

Ontario Energy Board **Commission de l'Énergie de l'Ontario**



EB-2004-0477

IN THE MATTER OF AN APPLICATION BY

**INDEPENDENT ELECTRICITY SYSTEM
OPERATOR**

FOR FISCAL 2005 FEES SUBMISSION FOR REVIEW

DECISION

May 24, 2005

EB-2004-0477

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

AND IN THE MATTER OF an Application by the
Independent Electricity System Operator for an order or
orders approving its proposed expenditure and revenue
requirements and the fees which it proposes to charge for
the year 2005.

BEFORE: Gordon Kaiser
Presiding Member

Paul Sommerville
Member

Paul Vlahos
Member

DECISION

May 24, 2005

TABLE OF CONTENTS

Introduction	1
Board Jurisdiction.....	3
The Issues.....	10
The Market Evolution Program	10
Day Ahead Market	11
Resource Adequacy Market.....	13
Market Pricing Initiative	16
IESO Stakeholding	17
Comparability of IESO Costs, Performance, and Output with the Costs, Performance, Outputs of Other System Regulators.....	21
Board Order	23
Cost Awards.....	24
Appendix A: History of the Proceeding.....	25
Participants and their Representatives	27
Witnesses	30
Appendix B: Settlement Agreement	31

INTRODUCTION

S. 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.

The Board may approve the 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.

By letter dated October 25, 2004 the IESO informed the Minister of Energy of its proposed expenditure and revenue requirements for 2005 and the fees it proposed to charge during 2005. By letter dated November 3, 2004 the Minister of Energy gave approval for the IESO to submit its proposed expenditure and revenue requirements for 2005 and the fees the IESO proposed to charge to the Ontario Energy Board for review.

On November 5, 2004, the IESO filed its proposed fees, revenue requirement and expenditures for its 2005 fiscal year with the Ontario Energy Board for review under section 19 of the *Electricity Act*. The Board assigned file number EB-2004-0477 to this matter.

The IESO sought Board approval of a revenue requirement of \$152.8 million and of expenditures including capital expenditures of \$56.7 million. The IESO also requested authorization to retain the 2004 accumulated surplus of approximately \$14.1 million for contingencies and rate stabilization for 2005. The IESO proposed to continue to charge the previously approved usage fee of \$0.959/MWh to all wholesale customers or market participants on all energy withdrawn for use or sale in the Ontario market and on all exports scheduled out of Ontario commencing January 1, 2005.

The Board issued a Notice of Application dated November 24, 2004 with respect to this matter; it was published on December 1, 2004. The Notice of Application stated that regardless of the results of any settlement process the Board determined that three areas would be addressed in the hearing:

- The Market Evolution Program and its associated costs
- The IMO accumulated surplus account and financial planning
- The cost implications of the transition to a new Independent Electricity System Operator (IESO)

Following the Notice of Application the IESO filed updated evidence on January 12, 2005 that reduced capital expenditures relating to the Market Evolution Program (MEP) by \$37 million and reduced the accumulated surplus to \$1.6 million.¹ On February 18, 2005 the Government passed Ontario Regulation 47/05 to transfer \$15 million of the IESO accumulated surplus of \$16.6 million to the Ontario Power Authority (OPA) to assist with start-up costs.

Following a settlement proposal, the remaining issues before the Board were:

- Market Evolution Program initiatives as described on pages 29 and 41 of the IESO's updated evidence.
- Should the Board recommend that IESO not make expenditures beyond a threshold amount in support of components of the Market Evolution Program pending the completion of the Market Evolution Program market rule amendment process under ss. 33 and 34 of the Electricity Act, 1998; and, if so, what should the threshold be?
- IESO stakeholder consultation.
- Comparability of IESO costs, performance and outputs with the costs, performance and outputs of other system operators.

The procedural history leading to the final list of issues is covered in an Appendix. Copies of the evidence, exhibits, arguments and a transcript of the proceeding are available for review at the Board's offices.

¹ The reduction in the accumulated surplus to \$1.6 million is the net effect of an updated balance of \$16.6 million (from \$14.1 million), and a transfer of \$15 million to the Ontario Power Authority.

The Board has considered the evidence, submissions and arguments in the proceeding, but has summarized the evidence and the positions of the parties only to the extent necessary to provide context for its findings.

BOARD JURISDICTION

The IESO argued at the outset of this proceeding that the Board's jurisdiction under s. 19 of the Act was limited to a review of the quantum of the proposed spending on Market Evolution Program projects and did not go to the merits of these programs. They further argued that any review of the merits of Market Evolution Program projects should be carried out under ss. 33 / 34 of the Act. In its Issues Day decision the Board rejected this view of its jurisdiction.²

Notwithstanding its ruling, the Board was concerned that duplicate reviews could take place under sections 19, 33 and 34. The Board was also of the view that ss. 33 / 34 seemed the more logical procedure to review the merits of MEP projects. The risk of this approach is that substantial spending on an MEP project could take place before any market rules had been issued and an opportunity for review arose. To prevent the potential for stranded spending on an initiative that could be set aside on ss. 33 / 34 review the Board proposed to identify an upper threshold on allowable spending on a Market Evolution Program initiative pending the review of a market rule to implement the initiative. Procedural Order 6, dated Friday, March 18, 2005 specified the so-called "threshold issue" as follows:

Should the Board recommend that IESO not make expenditures beyond a threshold amount in support of components of the Market Evolution Program pending the completion of the Market Evolution Program market rule amendment process under ss. 33 / 34 of the Electricity Act, 1998; and, if so, what should the threshold be?

Immediately following the issue of Procedural Order 6, Counsel to the IESO, Mr. Brown, notified the Board by letter of an alternative proposal.

Mr. Campbell of the IESO, in direct examination, explained that this proposal consisted of three essential elements:

² Issues Day Transcript, January 10, 2005, 714-749.

- In the normal course the IESO would propose MEP initiatives in its business planning cycle, and would seek OEB approval in its annual s. 19 review.
- In addition the annual IESO filing will identify a threshold over budgeted expenditures for each MEP project. The IESO would undertake not to exceed the total of the approved revenue requirement and expenditures, plus the threshold amount, for each MEP initiative, without returning to the OEB for approval. The IESO would return to the OEB when, in its regular budget forecasting exercises, it appeared likely to exceed the budgeted and threshold expenditures.
- Any new MEP project arising intra-year that had not been included in the previous s. 19 filing would be subject to a \$1 million cap on spending. If projections indicated that the IESO was likely to spend more than \$1 million on such a project, then the IESO would return to the OEB to seek approval.

Mr. Campbell offered three reasons in support of this proposal as a reasonable alternative to the framing of the threshold issue in Procedural Order 6:

- It is an appropriate balance of the various concerns that were raised by intervenors and the Board itself, such as the concern that spending may already be completed before a ss. 33 / 34 review takes place.
- It strikes a balance between the IESO's discretion to manage its business and normal regulatory oversight provided by the OEB.
- It provides a rigorous regulatory structure for these matters at reasonable regulatory cost.

As to why the IESO proposal was not linked in any way to the market rule amendment processes under ss. 33 / 34, Mr. Campbell stated that there is no necessary relationship between MEP expenditure amounts and market rule development. In some cases MEP spending could be largely on implementation after a market rule had been promulgated by the IESO thus leaving an opportunity for review of the merits of the MEP initiative in a ss. 33 / 34 review. However, in other cases, the bulk of the spending could occur at an earlier stage thus running the risk that the money would be spent before an opportunity had arisen for review

of the merits under ss. 33 / 34. Therefore the IESO proposal seeks to address the key control issue: guaranteeing reasonable opportunity for review before MEP expenditures are made.

As for the choice of the \$1 million number for intra-year MEP initiatives, Mr. Campbell's evidence was that it is meant to strike a balance between allowing the IESO the flexibility to respond to issues as they arise, while preserving the opportunity for meaningful regulatory oversight.

When asked by Counsel to the Association of Major Power Consumers of Ontario, Mr. Rodger, if the IESO proposal makes any distinction between intra-year projects resulting from external sources such as government policy, versus internal IESO initiatives, Mr. Campbell answered that no distinction was made. Regarding any limit on the number of intra-year MEP projects that might fall under the terms of the IESO proposal, Mr. Campbell indicated that no limit had been proposed. He indicated, however, that the real likelihood of many projects simultaneously advancing under the \$1 million threshold was close to non-existent.

Mr. Limbrick of the IESO stated that any possibility of exceeding the \$1 million threshold on an intra-year project would emerge early in the IESO's normal monthly project forecasts. Therefore, in such a circumstance, the IESO would be calling on the OEB for review well in advance of having spent the money on the project.

When asked if any other independent system operator receives similar treatment from its regulator, Mr. Campbell's answer was no.

Counsel to the Consumers Council of Canada, Mr. Warren, questioned how the current regulatory construct would deal with hypothetical situations where IESO spending might exceed the approved amount on an MEP, or any, program. Mr. Campbell answered that there were two possibilities depending on whether or not the IESO was carrying forward a sufficient surplus. In the first case where the IESO is carrying forward a sufficient surplus there would be an option to cover the spending overage via reduction of the surplus, and maintain the lower surplus going forward. In this case there would be no near-term rate impact.

In the second case where there is insufficient surplus the IESO would seek to recover the budget overage in its next s. 19 filing, thus leaving open the possibility of a rate impact.

Mr. Warren asked if, under the IESO proposal, the Board would be precluded from examining in the next s. 19 case any extra spending that had been approved as part of the IESO proposal in the year preceding that filing. Mr. Campbell's answer was no, and he indicated that one feature of the proposal was that the IESO would report in the next s. 19 cycle on any and all matters that had arisen during the year.

Counsel to the Association of Power Producers of Ontario, Ms. DeMarco, questioned whether the IESO proposal links any spending on an intra-year MEP project to stakeholdering. Mr. Campbell answered that there was no link in the proposal but such stakeholdering would always occur in the normal course of carrying out the IESO's business. When asked if the IESO would guarantee that such stakeholdering would occur, Mr. Campbell answered that he could give such a guarantee subject to a caveat that unusual circumstances could occur where normal stakeholdering would not or could not be accommodated.

Counsel to the Power Workers Union, Mr. Stephenson, enquired about the interplay between the s. 19 approval process and the ss. 33 / 34 market rule approval process. He asked if the IESO held the view that the ss. 33 / 34 review process was ill-suited to the issue of cost recovery for MEP projects because in many cases spending on an MEP initiative could occur in advance of the availability of a market rule for review. Mr. Campbell agreed with this.

Submissions of the Parties

In final argument Mr. Brown pointed out that unlike many regulated entities the IESO must come in annually for a review of expenditures, revenues and rates. In the IESO's view this provides the opportunity for a robust, comprehensive review on a regular basis. However, while the IESO believes current reviews work well under s.19, if the OEB believes that some extra oversight is required for MEP projects this can be accommodated by the IESO proposal.

While the IESO believes that the IESO proposal strikes a balance between needed management flexibility at the IESO and normal regulatory oversight, the proposal does run a risk of increasing regulatory burden and cost, as well as resulting in OEB micromanagement of the IESO.

With regards to the link between MEP spending and ss. 33 or 34 review, the IESO argues that the timing of expenditures on an MEP initiative do not necessarily correlate to the timing of market rule promulgation. Therefore the IESO proposal is a better option to that of linking spending approval to market rule review as contemplated by the threshold issue. In addition, on the question of whether the s. 19 and ss. 33 or 34 reviews are duplicative the IESO argued that s. 19 reviews and ss. 33 or 34 reviews are addressing two different situations. S. 19 deals with the regulatory oversight of the IESO by the OEB, while ss. 33 or 34 reviews are primarily an appellate function. Moreover, in the IESO's view, ss. 33 and 34 set high standards for appellate review. These sections look for very specific matters, and do not lead to a comprehensive review of the rule including its expenditure, revenue and rate consequences.

Finally, with regards to the thresholds contemplated in, respectively, the threshold issue, and the IESO proposal, Mr. Brown argued that there was no evidence before the Board that the IESO had acted imprudently with regards to spending in the past. In fact, the Day Ahead Market episode from 2004 showed that internal control mechanisms worked within the overall framework of s. 19 review.

Mr. Rodger stated that the IESO proposal was unnecessary and non-responsive to the concerns raised by the threshold issue. The proposal is unnecessary in that it deals with surprises or unanticipated expenditures and these can be handled by returning to the Board under s. 19 in order to seek a variance from a previous s. 19 decision.

Mr. Rodger also argued that the IESO proposal is not responsive to the threshold issue in that it does not deal with the concern that large amounts of MEP design expenditures could happen that stakeholders don't agree with in between s. 19 reviews.

Mr. Rodger took issue with Mr. Brown on whether any past mischief had arisen, or anything else had changed, that could justify extra oversight of the IESO's MEP spending. He listed three areas of concern: problems with IESO stakeholding, the impact of Bill 100 on the respective roles and responsibilities of the IESO and the OPA, and the fact that the new, independent IESO Board of directors is not yet in place. On

these grounds Mr. Rodger recommended that MEP expenditures be limited to a maximum of \$250,000 before a market rule review has taken place.

Mr. Warren submitted that the two arguments supporting some form of threshold issue were not, or were no longer, operative. The first - that a threshold serves as a means to control IESO spending until the respective roles of the IESO and the OPA had been delineated – was cancelled by evidence that any IESO spending on the RAM would be carried out in consultation with the OPA.

The second was a concern that significant MEP spending could take place on a rule that might be rejected in a ss. 33 / 34 review. As there is little prospect for such overspending in 2005 there is no need for any threshold constraint to be introduced in this year's decision. Rather than trying to improve on the regulatory structure that the legislature has established it should be accepted it for what it is. Therefore Mr. Warren does not accept the second rationale for a threshold concept. In addition, the threshold proposal advanced by the IESO would put the Board in the position of approving, in some non-binding sense, amounts for which there is no evidentiary basis. There is no reason for the Board to opine on speculative amounts. Also, the threshold would add regulatory cost and burden.

The CCC submission was supported by the Power Workers Union.

Ms. DeMarco pointed out that the Minister's advice to the IESO was to move forward with market evolution in a prudent and cost effective manner. In Ms. DeMarco's submission, the OEB has a special role to play in ensuring that market evolution expenditures are prudent and cost effective. Therefore she argues that some threshold spending measure for the IESO's MEP expenditure's is appropriate and perhaps in the amounts suggested by Mr. Brown.

Counsel to the Electricity Distributors Association, Mr. Moran, argued that the IESO threshold proposal was not necessary and was not responsive to the issue. Mr. Moran offered several reasons why the IESO proposal was not necessary. These are: the IESO's management discipline and responsibility to pursue the public interest, the recourse to a variance account, access to a line of credit, and finally, the potential to seek a variance under s. 19.

Mr. Moran argued that the IESO was not responsive to the issue as the threshold issue was not about cost overruns. Rather he characterized the threshold issue as concerning the relation between s. 19 approval of expenditure and ss. 33 / 34 review of market rules. In Mr. Moran's submission, s. 19 and ss. 33 / 34 could both concern themselves with review of the merits of a market evolution program item. In the s. 19 case the review would more likely be at a conceptual level. By the time the matter reached a s. 33 or 34 review, the issues would more likely be at a detailed, implementation level. In Mr. Moran's view, the IESO risks mispending public funds if it gets too far down the road on an MEP project before there is an opportunity for review in either a s. 19 or ss. 33 / 34 proceeding.

In written final argument the Vulnerable Energy Consumers Coalition submitted that the IESO proposal amounted to a request for a variance account for each MEP project, and did not respond to the issue of constraining costs until market rule amendments are completed.

In written final argument, Ontario Power Generation submitted that IESO management should be allowed appropriate discretion to spend those approved funds needed for development of detailed design principles, advancement of market rules for approval, and maintenance of working teams during any ss. 33 / 34 proceeding. However, it should not commit implementation money in advance of market rule approval under ss. 33 / 34 processes.

The OEB Hearing Team responded to Mr. Brown's argument that no mischief has occurred in the past to warrant an additional regulatory check via a threshold by arguing that no past fault is required to place a reasonable check on future actions. Mr. Lyle suggested that the Board may wish to impose conditions to ensure that MEP implementation dollars are not spent before any Board review takes place. In the case of the DAM there is no need to do so in 2005. However, in the case of the RAM the Board could consider limiting spending to the \$60,000 needed to develop technical-panel-ready market rules and complete any consultation with the OPA, prior to a Board review. Thus the \$400,000 would not be spent pending a Board review. Mr. Lyle indicated that he saw no particular problem with the IESO proposal – which is not connected to any market rule review – but did not view it as necessary or responsive to the issue.

Board Findings

The evidence and argument in the proceeding have clearly demonstrated that a threshold is not necessary. Several factors have removed the relevance of a threshold on IESO Market Evolution Program spending either in the form of the IESO proposal or as provided on the Issues List. As noted earlier, the threshold issue arose out of a concern over duplicative reviews of MEP initiatives. However, the Board found, at Issues Day, that s. 19 provided sufficient jurisdiction to review the merits of MEP initiatives. The IESO adopted this view later in the proceeding, and in fact has subsequently argued the merits of MEP programs. Also, the evidence of the IESO and other participants establish that delaying such reviews until the promulgation of market rules could be cumbersome and potentially unworkable, as market rules could be promulgated at any stage in an MEP initiative.

The Board finds that it may review the merits of an MEP initiative during the annual s. 19 budgetary review cycle. This review does not prejudice or pre-empt any review of a market rule amendment. The s. 19 review results in an approved budgetary and expenditure plan for the IESO for the year ahead. While the Board does not contemplate extraordinary intra-year s. 19 reviews of unanticipated MEP initiatives, such reviews are available as necessary when an intra-year project cannot be funded either from available surplus or redirected funds.

THE ISSUES

THE MARKET EVOLUTION PROGRAM

The Notice of Application indicated that the Market Evolution Program and its associated costs would be an area of inquiry in the proceeding regardless of any settlement agreement reached by the parties. The IESO's pre-filed evidence indicated that the Market Evolution Program currently included three projects: the Day Ahead Market (DAM), the Resource Adequacy Market (RAM), and the Market Pricing Initiative.

By letter dated January 4, 2005 IESO counsel informed the Board that the IESO board had, in December, 2004, given direction to IESO management to delay planned capital expenditures on DAM development and to update and extend its review of alternative DAM designs. As a result the IESO formally amended its application to the Board on January 12, 2005, and filed updated evidence with the Board on February 9, 2005 which reduced proposed capital expenditures from \$56.7 million to \$19.7 million

reflecting the removal of \$37 million in relation to DAM. Proposed operating expenditures on DAM were set at \$2.4 million. Proposed expenditures for the RAM and Market Pricing Initiative projects were not changed in the revised evidence.

Day Ahead Market

Evidence submitted by the IESO provided four primary rationales for pursuing a DAM in Ontario.

The first of these is to better coordinate electricity and gas markets, especially in light of the increasing importance of gas-fired generation in Ontario. Gas markets tend to operate on a day ahead basis while in the Ontario electricity market scheduling arrangements are made in real time.

Second is the need to better align the Ontario market with those of our major electricity trading partners which largely operate day ahead markets. This discrepancy increases the risks and difficulties associated with carrying out electricity trades between Ontario and its neighbours with day ahead markets.

Third, a DAM will increase the ability of many demand side participants to respond to price signals.

Finally, a DAM enhances reliability by providing day ahead unit commitment – in effect a planned dispatch of generation units – that is financially compensatory and therefore increases the likelihood of full generator compliance. It also plans the dispatch of generation over the day and therefore can produce a more reliable and efficient dispatch of generators.

IESO witnesses testified that the introduction of Bill 100 did not remove – but had changed - the reasons that support introduction of a DAM. As a result the IESO proposes to update its review of alternative DAM designs. This process will re-establish what the objectives of a DAM are, and create and compare high-level designs around these objectives. The IESO's evidence is that operating expenditures of \$2.4 million in 2005 are appropriate to this task. Mr. Kula of the IESO pointed out that stakeholders were extensively involved in the development of the DAM project.

On cross-examination by Counsel to AMPCO, IESO witnesses allowed that the bundle of day ahead market activities that arises from this process could be quite different from those proposed in the original IESO submission of evidence.

Submissions of the Parties

In final argument Mr. Brown noted that in addition to the four rationales for a DAM, there is consistency with government policy as evidenced by the letter from the Minister of Energy dated November 3, 2004. He also pointed to issues around timing. Proceeding with the work now will allow for orderly implementation in the medium term as concerns grow over gas market coordination and alignment with neighbours. In the near term, IESO staff would be in a position to report to the Board in October of 2005 as part of the next IESO rates case. Mr. Brown also pointed out that the decision to reassess DAM was driven by stakeholders. Finally Mr. Brown pointed out that the evidence on the costs of the IESO's DAM proposal stands uncontroverted by any of the intervenors.

Energy Probe expressed support of the IESO's position on DAM. VECC's final written argument stated that "...VECC is not comfortable with any Day Ahead Market initiatives going forward at the proposed level of \$2.4 million in 2005", but did not provide reasons. Other intervenors registered no objections to the IESO's proposals on DAM.

Board Findings

The Board notes the change in direction made by the IESO's Board of Directors in their December, 2004 meeting to delay any implementation of a DAM, carry out a consultation to re-establish the objectives of a DAM, and update the review of alternative DAM designs based on revised objectives. The Board finds that the IESO's proposed budget for the DAM consultation in the amount of \$2.4 million in operating expenditure in 2005 is reasonable and hereby approved. The Board believes that consultation on this matter is appropriate and will review the merits and costs of implementing any DAM initiative at the time one is proposed.

Resource Adequacy Market

The IESO's evidence on the Resource Adequacy Market indicated that this would be a market-based capacity procurement mechanism. It is intended to address the concern that spot electricity market prices may not be sufficiently high on average to attract the investment in generation and demand response capacity needed to meet future demands.

Mr. Limbrick explained that the IESO proposed to spend \$60,000 on completing draft market rules for the RAM and on discussions with the OPA as to whether or not it should go forward. If there was agreement between the OPA and the IESO on the IESO-designed RAM, then \$400,000 would be spent on implementation in 2005. Half of this amount would be capital expenditure and half would be operating expenditure.

Mr. Murphy of the IESO pointed out that Bill 100 had created the OPA which has the authority to procure adequate electricity supplies for the future, and that a RAM is one possible means of doing so.

On cross-examination from Counsel to AMPCO, Mr. Limbrick acknowledged that the RAM proposal had not met with the same degree of stakeholder consensus as with the DAM proposal.

When asked whether it was clear today whether the IESO should be pursuing the RAM or whether the OPA should be pursuing it, Mr. Campbell replied that the RAM would not be advanced without further discussions with the OPA.

On the question of whether the IESO should undertake the RAM or whether long term resource adequacy is an OPA responsibility, Mr. Campbell indicated that it was clear that RAM should move forward in a coordinated way but that the Minister of Energy had given some policy guidance in this area. Mr. Campbell provided a quotation from a statement by the Minister of Energy that indicated that fully mature electricity markets could exhibit various types of forward markets for energy and capacity, that moving forward with market evolution in a prudent and cost-effective manner would be a key priority for the IESO, and that doing so would allow for less reliance on the contracting processes of the OPA.

Submissions of the Parties

Mr. Brown submitted that the proposed spending on RAM was both appropriate and reasonable in its amounts. He indicated that the IESO will discuss the RAM initiative with the OPA and will only proceed with RAM implementation expenditures if the OPA agrees that it is a good idea and that the IESO should proceed. Mr. Brown stated that in this event many of the objections to RAM implicit in the intervenors' questions would evaporate.

Mr. Brown also argued that the RAM is consistent with government policy. The Government indicated that it did foresee the IESO exploring market-based capacity solutions. Moreover, Ontario regulation 426/04 says that the OPA should take into account the ability of IESO administered markets to meet needs for supply. Mr. Brown indicated that the IESO undertakes to notify the Board when and if agreement is reached with OPA in this regard.

On the reasonableness of the RAM budget, Mr. Brown pointed out that the first tranche is only \$60,000 – a small amount to complete some work and have discussions with OPA. As for the remaining \$400,000 the IESO proposes to spend if the OPA gives the green light, Mr. Brown pointed out that there is no other evidence in the record suggesting that this amount is wrong.

Counsel to AMPCO indicated that it was not a supporter of the RAM initiative during and after the IESO's stakeholdering process. However AMPCO is now satisfied that the IESO commitment to consult with the OPA before committing money to the RAM initiative meets its concerns. However the OEB should approve funds for IESO's liaison with the OPA on the condition that the IESO allow for stakeholder input into this process that the IESO will then forward to the OPA.

Further, assuming an agreement with the OPA and if the IESO pursues RAM, the IESO should spend the \$400,000 only after a RAM cost-benefit analysis is carried out as part of the \$400,000 budget.

Counsel to EDA argued that the IESO undertaking to not proceed with implementation of a RAM until agreement is reached with the OPA is insufficient. In the EDA's view the Electricity Act requires the OPA to develop an integrated power system plan and, as part of that, to identify and develop innovative strategies to encourage and facilitate competitive market-based responses and options for meeting overall system needs.

Therefore a near term agreement between the IESO and OPA in advance of the OPA's completion of an integrated power system plan is inappropriate. The OPA should identify a RAM or other procurement mechanism in the context of the integrated plan before giving a go ahead to anyone else to proceed with it. On these grounds the EDA submitted that the Board should recommend that the IESO not proceed with RAM spending at this time.

Counsel to CCC submitted that the IESO's undertaking to reach agreement with the OPA on RAM in advance of committing the \$400,000 in spending meets the CCC's concerns. Therefore the CCC recommends that the IESO's proposed RAM spending be approved.

VECC indicated in written argument that it did not support RAM spending pending clarification of the responsibilities of the IESO relative to those of the OPA.

Board Findings

The Board takes considerable comfort in the IESO commitment to proceed with RAM expenditures only after agreement is reached with the OPA. Moreover the Board is persuaded by the IESO's point, expressed in Mr. Campbell's response to Mr. Moran, that the IESO should not speculate as to the OPA's view on whether or where to locate the initiation of a RAM in the OPA's processes. However, the Board makes the following two observations:

- The substantive merits of the IESO's RAM proposal have not been reviewed in this proceeding at either a strategic / conceptual level or an implementation level
- It is well known that substantial controversy exists in the wider electricity market community as to the usefulness of resource adequacy or capacity markets in stimulating investment.

Therefore the Board approves the IESO's proposed expenditures in the amount of \$60,000 on liaison with the OPA respecting RAM. The Board also approves the IESO's proposed capital expenditures on RAM in the amount of \$200,000, and the proposed operating expenditures of \$200,000 on the conditions that the IESO not proceed with these expenditures without the agreement of the OPA, and the submission of copies of this agreement to the Board for review and approval of the activities that are proposed to be carried out by the IESO.

Market Pricing Initiative

The IESO explained that the Market Pricing Initiative is a stakeholdering initiative dealing at a tactical level with many issues around pricing in the IESO-administered markets. Stakeholders identified most of the issues but some had been identified by the IESO. The purpose of the initiative was to try to group the issues wherever there were synergies among them, then prioritize the groups. Mr. Limbrick stated that all of the \$300,000 proposed for expenditure under this initiative was “investigatory” in nature and none was for implementation of solutions. Any identified solutions could be implemented through the IESO’s normal OM&A budget, or, if more substantial, could become initiatives under the MEP.

Submissions of the Parties

Mr. Brown noted that the Market Pricing Initiative addresses a variety of issues in the real time market that stakeholders have identified as areas of concern. The \$300,000 amount is for investigatory work, not an implementation budget. On sourcing funds if the IESO and stakeholders agreed on a solution to a given problem, and on how to implement the solution, Mr. Brown highlighted three approaches:

- Find savings in another budget envelop and apply those savings to the solution implementation;
- Accept the IESO’s proposal for an intra-year \$1 million spending threshold with no OEB review;
- Wait until the 2006 fees review.

As for the budgeted amount of \$300,000, Mr. Brown pointed out that the reasonableness of this amount was uncontroverted.

Board Findings

The Board notes the constructive nature of the Market Pricing Initiative and that it engages stakeholders and the IESO in finding ways to improve the operation of the IESO-administered markets. In addition the Board notes that the IESO’s evidence with respect to the Market Pricing Initiative has not been challenged in any way by intervenors. The Board finds that the IESO’s proposed expenditure of \$300,000 on

investigatory work within the Market Pricing Initiative is reasonable and hereby approved.

IESO STAKEHOLDERING

Several intervenors had expressed concerns about the quality of IESO stakeholdering and, as a result, the matter appeared on the List of Agreed Issues presented to the Board at Issues Day on January 10, 2005.

On the first day of the oral hearing, the IESO's first witness panel was subject to direct and cross-examination on IESO stakeholdering. Responding to direct examination questions from Mr. Brown, IESO witnesses stated that stakeholdering is a process for obtaining advice from persons who may be affected by or have an interest in IESO decisions so as to enable the IESO to make better decisions. The IESO carries out stakeholdering on all changes to market rules, and material changes to market manuals, and any other matters that the IESO anticipates, or stakeholders identify, as having potential impacts on stakeholders. Regarding the current review of stakeholdering happening at the IESO, Mr. Campbell stated that there are three main drivers for the review:

- Responding to concerns about IESO stakeholdering that stakeholders have raised.
- The fact that there will no longer be stakeholders on the IESO board.
- The new s. 13.2 of the Electricity Act, which places on the IESO a positive obligation to gather and consider stakeholder views.

Mr. Warren questioned Mr. Campbell on various aspects of the working paper drafted by the IESO's stakeholdering consultant, Mr. David Watt. Mr. Campbell agreed that the working paper reflected a compendium of the views of those involved in the Watt review process on the strengths and weaknesses of IESO stakeholdering, and did not reflect an independent critical review of the process. When asked if he was prepared to confirm IESO adoption of any of the principles proposed for stakeholdering in the working paper, Mr. Campbell stated that he could not speak for IESO management on this as the Watt review process was still on-going and IESO management had not turned its mind to the issues yet.

Mr. Rodger questioned whether the IESO was a neutral participant in stakeholding activities. Mr. Campbell replied that in some cases the IESO may have views on a subject being considered. On matters critical to the IESO's mandate such as reliability, the IESO could not turn over its responsibilities to stakeholders via a stakeholding process.

Mr. Rodger asked, if the IESO had a direct interest in the outcome of a stakeholding process, would it be problematic that the IESO be the facilitator or manager of that process. Mr. Campbell replied that it would not be problematic because the IESO has a responsibility to address its obligations, but must try to do so in a way that responds to the issues as well as any concerns that stakeholders may have. When Mr. Rodger asked how Mr. Campbell would address the concern that the IESO may have an inordinate influence over the outcome of the stakeholding process, Mr. Campbell answered that he did not see it as an issue as long as the process is open and transparent.

On whether there should be an independent agency such as the OEB to facilitate IESO stakeholding Mr. Campbell stated that independent facilitators could be a good thing but that one technique should not be adopted universally as a rule.

Ms. DeMarco questioned how much money the IESO spends on stakeholding. Mr. Campbell answered that spending on stakeholding is not broken out separately.

Submissions of the Parties

Mr. Brown submitted that the Board should make no ruling on the Stakeholding issue other than to recommend that market participants and other engage with the IESO's review and general stakeholding efforts. Mr. Brown submitted that the IESO takes stakeholding very seriously, does a great deal of it, and that it is an integral part of doing business at the IESO.

The IESO's submissions were supported by the Power Workers Union.

Mr. Rodger stated that AMPCO believes that IESO stakeholding on technical matters related to implementation of existing market design are generally thought to be effective. However, the IESO's stakeholding on policy issues such as changes in market design has not been effective.

Mr. Rodger advised the Board to make a condition of order that the IESO identify stakeholdering expenditures as a separate item in s. 19 applications. Mr. Rodger also recommended that the Board accept the following as guiding principles of IESO stakeholdering:

- The IESO should be considered to be one stakeholder among the others;
- Stakeholder process managers should be independent of the IESO;
- Independent process managers should choose which consultants are involved in IESO stakeholdering initiatives;
- The independent process manager should be responsible for the establishment of processes for arriving at conclusions with opportunities for expressing dissenting views;
- During 2005 the OEB should convene a special proceeding to review the IESO's proposed new stakeholdering process.

Ms. DeMarco asked the Board to establish as a condition of approval of the IESO's stakeholder-related costs and activities that the IESO be guided by certain principles. These principles would include those put forward in Mr. Watt's working paper, those on page 2 of Tab 2 of Exhibit I.1.6, and the principles included in the Approved Canadian Standards Association standard pertaining to stakeholdering. Also, APPrO asks that the IESO file the resulting stakeholdering process with the next fees application.

Mr. Moran submitted that the Board should allow the IESO stakeholdering process and review to continue undisturbed at this time. There will be ample opportunity to review the results of the IESO stakeholdering review in future s. 19 cases. To that end Mr. Moran recommended that the Board make a condition of its order that the IESO file a description of its new stakeholdering process with the next s. 19 application.

The OEB Hearing Team noted that the IESO appears to be making a good faith effort to review and reform its stakeholdering processes. Mr. Lyle pointed out that intervenors had called no evidence to indicate what might be a better process for the IESO to follow in reviewing and reforming its stakeholdering, nor had they called evidence about what an IESO stakeholdering process should ultimately look like. Therefore it is not clear that

there is any benefit to intervening at this time in the stakeholdering review process that the IESO has launched.

Mr. Warren's closing argument on behalf of the CCC recommended that the Board pursue some steps in order to ensure "...the appearance of scrupulous fairness and balance...".

In this context Mr. Warren submitted that the Board recommend greater IESO funding for residential customer participation in all IESO stakeholdering activities, that such funding should use the OEB's rules until the IESO develops its own, that not every interest be represented but rather several interests combine behind one representative to achieve economies, and that stakeholder processes be chaired by independent facilitators. Because the IESO declined to state views on the stakeholdering process, Mr. Warren asked the Board to set out its own views as to what the IESO stakeholdering process should be.

VECC's final argument expressed dissatisfaction with the results of the IESO stakeholdering review so far and requested that the Board make as a condition of its order that the IESO conduct an inclusive, transparent process with the benefit of independent advice on its plan to meet the requirements set out in s. 13.2 of the Electricity Act.

In reply Mr. Brown noted that while some stakeholders argue that IESO stakeholdering has been inadequate, a lot of stakeholdering takes place. Its measure of success is not consensus but the extent to which there is an opportunity to register views with those who are making decisions about the design of the market. Mr. Brown argued that the IESO cannot be treated as one stakeholder among many. This misconstrues its obligation to design markets and pass rules as well as management's obligation to recommend to the IESO board.

Mr. Brown argued that for the OEB to impose or recommend any principles of stakeholdering at this time would undermine the current review process, and therefore would be highly inappropriate.

Mr. Brown stated that the IESO disagrees with all of the principles that AMPCO put forward – in particular that an independent agency should run the stakeholdering process. This conflicts directly with s. 13.2 of the Electricity Act which mandates the IESO to establish stakeholdering principles.

Finally Mr. Brown argued that there is no need for the OEB to launch a special s. 19 proceeding to review the results of the IESO stakeholdering review. The IESO's 2006 fees application will be before the Board in roughly six months' time and it will contain a report on the new process.

Board Findings

The Board is persuaded by the arguments made by the applicant and some intervenors that there is little to be gained through any significant Board intervention in the IESO's stakeholdering review process at this time. Therefore the Board directs the IESO to file its proposed stakeholdering process and proposed funding of same with the Board for approval before implementation when the proposal becomes available.

COMPARABILITY OF IESO COSTS, PERFORMANCE, AND OUTPUT WITH THE COSTS, PERFORMANCE, OUTPUTS OF OTHER SYSTEM REGULATORS

The issue of cost comparison has been discussed at several of the IESO's previous fees cases. In this proceeding witnesses for the IESO answered questions about the cost comparison agreement signed by the IESO and other independent system operators (ISOs) in North America. As well, IESO witnesses provided information about the issuance of a notice of inquiry by the U.S. Federal Energy Regulatory Commission (FERC) on the matter of establishing a uniform system of accounts (USA) for ISOs.

The inter-ISO cost comparison initiative has four objectives. These are:

- To gain a better understanding of cost drivers in ISOs;
- To improve the mutual understanding of each other's operations in the ISO community;
- To develop meaningful information that could be shared with stakeholders;
- To use the cost comparison initiative as a business tool.

This initiative was well underway when in September 2004 FERC issued its notice of inquiry. Under direct examination by Mr. Brown, Mr. Sherkey of the IESO indicated that he did not know when the FERC would issue its next report on what the cost categories in the USA should be. In the meantime the IESO has filed with the OEB the updated cost comparison information based on publicly available information as it has in the

past. Since this report does not use standardized account definitions it does not provide apples-to-apples comparisons.

Counsel to AMPCO asked what the role of stakeholders would be in the FERC process. Mr. Campbell answered that it is quite open for stakeholders to make comments to FERC on whether the USA being developed is appropriate. Mr. Rodger also asked what role the Board had going forward. Mr. Sherkey indicated that the Board could expect to receive much more detailed cost comparison information in the future. Mr. Rodger expressed concerns about the undetermined amount of time before the FERC process concludes, to which Mr. Sherkey replied that the IESO could not control the FERC process.

Mr. Rodger also asked if the IESO would continue to file the publicly available information in the event the FERC process takes a long time. Mr. Sherkey replied that he could not see the need given that everyone seemed to agree that it is not providing useful information.

As to why confidentiality is needed in the FERC process, Mr. Sherkey said that it is absolutely customary for organizations to sign non-disclosure agreements when working on a project in which a lot of data will be exchanged.

Mr. Janigan asked why bilateral agreements on benchmarking would not be entered into – between the IESO and the New York ISO for example. Mr. Sherkey replied that since each ISO tends to be different it is important for comparability to get as many involved in the project as possible.

On the question by the Board Panel whether the confidentiality provisions of the FERC process will inhibit the testing of evidence in public forums such as this one on cost comparisons, Mr. Sherkey replied that the intention of the whole process is to produce reports suitable for making comparisons across system operators.

Submissions by the Parties

Mr. Brown submitted that the ISO and now FERC cost comparison initiative is a “good news” story and recommended that the Board simply wait for the results of the process. Several intervenors agreed with this view but urged the Board to emphasize the importance of the cost comparison initiative in its decision. Mr. Rodger stated that the IESO should continue to file cost comparisons based on publicly available information

despite the identified limitations of the data. Mr. Brown replied that there was little point to this and that cost comparison should be done right.

Board Findings

The Board is persuaded by the arguments of the applicant that the current cost comparison exercise unfolding under the aegis of the FERC is the best way to make meaningful benchmarking comparisons with other system operators. Therefore the Board directs the IESO to file the information compiled in accordance with the FERC process when that process is complete.

BOARD ORDER

The Board approves:

- The IESO's proposed 2005 revenue requirement, as amended, of \$152.4 million;
- The IESO's proposed 2005 expenditures, as amended, of \$151.6 million;
- The IESO's proposed fees for 2005 of \$0.959/MWh.

The Board's approval of the IESO's 2005 expenditures on the RAM is conditional on:

- The IESO not proceed with these expenditures without the agreement of the OPA;
- The submission of copies of this agreement to the Board for review and approval of the activities that are proposed to be carried out by the IESO.

COST AWARDS

The Board received submissions and claims for costs from the following parties:

- Consumers Council of Canada (CCC)
- Energy Probe
- Association of Major Power Consumers of Ontario (AMPCO)
- Vulnerable Energy Consumers of Canada (VECC)

The Board was assisted by the contributions of the parties and awards CCC, Energy Probe, AMPCO, and VECC 100% of their reasonably incurred costs in connection with their participation in this proceeding, subject to assessment by the Board's Cost Assessment Officer.

The Board orders that the eligible costs of intervenors, as assessed by the Cost Assessment Officer, shall be paid by the Independent Electricity System Operator upon receipt of the Board's Cost Order.

DATED at Toronto on May 24, 2005

Original Signed By

Gordon Kaiser
Presiding Member

Original Signed By

Paul Sommerville
Member

Original Signed By

Paul Vlahos
Member

APPENDIX A: HISTORY OF THE PROCEEDING

The Board issued six procedural orders in connection with this proceeding. They provided for technical conferences, a discovery process, intervenor evidence filing, issues identification, a settlement process and a date for commencement of the oral hearing.

On December 13, 2004 the Board issued Procedural Order 1, which provided for an issues conference to be held at Board offices on Wednesday, January 5, 2005. It also provided for an Issues Day hearing before the Board, which was held on Monday, January 10, 2005. Procedural Order 1 also established a process for interrogatories and responses on the pre-filed evidence. Interrogatories were filed with the Board by January 19, 2005, and the IESO filed responses by February 9, 2005. Procedural Order 1 also provided a process for the filing of evidence by intervenors but no such evidence was filed.

On January 4, 2005 the IESO notified the Board of two changes to its Fiscal 2005 Fees submission. The first change reflected an IESO Board decision to update its review of alternative designs for a Day Ahead Market (DAM), and delay any significant capital expenditures on DAM through 2005. The second change dealt with a Memorandum of Understanding entered into by the IESO and the Ministry of Energy to make available \$15 million of the IESO's accumulated operating surplus to assist the Ontario Power Authority (OPA) in its start-up activities.

The Issues Conference held on January 5, 2005 resulted in a List of Agreed to Issues and a List of Contested Issues. During the Issues Day held on January 10, 2005, a panel of the Board heard submissions on the Listed of Contested Issues.

On January 12, 2005 the Board issued Procedural Order 2, which provided for a transcribed Technical Conference to be held at the Board's offices on Friday January 14, 2005.

On January 13, 2005 the Board issued Procedural Order 3, which provided the approved Issues List for the hearing. During the Issues Day held on January 10, 2005, a panel of the Board heard submissions on the List of Contested Issues. The first contested issue was whether the Board has jurisdiction under s. 19 of the *Electricity Act* (the "Act") to review the merits of the components of the Market Evolution Program

("MEP") as part of its review of the IESO's expenditure and revenue requirements. The Board found that it had this jurisdiction. However, the Board also found that the merits of the MEP can be effectively reviewed in accordance with the market rule amendment review process under ss. 33 / 34 of the *Act*, on the condition that the IESO undertake that "no expenditures would be incurred in this area without a market rule having been established to accommodate and encapsulate those expenditures, and the review process having been completed."

The Board therefore proposed that expenditure commitments that the IESO may make in 2005 be capped pending the completion of a market rule amendment review process for the MEP and requested that the IESO advise whether it was prepared to provide an undertaking to that effect. The IESO advised that it was not prepared to provide such an undertaking. As a result the Board ruled that the following issue would be addressed in the proceeding:

"Should the Board recommend that the IESO not make expenditures beyond a threshold amount in support of the Market Evolution Program pending the completion of the Market Evolution Program market rule amendment process under ss. 33 / 34 of the *Electricity Act*; if so, what is the threshold?"

The second disputed issue addressed the IESO's legal authority to enter into the Memorandum of Understanding. In this regard, the Board indicated that it would address the following issue in the proceeding:

"What is the IESO's legal authority to enter into the Memorandum of Understanding?"

On February 4, 2005 the Board issued Procedural Order 4, which provided for a Technical Conference to be held at Board offices to provide intervenors and the Board's Hearing Team an opportunity to ask the IESO questions regarding the prefiled evidence and its responses to interrogatories. Procedural Order 4 also provided for a Settlement Conference and for the Board to receive the Settlement Agreement negotiated among the parties.

On February 17th, 2005 the Board issued Procedural Order 5, which revised the dates for the Settlement Conference (to start March 1, 2005), and the hearing to receive the Settlement Agreement (to March 3, 2005). The date for the commencement of the oral hearing was revised to March 29, 2005.

A Settlement Conference was held on March 1 and 2, 2005. It resulted in a Proposed Settlement Agreement.

The Board sat to receive the Proposed Settlement Agreement on Thursday March 3, 2005. The Board reserved its decision on the Proposed Settlement Agreement and required the IESO to revise the document so as to incorporate the clarifications that were provided orally. The IESO filed this revised version of the Proposed Settlement Agreement with the Board on March 8, 2005; a copy of this document is provided as an Appendix to this Decision.

On March 18, 2005 the Board issued Procedural Order 6, which gave reasons why two issues originally identified in the Notice of Application (and the issue identified in Procedural Order 3 relating to the Memorandum of Understanding) would not remain as issues in the hearing, and otherwise accepted the Settlement Agreement negotiated between the applicant and the intervenors. Procedural Order 6 then listed the remaining issues to be heard in the proceeding. The last issue on Procedural Order 6 was "IESO performance indicators, if this issue is not resolved prior to the hearing." Counsel for the IESO reported at the first day of the hearing that in fact this issue had been resolved, and had been the subject of a settlement agreement between the IESO and Ontario Power Generation Inc., the intervenor with the interest in this issue.

PARTICIPANTS AND THEIR REPRESENTATIVES

The Board granted intervenor status to twenty one parties and granted observer status to three parties. Below is a list of intervenors and their representatives:

Hydro One Networks Inc.
Glen MacDonald

TransCanada Energy Ltd.
Alan Ross
Margaret Duzy

Ontario Energy Association
Bernard Jones

Ontario Power Generation Inc.
Colin Anderson

The Vulnerable Energy Consumers Coalition
Michael Janigan
Roger Higgin

ECNG Partnership
Bill Killeen

Power Worker's Union
Richard Stephenson
Bob Menard
Judy Kwik

Association of Major Power Consumers in Ontario
Mark Rodger
Mary Ellen Richardson

Energy Probe
Thomas Adams
David MacIntosh

Electricity Distributors Association
Pat Moran
Maurice Tucci

Coral Energy Canada Inc.
Paul Kerr
Charles Keizer

Toronto Hydro-Electric System Limited
Richard Zebrowski

TransAlta Cogeneration L.P. and TransAlta Energy Corp.
Lisa DeMarco
Sandy O'Connor

Electric City Corp.
Thomas Brett

Ontario Federation of Agriculture
Ted Cowan

The Society of Energy Professionals
Rick Coates

Association of Power Producers of Ontario
Lisa DeMarco
David Butters

Union Gas Limited
Patrick McMahon

Electricity Market Investment Group
Robert Power

Consumers Council of Canada
Robert Warren
Julie Girvan

Ontario Energy Board Hearing Team
Mike Lyle
Elaine Wong

Below is a list of observers, and their representatives, to the proceeding:

Brascan Energy Marketing Inc.
Mr. Peter Bettle

Superior Energy Management
Gerald M. Haggarty

Rogers Communications Inc.
John T. Armstrong

WITNESSES

The following IESO employees appeared as witnesses:

Bruce Campbell
Vice-President, Corporate and Legal Affairs

Derek Cowbourne
Vice-President, Market Services

Len Kula
Project Manager, Day Ahead Market

William Limbrick
Vice-President, Information Technology and Infrastructure

Paul Murphy
Chief Operating Officer, Market Operations and Forecasts

Gary Sherkey
Vice-President, Chief Financial Officer, Treasurer

APPENDIX B: SETTLEMENT AGREEMENT

STIKEMAN ELLIOTT

Stikeman Elliott LLP Barristers & Solicitors

5300 Commerce Court West, 199 Bay Street, Toronto, Canada M5L 1B9
Tel: (416) 869-5500 Fax: (416) 947-0866 www.stikeman.com

David M. Brown
Direct: (416) 869-5602
E-mail: dmbrown@stikeman.com

BY COURIER

March 8, 2005
File No.: 101926-1032

Mr. John Zych
Board Secretary
Ontario Energy Board
2300 Yonge Street
26th Floor
Toronto, Ontario M4P 1E4

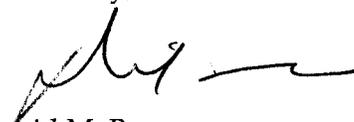
Dear Mr. Zych:

**Re: Independent Electricity System Operator ("IESO")
Fiscal 2005 Fees
EB-2004-0477**

On March 3, 2005 the IESO and certain Intervenors appeared before the Board to present the proposed Settlement Agreement in this proceeding. At the end of the hearing the Board requested that the Settlement Agreement be redrafted to clarify certain portions.

Since that time the IESO has circulated revised drafts of the Settlement Agreement to Intervenors and has obtained their concurrence on a revised version. I attach 9 copies of the final form of the Settlement Agreement for consideration by the Board.

Yours truly,


David M. Brown

DMB/kh
encl.

cc: Helen Lainis
IESO

All Registered Intervenors

TORONTO
MONTREAL
OTTAWA
CALGARY
VANCOUVER
NEW YORK
LONDON
HONG KONG
SYDNEY

INDEPENDENT ELECTRICITY SYSTEM OPERATOR (IESO)
FISCAL YEAR 2005 FEES SUBMISSION FOR REVIEW
SETTLEMENT AGREEMENT
EB-2004-0477

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-2004-0477 Submission for Review. A Settlement Conference was conducted on March 1 and 2 of 2005, 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 Major Power Consumers in Ontario (AMPCO);
- Association of Power Producers of Ontario (APPPrO);
- Consumers Council of Canada (Council);
- Electricity Distributors Association (EDA);
- Energy Probe Research Foundation (Energy Probe);
- Ontario Energy Board’s Hearing Team (OEB Team);
- Ontario Federation of Agriculture (OFA);
- Ontario Power Generation (OPG);
- Power Workers’ Union (PWU);
- TransCanada Energy; and
- Vulnerable Energy Consumers Coalition (VECC)

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

1. Financial Management
2. The Effect of Bill 100
3. Cost Incurred in 2005
4. Stakeholding
5. Rate and Fee Design
6. Benchmarking
7. Performance Indicators
8. Memorandum of Understanding
9. 2005 Expenditure and Revenue Requirement: Market Evolution Program

Each issue falls into one of the following categories:

- a) an issue for which there is complete settlement, because the IESO and all of the other parties who discussed the issue either agree with the settlement or take no position on the issue:
- b) an issue for which there is no settlement, because the IESO and other parties who discussed the issue are unable to reach an agreement to settle the issue.

The OEB Hearing Team takes 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.

1. Financial Management

- 1.1. Impact of the change in the accrued surplus for the IESO's rate stabilization proposals:
 - 1.1.1. Rationale for retaining an accumulated surplus
 - 1.1.2. Impact of the December 23, 2004 Memorandum of Understanding
 - 1.1.3. Implications on 2005 operations
- 1.2. Financial practices, including budgeting process, debt position and fluctuations in debt levels, and policies for providing financial support for non-IESO activities.

There is an agreement to settle issues 1.1 and 1.2 on the following basis:

1.1 In considering alternatives for disposition mechanisms for the deferral account balance, intervenors felt that the ultimate beneficiaries of the deferral account balance should be the market participants and that it would be a reasonable approach for surplus in excess of a threshold amount to be returned to market participants, as it is market participants that paid those funds initially, in lieu of the IESO continuing to hold surplus amounts in excess of a threshold amount for an indefinite period of time.

The parties agreed that should the amount in the IESO's variance account exceed \$5 million at the end of a year, any excess over \$5 million would be returned to market participants in the form of a rebate in the following year, based on the market participant allocated quantity of energy withdrawn during the prior year. If the excess is less than the cost of processing the rebate, in the normal course this is estimated to be less than \$20,000, the IESO retains the discretion to not rebate the excess.

The following evidence supports this settlement:

Exhibit B, Tab 1, Schedule 1: 2005-2007 Business Plan, Pages 50-53;
Interrogatory # 5.10;
Interrogatory # 8.4.

The following parties support the agreement on this issue: AMPCO, Council, EDA, Energy Probe, OFA, PWU and VECC

The following parties take no position on this issue:
APPrO, OPG and TransCanada Energy

1.2 The IESO undertakes to review its current written policy on charitable donations in order to provide more detail on those activities that qualify for donations from the IESO and, to that end, will consider the elements proposed in the filed evidence by the Ontario Federation of Agriculture: Considerations for a Policy for – Expenditures Not Directly in Support of Corporate Objectives.

The following evidence supports this settlement:

Interrogatory # 11.2

The following parties support the agreement on this issue: Council, OFA, and PWU

The following parties take no position on this issue:
AMPCO, APPrO, Energy Probe, EDA, OPG, TransCanada Energy and VECC

2. The Effect of Bill 100

- 2.1. Impact of Bill 100 on the duties and operations of the IESO in 2005 and the consequent impact on 2005 expenditures and revenue requirements.
- 2.2. Scope of the services provided by the IESO to the Ontario Power Authority and the Ontario Energy Board, including the associated costs and compensation.

The parties discussed both issues 2.1 and 2.2 at the Settlement Conference. The parties agreed to settle both issues 2.1 and 2.2 on the following basis:

The parties agreed to that during 2005 the IESO will track costs associated with any services provided to OPA and the OEB and report on the nature and amount of the costs associated with these services incurred in 2005 in its Fiscal Year 2006 Fees Submission for Review.

The IESO commits to consider, as part of its on-going discussions with the OEB and OPA, the use of service level agreements for any on-going services to be provided to OPA and the OEB.

The IESO also undertakes that in 2005 it will not commit to any contracts longer than one year for services with the OPA and OEB.

The intervenors were concerned about the potential for duplication or overlap but recognized that there was considerable uncertainty for 2005, since the OPA is still in the process of being set up. In recognizing this uncertainty, the parties were of the view that the best way to approach the problem was to have the IESO track all of the costs associated with providing any services to the OPA or OEB. The IESO's agreement to consider the use of service-level agreements and its undertaking not to enter into any contracts longer than one year for services is intended to ensure that costs are not inappropriately stranded. It was partly on this basis that the intervenors were prepared to settle issue 3 as well.

The following evidence supports this settlement:

Exhibit B, Tab 1, Schedule 1: 2005-2007 Business Plan, Pages 4-5;
Interrogatory # 1.1;
Interrogatory # 1.2;
Interrogatory # 1.3;
Interrogatory # 1.8;
Interrogatory # 1.9;
Interrogatory # 11.8.

The following parties support the agreement on this issue: AMPCO, APPrO, Council, EDA, Energy Probe, OFA, PWU and VECC

The following parties take no position on this issue:
OPG and TransCanada Energy

3. Cost Incurred in 2005

- 3.1. Appropriate level of costs - including:
 - 3.1.1. Operations, Maintenance and Administration
 - 3.1.2. Labour (costs and strategies)
 - 3.1.3. Depreciation
 - 3.1.4. Capital expenditure management

In its Revised 2004-2005 Financial Information filed on February 9, 2005 as Exhibit B, Tab 4, Schedule 1, the IESO stated that it was seeking approval for a 2005 revenue requirement of \$152.4 million and capital expenditures of \$20.1 million. Of those amounts, the OM&A and capital expenditures proposed for

Market Evolution Program initiatives total \$3.2 million and \$0.2 million respectively.

Issue 3 was settled on the following basis:

(i) The parties reached agreement on \$149.2 million of the IESO's 2005 proposed revenue requirement (i.e. \$152.4 million less \$3.2 million OM&A for Market Evolution Program initiatives) and \$19.9 million of the IESO's 2005 proposed capital expenditures (i.e. \$20.1 million less \$0.2 million in capital expenditures for Market Evolution Program initiatives). This agreement was subject to the following:

In 2005, the management of the IESO, having consulted with the intervenors to this proceeding by means of a meeting regarding the terms of reference, will retain a consultant other than Towers Perrin to perform a full review of the IESO's compensation and its comparative position in the marketplace. This does not preclude the IESO from retaining the services of Towers Perrin for any purpose.

The intervenors taking a position on this issue are concerned that the IESO's compensation may be too high, in absolute terms and in comparison with similarly situated entities in the marketplace.

[The following parties support the agreement on this issue:
AMPCO, Council, EDA, Energy Probe, OFA, and VECC

The following parties take no position on this sub-issue: APPrO,
PWU, and TransCanada Energy].

(ii) The parties did not reach agreement on the proposed costs associated with the Market Evolution Program initiatives as described on pages 29 and 41 of the IESO's updated evidence - Revised 2004-2005 Financial Information (i.e., DAM, RAM, Market Pricing and Program Management) – \$3.2 million OM&A and \$0.2 million in capital expenditures. That issue will be subject to a hearing.

The evidence in support of this agreement is as follows:

Exhibit B, Tab 1, Schedule 1: 2005-2007 Business Plan;
Exhibit B, Tab 4, Schedule 1: Revised 2004-2005 Financial Information.

OPG takes no position on issue 3.

4. Stakeholdering

4.1. IESO Stakeholder Consultation

There is no agreement to settle this issue.

5. Rate and Fee Design

- 5.1. Cost Allocation
- 5.2. Translation of costs into fees and charges
- 5.3. Direct incidence of fees and charges among market participants and energy customers

The parties agreed to the IESO's proposal to continue the current usage fee of \$0.959/MWh and application fee of \$1,000 for 2005 and that the IESO will undertake (i) to complete for its Fiscal Year 2006 Fees Submission for Review the last 3 steps outlined in Appendix A – IMO Proposed Fee Unbundling Plan of Attachment 24 (Exhibit B, Tab 2, Schedule), which is also attached to this Settlement Proposal and (ii) to submit as part of that case proposed draft terms of reference for a study of the cost incidences for fee unbundling options (i.e., different fee structures such that the study examines fees paid by different groups, e.g., market participants, consumers).

The evidence in support of this agreement is as follows:

Exhibit B, Tab 1, Schedule 1: 2005-2007 Business Plan, Pages 49-50;
Exhibit B, Tab 5, Schedule 1: Context for FERC Staff Report and FERC NOI;
Exhibit B, Tab 5, Schedule 2: FERC Staff Report on Day One RTO Costs;
Exhibit B, Tab 5, Schedule 3: FERC NOI;
Interrogatory # 7.26;
Interrogatory # 7.27;
Interrogatory # 8.8;
Interrogatory # 8.9;
Interrogatory # 11.1;
Interrogatory # 11.2;
Interrogatory # 12.2;
Interrogatory # 12.3.

The following parties support the agreement on this issue: AMPCO, Council, EDA, Energy Probe, OFA, and VECC

The following parties take no position on this issue:
APPo, OPG, PWU and TransCanada Energy

6. Benchmarking

- 6.1. Comparability of IESO costs, performance and outputs with the costs, performance and outputs of other system operators

There is no agreement to settle this issue.

7. Performance Indicators

- 7.1. IESO performance indicators

The parties agreed to consider this issue settled on the basis that the IESO provide, prior to the commencement of the hearing, a satisfactory response to OPG's proposed modifications to IESO performance metrics (absolute error and bias for the 3 hour out day-at-hand demand forecast), as submitted on March 1, 2005. The IESO's response will be provided to all intervenors and filed with the Board.

The evidence in support of this agreement is as follows:

Exhibit B, Tab 1, Schedule 1: 2005-2007 Business Plan, Pages 61-65;
Interrogatory # 4.10;
Interrogatory # 4.11;
Interrogatory # 4.12;
Interrogatory # 4.13;
Interrogatory # 4.14.

The following parties support the agreement on this issue: OPG, and Energy Probe

The following parties take no position on this issue:
AMPCO, APPrO, Council, EDA, OFA, PWU, TransCanada Energy and VECC

8. The Memorandum of Understanding

- 8.1. What is the IESO's legal authority to enter into the Memorandum of Understanding?

In view of the publication of Ontario Regulation 47/05, this is no longer an issue for this proceeding.

The following parties support the agreement on this issue: AMPCO, APPrO, Council, EDA, Energy Probe, OFA, OPG, PWU, and VECC

The following party takes no position on this issue: TransCanada Energy

9. 2005: Expenditure and Revenue Requirement: Market Evolution Program

- 9.1. Should the Board recommend that the IESO not make expenditures beyond a threshold amount in support of the Market Evolution Program pending the completion of the Market Evolution Program market rule amendment process under ss. 33 and 34 of the *Electricity Act*; if so, what threshold?

There is no agreement to settle this issue.

APPENDIX A - IMO PROPOSED FEE UNBUNDLING PLAN

Steps for Unbundling	Timeline and Impacting Factors
<p>Identification and Definition of IMO Activities:</p> <ul style="list-style-type: none"> • Develop a complete inventory of all activities performed by the IMO and their associated costs. 	<ul style="list-style-type: none"> • Completed last year. • Update for this year. • Target date August 2002.
<p>Preliminary Mapping of Activities into Service Categories:</p> <ul style="list-style-type: none"> • Look for logical groupings of activities and consider alignment with <ul style="list-style-type: none"> - Operating and Other Agreements between market participants and the IMO - Organizational departments performing the activity - Settlement charges - Customer segment - Computer application or system - Other ISO/RTO unbundled fee structure - Market design elements 	<ul style="list-style-type: none"> • Completed last year based on alignment with organizational departments performing the activity and computer application or system. • Complete for this year based on alignment with other logical groupings: <ul style="list-style-type: none"> - Other ISO/RTO unbundled fee structures - Market design elements • Target date September 2002.
<p>Service Category Refinement:</p> <ul style="list-style-type: none"> • Each service should be clearly defined. • Each service should be large enough to be worth the unbundling effort. • Costs and usage for each service should be predictable. • Services used by the same customers may be grouped. 	
<p>Determination of Cost for Each Service:</p> <ul style="list-style-type: none"> • Determine costs to perform each activity. • Map activities to each service. • Use mapping to aggregate costs of each service. • Allocate common costs amongst services. 	
<p>Assign Appropriate Billing Determinant to Each Service:</p> <ul style="list-style-type: none"> • Evaluate on basis of economic fairness, ie. <ul style="list-style-type: none"> - Cost causation - Value of benefits received • Assess potential impact on: 	

Steps for Unbundling	Timeline and Impacting Factors
<ul style="list-style-type: none">- Market behaviour- IMO operations and impact on infrastructure requirements- Likelihood and amount of over/under collected- Price certainty- Materiality and practicality	