right to make such recommendation to the SAC and will work constructively under the approach adopted

2.0 CAPITAL SPENDING

- 2.1** In its 2007 fees application, the IESO will file a Capital Project List similar in form to Appendix 3 in the 2006- 2008 Business Plan that includes additional information showing the actual 2005 expenditures for the capital projects forecast for 2005 and year to date 2006 expenditures for the capital projects forecast in 2006.
- 2.2** The IESO is committed implementing its priority 2006 initiatives according to the following timelines subject to the Understanding of the Parties set out below.

Reliability Issues (See Section 2.2.2 of Decision and Order)

- Prior to the summer of 2006;

Market Pricing Initiatives (See Section 2.2.2 of Decision and Order)

- To be implemented in parallel with the implementation of the DACP, to the extent feasible without jeopardizing the June 1, 2006 DACP in-service date;

Market Evolution Programs (See Section 2.2.2 of Decision and Order)

- to resume and advance this work with stakeholders in accordance with the Resolution of the Board of Directors dated December 7, 2005.

General Understanding of the Parties

The parties understand that the IESO's ability to fulfill its commitments set out above relating to "Timelines" is subject to: (i) the completion and results of any required stakeholdering processes, which may involve discussions and resolutions on the timing of implementing the above mentioned initiatives; (ii) the IESO's ability to access required resources such as outsider vendors to implement the agreed upon solutions; and (iii) the availability of human resources in the event of extraordinary circumstances impacting the IESO.

3.0 OPERATING SURPLUS

The IESO shall continue the existing process for the treatment of accumulated operating surplus, i.e., that any surplus in excess of \$5m should be returned to the market participants as a rebate in the following year based on each market participant's allocated quantity of energy withdrawn during the prior year

4.0 BENCHMARKING

The IESO shall report costs consistent with FERC's Order No. 668 cost categories, and will include in its 2007 Fees Submission such comparative information as is available at that time.

5.0 COORDINATION BETWEEN IESO AND OPA

The IESO shall file, as part of its 2007 Fees Submission, the following:

- a copy of the OPA/IESO Master Service Agreement to be executed by the IESO and OPA, subject to any confidentiality concerns;
- any schedules negotiated thereunder, subject to any confidentiality concerns; and,
- the actual costs incurred and charged by the IESO to the OPA for services provided in 2006.

**APPENDIX "B" TO
DECISION AND ORDER
BOARD FILE No. EB-2005-0499
DATED February 14, 2006**

INTERVENTION LIST

EB-2005-0499

**Independent Electricity System Operator
Fiscal 2006 Fees Submission for Review
APPLICANT AND LIST OF INTERVENORS**

January 25, 2006

Applicant

Rep. and Address for Service

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System Operator**

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Intervenors

Rep. And Address for Service

**1. Vulnerable Energy Consumer's
Coalition ("VECC")**

**Contact changed dated Jan 25,
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**APPENDIX "C" TO
DECISION AND ORDER
BOARD FILE No. EB-2005-0499
DATED February 14, 2006**

OBSERVER LIST

November 25, 2005

EB-2004-0499

**Independent Electricity System Operator
Fiscal 2006 Fees Submission for Review
APPLICANT AND LIST OF OBSERVERS**

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**APPENDIX "D" TO
DECISION AND ORDER
BOARD FILE No. EB-2005-0499
DATED February 14, 2006**

ISSUES LIST

INDEPENDENT ELECTRICITY SYSTEM OPERATOR (“IESO”)

FISCAL 2006 FEES SUBMISSION FOR REVIEW

ISSUES LIST

EB-2005-0499

December 14, 2005

1.0 Operating Cost

- 1.1 Why are the IESO's staff costs increasing from 2005 - 2008 while some of their previous responsibilities are allocated to the OPA? Are the IESO's staff costs reasonable given skills, quality and experience required?
- 1.2 Are the IESO's pension costs and strategy reasonable?
- 1.3 Why have total expenses not declined over the years to reflect the benefits of knowledge gained, efficiencies and experience? Is the trend from inception (1999) to 2008 appropriate?
- 1.4 Are the forecast expenditures for the reliability initiatives for 2006 reasonable and appropriate?
- 1.5 Provide an Update the 2005 performance measures. Is the IESO meeting the performance measures?
- 1.6 What is the status of the implementation of the 2005 settlement agreement on modification to IESO performance metrics (for absolute error and bias calculation for on-peak and off-peak hours for both day ahead, one and three-hour-out day-at-hand demand forecast), and what is the proper process for determining appropriate performance metrics?

2.0 Capital Spending

- 2.1 Are the forecast expenditures for the Day Ahead Commitment Process (DACP) and the other reliability measures reasonable and appropriate?
- 2.2 Does the IESO have all the necessary market rules in place for the development of the DACP?
- 2.3 What is the level of IESO commitment to DACP and is this sufficient for funding approval?

3.0 Operating Surplus

- 3.1 What is the appropriate amount of accumulated surplus that the IESO should retain?
- 3.2 Is the forecast of the surplus accurate?
- 3.3 How should the excess surplus be returned to market participants?

4.0 Benchmarking

- 4.1 What is the status of the FERC cost comparison initiative?
- 4.2 What are the proposed cost categories for comparison? Are they appropriate?

5.0 Coordination between IESO and OPA

- 5.1 Is there any overlap or duplication of activities? What is the process to eliminate overlap and duplication between these two agencies?

**APPENDIX "E" TO
DECISION AND ORDER
BOARD FILE No. EB-2005-0499
DATED February 14, 2006**

SETTLEMENT AGREEMENT

Filed: February 1, 2006
EB-2005-0499
Exhibit B
Tab 11
Schedule 1

INDEPENDENT ELECTRICITY SYSTEM OPERATOR (IESO)
FISCAL YEAR 2006 FEES SUBMISSION FOR REVIEW
SETTLEMENT AGREEMENT

EB-2005-0499

This Settlement Proposal is filed with the Ontario Energy Board (“the OEB”) for consideration in the determination of the Independent Electricity System Operator (“the IESO”) EB-2005-0499 Submission for Review. A Settlement Conference was conducted on January 30 and 31 of 2006, in accordance with Rule 38 of the OEB’s *Rule of Practice and Procedure* and the OEB’s *Settlement Conference Guidelines*. The Settlement Proposal arises from the Conference.

The following parties participated in the settlement discussions:

- The IESO;
- Association of Power Producers of Ontario (APPrO);
- Canadian Manufacturers & Exporters (CME);
- Energy Probe Research Foundation (Energy Probe);
- Ontario Power Generation (OPG);
- Power Workers’ Union (PWU);
- Society of Energy Professionals (SEP); and
- Vulnerable Energy Consumers Coalition (VECC)

The Settlement Proposal deals with all issues of the Board’s Issues List:

1. Operating Cost
2. Capital Spending
3. Operating Surplus
4. Benchmarking
5. Coordination between the IESO and Ontario Power Authority (OPA)

The parties have settled all issues.

The OEB Staff take no position on any issue and as a result is not party to this proposal.

This Settlement Proposal was prepared in accordance with Rule 39 and the Settlement Guidelines. The Settlement Proposal accordingly describes the agreements reached on the settled issues, including the rationale, and provides a direct and transparent link between each settlement and the supporting evidence in the record to date. In this regard, the parties agree that the evidence provided with the IESO’s Submission for Review is sufficient to support the Settlement Proposal in relation to the settled issues. Moreover, the quality and the detail of the supporting evidence together with the corresponding rationale will allow the Board to make findings on the settled issues.

IESO 2006 Revenue Requirement, Expenditures and Fees

The parties reached agreement on the IESO's 2006 proposed revenue requirements of \$147.8 million and proposed 2006 capital expenditures of \$25.0 million.

The parties also agreed to the reduced IESO usage fee of \$0.909/MWh commencing January 1, 2006 and to the continuation of the \$1,000 application fee.

The following evidence support this settlement:

*Amended Submission for Review, Exhibit A, Tab 1, Pages 1-4;
Exhibit B, Tab 1, Schedule 1: 2006-2008 Business Plan, Pages 22, 30, 37-38.*

Other Matters

Several parties raised concerns regarding some of the issues set out in the Issues List and the settlement of these concerns is described below:

1.0 Operating Cost

- 1.1 Why are the IESO's staff costs increasing from 2005 - 2008 while some of their previous responsibilities are allocated to the OPA? Are the IESO's staff costs reasonable given skills, quality and experience required?
- 1.2 Are the IESO's pension costs and strategy reasonable?
- 1.3 Why have total expenses not declined over the years to reflect the benefits of knowledge gained, efficiencies and experience? Is the trend from inception (1999) to 2008 appropriate?
- 1.4 Are the forecast expenditures for the reliability initiatives for 2006 reasonable and appropriate?
- 1.5 Provide and update the 2005 performance measures. Is the IESO meeting the performance measures?
- 1.6 What is the status of the implementation of the 2005 settlement agreement on modification to IESO performance metrics (for absolute error and bias calculation for on-peak and off-peak hours for both day ahead, one and three-hour-out day-at-hand demand forecast), and what is the proper process for determining appropriate performance metrics?

A. Pension Plan

The following parties raised concerns about the IESO's pension plan:

- CME;
- VECC;
- Energy Probe

The parties have agreed to settle these concerns on the following basis:

The IESO has agreed to report to the Human Resources and Governance Committee of the IESO's Board of Directors the following:

- (i) that some intervenors wish the IESO to design and conduct a study which will explore the advantages and disadvantages of Defined Benefit Programs vs. Defined Contribution Programs for all employee categories of the Applicant;
- (ii) that intervenors wish to have input into the selection of the consultant doing the study and the terms of reference;
- (iii) that intervenors desire that these concerns be reported to the full Board of Directors of the IESO.

The IESO has further agreed to provide to intervenors (i) documentation demonstrating that the Human Resources and Governance Committee of the IESO Board has received and considered the intervenors' request and (ii) the response from the Human Resources and Governance Committee of the IESO Board of Directors to the intervenors' request. The IESO will also file such documentation and response with the OEB by way of fulfilling this undertaking.

The following evidence support this settlement:

Exhibit B, Tab 1, Schedule 1: 2006-2008 Business Plan, Pages 27-29;
Exhibit B, Tab 4, Schedule 1: The IESO's Compensation Programs
Interrogatory #s 1.3; 4.1, 6.1 to 6.12.

The following intervenors took no position on the pension plan issue:

- APPrO;
- OPG;
- Society;
- PWU

B. Compensation

The parties have agreed that the IESO, as part of its 2007 Fees Case filing, will provide its views on whether or not it is appropriate to set targets for the IESO's compensation levels on a quartile or some other basis.

The following evidence support this settlement:

Exhibit B, Tab 1, Schedule 1: 2006-2008 Business Plan, Page 25;
Exhibit B, Tab 4, Schedule 1: The IESO's Compensation Programs;
Exhibit B, Tab 5, Schedule 1: Section 7 of Status Report on Undertakings;
Exhibit B, Tab 9, Schedule 1: Minutes of the Regulatory Affairs Standing Committee, June 29, 2005;
Interrogatory #s 4.2 and 4.3

The following intervenors took no position on the compensation issue:

- Society;
- PWU;
- APPrO

C. Demand Forecast Performance Metrics

Some intervenors expressed a desire to have the day ahead and the day at hand performance metrics reported on an on-peak seasonal basis in lieu of the current annual basis and further requested that the processes and tools be reviewed to seek improvement in the accuracy of these forecasts.

The IESO expressed the view that the Stakeholder Advisory Committee (SAC) or its Committees would be the most appropriate forum in which to consider this issue. The IESO also advised that issues around deviations from forecasts, especially deviations from day ahead forecasts, are currently under review by the IESO.

With regard to demand forecast performance metrics, some intervenors and the IESO agreed on the following:

The IESO will publish on its public website on a monthly basis (1) the bias calculations for on peak and off peak hours for both day ahead and one and three hour out day at hand measures, and to be shown separately for on and off peak periods, and (2) the number of days in which the absolute value of error in any hour exceeds 3%, for both day ahead and one and three hour out day at hand measures, including the maximum absolute error in which any hour exceeds the 3% value.

Further, with an eye to improving the accuracy of the demand forecast, some intervenors will recommend to the SAC that a task force (1) be established to examine ways to narrow the range of forecasting deviations, (for day ahead as well as day-at hand) and (2) commence its work and report back to the SAC with its recommendations as soon as possible. The IESO will not oppose a recommendation to establish a task force, however, should the IESO believe that there is another more appropriate means to address this issue, the IESO reserves the right to make such recommendation to the SAC and will work constructively under the approach adopted.

The following evidence support this settlement:

Exhibit B, Tab 5, Schedule 1: Section 8 of Status Report on Undertakings; Interrogatory #s 2.2, 3.1 c) and 3.2.

The following intervenors took no position on this issue:

- APPrO;
- CME;
- VECC;
- Society;
- PWU

D. OM&A Costs for Current market Issues

The parties have agreed that on a trial basis for the 2006 forecast year the IESO will provide, as part of its 2007 Fees Case filing, an informed estimate of the actual OM&A costs incurred in 2006 on each identified current market initiative in the event that such OM&A costs for any initiative exceeds \$500,000, to be updated once final 2006 costs are known.

The parties' agreement respecting costs charged by the IESO to the OPA is set out in Section 5.0 below.

The following evidence support this settlement:

Exhibit B, Tab 1 Schedule 1: 2006-2008 Business Plan, Pages 16-17 and 29; Interrogatory #s 1.5 to 1.7 and 5.1 to 5.7.

E. Funding for IESO stakeholder processes

The IESO advises that IESO management plans to bring to the IESO's Board of Directors in the near future a proposal for a pilot project for intervenor funding for IESO stakeholdering processes.

The following evidence support this settlement:

*Exhibit B, Tab 1 Schedule 1: 2006-2008 Business Plan, Page 8;
Interrogatory #s 5.8.*

2.0 Capital Spending

- 2.1 Are the forecast expenditures for the Day Ahead Commitment Process (DACP) and the other reliability measures reasonable and appropriate?
- 2.2 Does the IESO have all the necessary market rules in place for the development of the DACP?
- 2.3 What is the level of IESO commitment to DACP and is this sufficient for funding approval?

A. Capital Expenditures

Some intervenors expressed a desire to be provided with information comparing actual capital expenditures on capital projects in a year against forecast expenditures for such projects.

All parties agreed to settle this issue on the basis that in its 2007 fees application, the IESO will file a Capital Project List similar in form to Appendix 3 in the 2006-2008 Business Plan that includes additional information showing the actual 2005 expenditures for the capital projects forecast for 2005 and year to date 2006 expenditures for the capital projects forecast in 2006.

The following evidence support this settlement:

*Exhibit B, Tab 1, Schedule 1: 2006-2008 Business Plan, Pages 19-20 and Appendix 3: Capital Projects.
Interrogatory #s 1.5 to 1.8 and 5.1 to 5.7.*

B. Timelines for Current Market Issues and Initiatives

In its pre-filed evidence, the IESO has identified the following priority current market issues:

- (a) Reliability Issues and Initiatives including:
 - i. the DACP

- ii. Demand Response (the ELRP)
- iii. Internal resource dispatch
- iv. Intertie scheduling

(b) Market Pricing Issues and Initiatives including:

- i. The appropriate ramp rate multiplier to be employed in the Market Schedule
- ii. Whether intertie transactions should be considered in the calculation of the Ontario Market Clearing Price, and

(c) Market Evolution Programs including resuming and advancing work with stakeholders on the Day-Ahead Market.

In relation to Reliability Issues and Initiatives identified in (a) above, the IESO is committed to implementing these initiatives prior to summer of 2006 subject to the General Understanding of the Parties set out below.

In relation to all Market Pricing Issues and Initiatives identified in (b) above, the IESO is committed to implementing these initiatives in 2006 in parallel with the implementation of the DACP, to the extent feasible without jeopardizing the June 1, 2006 DACP in-service date and subject to the General Understanding of the Parties set out below.

The IESO is also committed to resuming and advancing work with stakeholders on the Day-Ahead Market identified in (c) above, in accordance with the Resolution of the Board of Directors dated December 7, 2005, subject to the General Understanding of the Parties set out below.

General Understanding of the Parties

The parties understand that the IESO's ability to fulfill its commitments set out above under this 2.0 series of issues relating to "Timelines" is subject to: (i) the completion and results of any required stakeholdering processes, which may involve discussions and resolutions on the timing of implementing the above-mentioned initiatives; (ii) the IESO's ability to access required resources such as outsider vendors to implement the agreed upon solutions; and (iii) the availability of human resources in the event of extraordinary circumstances impacting the IESO.

The following evidence support this settlement:

Exhibit B, Tab 1, Schedule 1: 2006-2008 Business Plan, Pages 5-7;
Exhibit B, Tab 10, Schedule 1: Update re: Day-Ahead Commitment Process and Reliability Initiatives;

Interrogatory #s 1.7, 5.1, 5.3, 5.4 and 5.5.

3.0 Operating Surplus

- 3.1 What is the appropriate amount of accumulated surplus that the IESO should retain?
- 3.2 Is the forecast of the surplus accurate?
- 3.3 How should the excess surplus be returned to market participants?

The parties agreed to the continuation of the treatment of deferral account balances as agreed upon in the Settlement Agreement in EB-2004-0477.

The following evidence support this settlement:

*Amended Submission for Review, December 13, 2005: Exhibit A, Tab 1, Pages 1-2;
Exhibit B, Tab 1, Schedule 1: 2006-2008 Business Plan, Pages 12 and 39;
Exhibit B, Tab 5, Schedule 1: Section 4 of Status Report on Undertakings;
Interrogatory #s 1.9 to 1.11.*

The following intervenor took no position on the operating surplus issue:

- APPrO

4.0 Benchmarking

- 4.1 What is the status of the FERC cost comparison initiative?
- 4.2 What are the proposed cost categories for comparison? Are they appropriate?

The IESO confirmed to the parties that it will track and report costs consistent with FERC's Order No. 668 cost categories, and will include in its 2007 fees case such comparative information as is available at that time.

The following evidence support this settlement:

Exhibit B, Tab 5, Schedule 1: Section 3 of Status Report on Undertakings;

Exhibit B, Tab 7, Schedules 1, 2 and 3: FERC NOPR on Accounting and Financial Reporting and IESO and ISO/RTO Comments on FERC's NOPR; Interrogatory #s 1.12 to 1.14.

5.0 Coordination between IESO and OPA

5.1 Is there any overlap or duplication of activities? What is the process to eliminate overlap and duplication between these two agencies?

The IESO's evidence discloses that in 2006 the IESO anticipates providing services to the OPA and charging the OPA for such services on a cost recovery basis. The IESO has filed the Memorandum of Understanding (Ex. B, Tab 8, Schedule 1) entered into between the IESO and the OPA. The IESO commits to filing as part of its 2007 fees case:

- (i) a copy of the OPA/IESO Master Service Agreement to be executed by the IESO and OPA, subject to any confidentiality concerns;
- (ii) any schedules negotiated thereunder, subject to any confidentiality concerns; and,
- (iii) the actual costs incurred and charged by the IESO to the OPA for services provided in 2006.

The following evidence support this settlement:

Exhibit B, Tab 1, Schedule 1: 2006-2008 Business Plan, Pages 4, 9, 23 and 36-37;

*Exhibit B, Tab 5, Schedule 1: Section 6 of Status Report on Undertakings;
Exhibit B, Tab 8, Schedule 1: Memorandum of Understanding: Principles to Govern Coordination Between the OPA and the IESO;
Interrogatory #s 1.1, 1.15, 1.16 and 2.4.*