

STATUS REPORT

OBLIGATIONS AND UNDERTAKINGS ARISING OUT OF

THE IESO'S FISCAL 2005 FEE SUBMISSION FOR

REVIEW

October 27, 2005

I. DECISION WITH REASONS

1. RESOURCE ADEQUACY MARKET

Obligation:

The Board's approval of the IESO's proposed 2005 capital expenditures on RAM in the amount of \$200,000 and the proposed operating expenditures of \$200,000 was approved on the condition that the IESO should not proceed with these expenditures without the agreement of the Ontario Power Authority (OPA), and that the IESO must submit to the Board copies of any agreement with OPA for review and approval of the activities that are proposed to be carried out by the IESO.

Status:

As noted in the 2006 – 2008 Business Plan, in response to the events of 2005 the IESO has focused its efforts on addressing current market issues prior to proceeding with significant market evolution. As such, and consistent with the IESO's stated objective of closely co-ordinating with OPA, the IESO has not proceeded with implementation of RAM in 2005, nor is it proposing any capital and operating expenditures on RAM for the fiscal year 2006.

2. IESO STAKEHOLDERING

Obligation:

The Board directed 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.

Status:

On August 10, 2005 the IESO submitted its proposed stakeholdering process to the Board for approval. The IESO's proposed stakeholdering process is based on the *Final Report to the IESO Board of Directors: IESO Stakeholder Engagement Review: Recommended Stakeholder Engagement Principles, and Mechanism*, with an estimated cost of \$304,000 for 2005.

The Board approved the IESO proposed stakeholdering process and related 2005 funding in its Supplementary Decision issued on September 20, 2005.

On September 23, 2005, the IESO Board of Directors appointed the first members to the newly formed Stakeholder Advisory Committee. The IESO's proposed funding for the stakeholdering process for fiscal year 2006 is \$867,407.

The above referenced documents are part of the IESO's pre-filed evidence for its fiscal year 2006 fees submission for review:

Reference	Document
<ul style="list-style-type: none"> Exhibit B, Tab 6, Schedule 1 	<ul style="list-style-type: none"> IESO Letter to OEB for submission of proposed stakeholdering process and funding, dated August 10, 2005.
<ul style="list-style-type: none"> Exhibit B, Tab 6, Schedule 2 	<ul style="list-style-type: none"> Supplementary Decision issued by OEB on September 20, 2005.
<ul style="list-style-type: none"> Exhibit B, Tab 6, Schedule 3 	<ul style="list-style-type: none"> List of Members of the Stakeholder Advisory Committee.

3. COST COMPARISONS WITH OTHER SYSTEM OPERATORS

Obligation:

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.

Status:

It is anticipated that information compiled in accordance with the FERC process will become available during 2006. The NOPR is scheduled to become effective as of January 1, 2006.

Background:

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 responds 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. The IESO filed the NOI, including joint comments with its US and Canadian counterparts that it submitted to FERC, as part of its fiscal year 2005 fees submission for review.

The NOPR will update FERC's Uniform System of Accounts (USofA) in order to improve the transparency of financial information and to better understand the costs of RTOs. These proposed accounting and financial changes and updates identified in the NOPR are scheduled to become effective on January 1, 2006, and are summarized below:

- Establishes new accounting categories to capture the costs of:
 - (i) **assets owned and used by ISOs/RTOs**, which are primarily information technology (computer hardware and software);
 - (ii) **market-related services performed by ISOs/RTOs** such as the facilitation of day-ahead and real-time energy markets, ancillary services markets and market monitoring and compliance;
 - (iii) **transmission-related services performed by ISOs/RTOs** such as system control, dispatching, monitoring and operating the transmission system for reliability, connection assessments and long-term planning and standards development.
- Requires ISOs/RTOs to include in their monthly settlement statements a breakdown of the allocation of their operational costs within the following three categories:
 - (i) Scheduling, System Control and Dispatch Services
 - (ii) Long-Term Reliability Planning and Standards Development Services
 - (iii) Market Facilitation, Monitoring and Compliance Services

In response to the NOPR, the IESO filed its own comments and joint comments with its counterparts in the US and Canada to FERC. In their joint comments, the ISOs/RTOs sought flexibility in making the cost breakdowns available through comparable means such as postings on the ISOs/RTOs website rather than on the monthly settlement statements given that modification to existing billing systems would be expensive and time-consuming both to the ISOs/RTOs and market participants.

In its own comments filed to FERC, the IESO noted the OEB's recognition of our participation in this process and the IESO's intention to submit to the OEB any comparable breakdowns made available by ISOs/RTOs, as part of its annual rate review.

The above referenced documents are part of the IESO's pre-filed evidence for its fiscal year 2006 fees submission for review:

Reference	Document
• Exhibit B, Tab 7, Schedule 1	• FERC's NOPR on Accounting and Financial Reporting for Public Utilities Including RTOs.
• Exhibit B, Tab 7, Schedule 2	• IESO Comments on FERC's NOPR.
• Exhibit B, Tab 7, Schedule 3	• ISO/RTO Council Joint Comments on FERC's NOPR.

II. SETTLEMENT AGREEMENT

4. DISPOSITION OF DEFERRAL ACCOUNT BALANCE

Undertaking:

It was agreed that any surplus held by the IESO at the end of a year in excess of \$5.0 million is returned to the 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.

Status:

The 2005 projected operating results would result in an accumulated operating surplus of \$13.9 million by year-end. This is determined by adding last year's actual accumulated surplus of \$18.9 million, less the \$15.0 million in funding for the Ontario Power Authority, to this year's projected surplus of \$10.0 million. The IESO is estimating a refund of approximately \$8.9 million.

It is proposed that the final amount to be refunded be based on the IESO's audited financial statements for the fiscal year 2005 and that the refund be billed to market participants in the next billing cycle following the month in which the 2005 financial statements are approved by the IESO Board of Directors.

5. POLICY ON CHARITABLE DONATIONS

Undertaking:

The IESO undertook 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.

Status:

The current mandate with respect to charitable donations within the IESO is found in the Organizational Authority Register and states, "The Chief Financial Officer or Director, Finance must approve all charitable donations made by the Corporation in advance". In practice the only charitable donations from the IESO are made on behalf of pensioners at the time of their death. The donation amount is \$50.

At the September 23, 2005 meeting of the Board of Directors, the IESO sought direction from the Board on whether to have a company policy on charitable donations. The Board requested that two alternative policies be developed for their review and approval at a later date.

The IESO is currently evaluating the policies from other ISOs, Ontario Hydro successor companies and the above mentioned document from the Ontario Federation of Agriculture in order to develop the two alternatives requested by the Board of Directors. These are expected to be presented to the Board early in 2006.

6. SERVICES PROVIDED TO OPA AND THE OEB

Undertaking:

There were two parts to this undertaking:

(i) Tracking and Reporting of Costs

During 2005, the IESO would track costs associated with any services provided to OPA and the OEB and report in its fiscal 2006 fees submission on the nature and amount of the costs incurred in 2005 associated with these services.

(ii) Use of Service Level Agreements

The IESO also committed 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 undertook that it would not commit to contracts for services with either for longer than one year.

Status:

The table below summarizes the nature and amount of costs incurred in 2005 by the IESO services provided to OPA and the OEB and planned to be incurred in fiscal year 2006, as well as the service level arrangements made for any on-going services to these entities.

Nature Of Services	Costs of Services			Service Level Arrangements
	Category	Actual 2005	Budget 2006	
To OPA:				
<ul style="list-style-type: none"> Long-term forecasting and system assessments to support OPA's system planning responsibilities 	<ul style="list-style-type: none"> OM&A – Labour Revenue – Cost Recovery 	<ul style="list-style-type: none"> \$155,106 \$0 	<ul style="list-style-type: none"> \$300,000 (300,000) 	<ul style="list-style-type: none"> M. O. U. Principles to Govern Co-ordination of Activities between the OPA and the IESO.
To OEB:				
<ul style="list-style-type: none"> Market Surveillance Panel Support for OEB's Market Surveillance Panel 	<ul style="list-style-type: none"> OM&A – Labour OM&A – Labour 	<ul style="list-style-type: none"> \$173,000 \$574,909 	<ul style="list-style-type: none"> \$0 \$577,331 	<ul style="list-style-type: none"> Protocol Relating to Market Surveillance Panel Effective April 25, 2005 to April 25, 2006 Starting in year 2006, Market Surveillance Panel costs are assumed by the OEB.

The above referenced documents are part of the IESO's pre-filed evidence for its fiscal year 2006 fees submission for review:

Reference	Document
• Exhibit B, Tab 8, Schedule 1	• M. O. U. Principles to Govern Co-ordination of Activities between the OPA and the IESO
• Exhibit B, Tab 8, Schedule 2	• Protocol Relating to Market Surveillance Panel

7. COMPENSATION SURVEY

Undertaking:

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.

Status:

The IESO held a meeting with intervenors and members of the Regulatory Affairs Standing Committee on June 20, 2005 asking intervenors to provide feedback on which elements of the IESO's proposed terms of reference should be considered by the new consultant. Prior to the meeting, material on progress to date and proposed terms of reference were provided to intervenor contacts and participants of the Regulatory Affairs Standing Committee. All were invited to attend the meeting.

At the meeting, a presentation was made to review the previously distributed material in detail. Stakeholders provided feedback which was documented within the minutes from the meeting. The minutes were made available to all invited members and were posted on the IESO public website through the Regulatory Affairs page.

The main elements of feedback suggested by the stakeholders were:

- In selecting comparator organizations, the IESO's increasing role in the areas of communication and education of market participants and other industry players should be considered.
- The stakeholders indicated that they were hoping to see new approaches such as the ability to take account of differences in experience levels of employees and some further disaggregation by staff groupings.
- The stakeholders also indicated that they were interested in insuring that firms were included with the potential of attracting IESO staff and with whom the IESO competes for talent (including U.S. firms)
- The stakeholders also wanted to ensure that appropriate methodologies were in place, particularly for job matching, within this survey undertaking.

The survey has been completed. The Hay Group was selected to conduct the survey following a review of several other candidate organizations. The results of the survey are being applied to the IESO's internal needs as well as the OEB's needs, including its application for the IESO's 2006 Management Compensation Program and for collective bargaining purposes.

The survey methodology was able to accommodate many of the above elements suggested by stakeholders:

- The IESO list of comparator organizations were adjusted to include organizations possessing similar communication/education roles with the inclusion of the OEB, the Electrical Safety Authority, the Ontario Securities Commission and others.
- The methodology for this year's approach included comparisons of IESO's actual salaries to market as well as IESO's salary structure (or policy line). The former would reflect levels of experience of IESO staff to market compensation whereas the latter compares only journey person rates for the IESO to market compensation (thereby not reflecting IESO levels of experience).
- The methodology for this year's approach, for the first time, provided a complete compensation picture by providing comparisons for fixed compensation, cash compensation (fixed compensation plus annual variable compensation component) and total compensation (fixed compensation plus annual variable compensation plus pension benefits, plus all other benefits and prerequisites, plus long term incentive/capital accumulation programs) by various staff disaggregations.
- Several different organizations were added to the database and greater differentiation of comparator communities was introduced. The driver for this was to provide comparator organizations which better aligned with attraction/retention principles for each of the staff groupings. Thus differentiation/segmentation of comparator groupings for Management, PWU-represented employees and Society-represented employees were applied. U.S. organizations were not included for reasons outlined in the above cited minutes from the July 29th meeting with the Regulatory Affairs Standing Committee.
- The survey undertaken this year utilized the Hay Job Evaluation methodology to standardize job matching. The Hay Job Evaluation methodology provided a point factor approach to evaluating jobs by comparing knowledge, thinking and responsibility standards to all IESO positions and to those in the comparator community. Using this technique, jobs of similar size and scope were compared within the analysis.

The results of the above referenced analysis are outlined in the document entitled "IESO Compensation Programs".

The above referenced documents are part of the IESO's pre-filed evidence for the fiscal year 2006 fees submission for review:

Reference	Document
• Exhibit B, Tab 4, Schedule 1	• IESO Compensation Programs
• Exhibit B, Tab 9, Schedule 1	• Minutes of Regulatory Affairs Standing Committee Meeting for June 29, 2005.

8. PERFORMANCE INDICATORS – DAY AT HAND FORECAST

Undertaking:

The IESO undertook the following commitments with respect to its performance metrics:

- (i) Recommend to the new permanent IESO Board an additional measure for 2005, the 3 hour ahead demand forecast error; and,
- (ii) Provide to the Regulatory Affairs Standing Committee (RASC) members, the bias values for demand forecasts and the absolute error in which any error exceeds the 3% value for the demand forecasts.

Status:

In July 2005, the new permanent IESO Board approved the additional performance metric to measure the 3 hour ahead demand forecast.

Given the dissolution of the Regulatory Affairs Standing Committee, the IESO intends to provide the information as per (ii) above, under the new stakeholding process and advise the newly appointed Stakeholder Advisory Committee at its next meeting scheduled for November 2005.

9. RATE AND FEE DESIGN

Undertaking:

The IESO undertook with respect to rate unbundling:

- (i) To complete the last 3 steps outlined in the Appendix A – IMO Proposed Fee Unbundling Plan (the paper was part of the IESO's filed evidence for its fiscal year 2003 and fiscal year 2005 submissions for review); and,
- (ii) Submit proposed draft terms of reference for a study of the cost indices for fee unbundling options.

Status:

On (i):

Step 1: Service Categories

The IESO used the service categories based on the cost of service model presented in prior submissions as the basis to assign its 2006 budget operating costs. These service categories are a function of the IESO's mandate, primarily directing the operation of the Ontario's bulk electricity system and the administration of the electricity markets in Ontario and are as follows:

1. Directing the Operations of the Electricity System:

The IESO directs the operation of Ontario's bulk electricity system. The purpose of this direction is to ensure the ongoing reliable supply and delivery of electricity throughout the province. This direction process begins well in advance of each operating day and progresses through to actual time. It encompasses many critical aspects including:

- Real-time minute to minute operation of the system within its capabilities and in a manner which meets reliability standards and agreements;
- Determination of system capability within which the system can operate reliably;
- Management of facility outage plans proposed by participants;

- Establishment of reliability standards;
- Ensuring ancillary service requirements are met;
- Ongoing assessments of reliability impacts;
- Development of operating agreements with Ontario Transmitters and neighbouring system operators to coordinate operation of the system;
- Preparation of emergency plans and conduct of drill exercises;
- Assessments of requirements for new connections to the system.

This requires sophisticated tools, databases, models and analysis, as well as reliance on distributed communications and computer infrastructure to monitor and direct operations of the electricity system.

2. Administering the IESO Markets:

This service category includes activities to conduct and administer the energy, ancillary service and transmission rights markets and include:

- Acceptance of offers from producers of electricity and providers of reserves and bids from consumers of electricity;
- Determination of market-clearing price (or spot market price);
- Auction financial transmission rights to allow wholesale market participants who import or export power to hedge their prices across the interconnections;

3. Customer Services:

The IESO provides a suite of services to help market participants understand and participate in the IESO-administered markets and to provide customer-responsive support and include:

- Participant training programs which consist of written guides, classroom sessions and on-line web courses;
- A publicly accessible Help Centre which provides prompt response to questions using a rigorous tracking process;
- Access to a wide variety of Market Information and Communications, which contributes to connecting the marketplace and forming a virtual community of shared information. The IESO provides timely information and documentation in the form of manuals on market rules and procedures available on demand from the website, immediate real-time price information, regular reports on performance of IESO markets, and other pertinent material.

4. Settlements:

This service spans all activities from reading meters to funds transfers for payment and includes

- Billing of payments for all transactions handled in the wholesale marketplace, including ;
- Daily reconciliation of purchases and sales;
- Management of prudential requirements;
- Collection and validation of metering data, including registration of meter installations and conduct of meter audits.

5. Market Development, Assessment and Compliance

The IESO supports the work of the Market Surveillance Panel and the Dispute Resolution Panel and also performs daily monitoring and data analysis on the markets.

It also enforces compliance with market rules by market participants and reviews uplifts payments (Intertie Offer Guarantees and Congestion Settlement Management Credits) to ensure they are allowed under the market rules and takes action to adjust payments if they are not.

The IESO also maintains the market rules, including rule amendments in response to market needs.

6. Market Participation Administration

The IESO has put into place several administrative processes to better facilitate how market participants transact in the marketplace, including authorization and facilities registration.

Step 2: Cost Allocation

Consistent with the cost allocation methodology for the mapping of the IESO's annual revenue requirements to the services used in prior submissions for review, the IESO has allocated the costs of its IESO's 2006 budget operating costs to the service categories described above.

The allocation considered the degree to which each work program within a business unit could be directly attributed to the specific services. For the work programs that could not be allocated directly, they were designated as "common" costs and then allocated them in proportion to the direct costs. The allocation for interest and amortization (capital carrying costs) was based on the asset allocation to services.

It should be noted that this mapping is for illustrative purposes only and does not constitute a comprehensive rate unbundling exercise.

Step 3: Beneficiary of Service and Billing Unit Assignment

In assigning billing units for a service category, a rate design must consider two major aspects:

(i) *Economics* – Billing units should be assigned to a service category on the basis of cost causation or on the basis of benefits received. Recovering costs based on the number of schedules submitted is an example of recovery based on cost causation, and recovering costs based on the MWh of energy actually withdrawn is an example of recovery based on benefits received.

(ii) *Implementation* - Other factors to consider in assigning billing units to service categories including the following issues associated with implementing the rate design:

- Materiality
- Price certainty and minimizing the potential for over/under recovery
- Minimize impact on market behaviour and IESO operations
- Practicality

A preliminary determination of the beneficiary of the service categories and, where feasible, a recommendation for the appropriate billing unit to be assigned to the service categories follows:

1. Directing the Operations of the Electricity System:

The operation of a safe and reliable electricity system is provided for the purpose of serving load. Although a reliable system benefits suppliers, ensuring that suppliers can get their energy to market is not the primary goal of reliability. IESO's efforts for reliability all focus on ensuring load is served and is concerned with the physical aspects of managing energy flows. To reiterate, the fundamental objective in these activities is to maintain service to the loads on the system.

As a result, 100% of load is the beneficiary of this service.

Energy transacted (MWh) offers a more appropriate billing unit than other possibilities. As an example, unlike capital expenditures for transmission systems, which closely align with system peaks, the activities and costs of the IESO are focused on reliability at all hours, not just peak periods.

2. Administering the IESO Markets:
3. Customer Services:
4. Settlements
5. Market Development, Assessment and Compliance:
6. Market Participant Administration:

The existence of competitive markets, and the efficient operation of the markets, benefits both load and suppliers. In addition, both load and suppliers benefit from: settlement services that transfer funds between the different suppliers and loads for the purchases and sales of electricity in a single invoice and a single funds transfer payment; the provision of information on all matters related to the electricity system and market operations; the delivery of comprehensive participant and education training; the IESO's Help Centre, serving as the single point of contact for all queries and; from the enforcement of market rules.

As a result, 80% of load and 20% of supply are the beneficiaries of these services and the allocation is based on the level of the load and supply resources administered by the IESO systems.

It should also be noted that other unbundled ISOs have a similar share between load and supply:

ISO/RTO	Load Share	Supply Share
• NYISO	77%	23%
• PJM	80%	20%
• ISO NE	70%	30%
• Cal ISO	89%	11%

A number of billing units were used to illustrate the magnitude of the unit charge. For example, when the number of registered market participants was used to recover the costs from these services, the high unit charge may create barriers to entry, reducing the liquidity of the markets.

The table below summarizes the results of Steps 1, 2, and 3:

Annual	Total	Direct Electricity System	Administer IESO Markets	Customer Services	Settlements	Assess & Develop Markets	Market Participant Administration
Beneficiary of Service		100% Load	80% Load 20% Supply	80% Load 20% Supply	80% Load 20% Supply	80% Load 20% Supply	80% Load 20% Supply
Dollars To Recover (in 000s)	\$147,800	\$46,300	\$26,200	\$11,300	\$39,500	\$11,400	\$13,100
Billing Determinants and Unit Charge:							
Energy Transacted (155 TWh)	\$0.954 Per MWh	\$0.299 Per MWh	\$0.169 Per MWh	\$0.073 Per MWh	\$0.255 Per MWh	\$0.074 Per MWh	\$0.09 Per MWh
Bids/Offers Cleared (2 Million)	\$73.900 Per Bid/Offer Cleared	\$23.150 Per Bid/Offer Cleared	\$13.100 Per Bid/Offer Cleared	\$5.650 Per Bid/Offer Cleared	\$19.750 Per Bid/Offer Cleared	\$5.700 Per Bid/Offer Cleared	\$6.550 Per Bid/Offer Cleared
Settlement Statements Issued (130,000)	\$1,136.923 Per Statement	\$356.154 Per Statement	\$201.538 Per Statement	\$86.923 Per Statement	\$303.846 Per Statement	\$87.692 Per Statement	\$100.769 Per Statement
Market Participants Registered (300)	\$492,667. Per Participant	\$154,333. Per Participant	\$87,333. Per Participant	\$37,667. Per Participant	\$131,667. Per Participant	\$38,000. Per Participant	\$43,667. Per Participant

On (ii):

Proposed Draft Terms for a Study of the Cost Indices for Fee Unbundling Options

Overall Objective

The objective of this effort is to develop fee unbundling options for the recovery of the IESO's annual costs for services offered by the Independent Electricity System Operator (IESO).

Approach

The report will be produced in a format suitable for submission to stakeholders and to regulatory or other agencies.

The IESO's Manager of Regulatory Affairs will sponsor and support this effort.

Terms of Reference

- Design fee unbundling options which will involve:
 - Review of unbundling efforts at other ISO/RTOs
 - Development of draft service categories
 - Allocation of time and costs among categories
 - Identification of Market Participant Group causing or benefiting from each service category
 - Definition of billing determinants for each category
 - Evaluation of billing determinants for each category
 - Develop possible rate designs/billing determinants
 - Review of rate designs and implementation issues
- Present a draft report to stakeholders for comments.
- Prepare a final report and distribute to stakeholders
- Present the results to stakeholders.