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COURIER

November 2, 2009
File No.: 101926.1054

Ms. Kirsten Walli
Ontario Energy Board
Yonge-Eglinton Centre
P.O. Box 2319, Suite 2700
2300 Yonge Street
Toronto ON M4P 1E4

Dear Ms. Walli:

Re: Independent and Electricity System Operator - Fiscal 2010 Fees Submission for Review: EB - 2009 – 0377

We are counsel to the Independent Electricity System Operator (the "IESO").

Pursuant to section 19.1(3) of the *Electricity Act*, the IESO is authorized to submit its proposed expenditure and revenue requirements for 2010 and the fees the IESO proposes to charge during 2010 to the Ontario Energy Board for review. Accordingly, please find enclosed in PDF-searchable electronic form the IESO's Submission for Review for its 2010 expenditure, revenue requirements and fees. The requisite number of paper copies will follow by courier along with a CD.

There are several procedural matters that we wish to raise with the Board at this time. First, as the Board directed in previous years, and as requested in the enclosed 2010 Fees Submission, the IESO proposes that notice be given as follows:

- The IESO shall post the Notice of Application, including the pre-filed evidence on the IESO's website at the "Regulatory Affairs" page;
- An announcement, in English and French, will also be posted on the "Participant News" page and will be automatically emailed to all market participants and interested parties who are

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registered to receive IESO news and other communiqués (this will include all connection proponents with respect to whom the IESO maintains a public registry); and

- The IESO shall deliver a copy of the Notice of Application, including the pre-filed evidence, to all registered intervenors and observers in the IESO's 2008 and 2009 Fees Submissions for Review.

Second, as in the case of previous years' proceedings, the IESO requests that a draft issues list be posted for comment along with the Notice of Application. Enclosed is a proposed draft issues list.

Lastly, as in recent years, the IESO requests that the Board consider setting aside one or two days to hold an initial technical conference in lieu of interrogatories to be followed shortly afterwards by a settlement conference.

Please contact me or Biju Gopi of the IESO if you have any questions or wish to discuss these points further.

Yours truly,

Glenn Zacher

/sc
Encl.

DRAFT

PROPOSED ISSUES LIST
INDEPENDENT ELECTRICITY SYSTEM OPERATOR ("IESO")
FISCAL YEAR 2010 FEES SUBMISSION FOR REVIEW
EB-2009-0377

1.0 Operating Cost

1.1 Are the IESO's projected OM&A Costs reasonable?

1.2 Are the IESO's projected staff costs and strategy for setting compensation levels reasonable?

1.3 How do the IESO's ABCP investments affect its operating costs and 2010 revenue requirement?

2.0 Capital Spending

2.1 Is the IESO's proposed 2010 capital expenditure envelope reasonable?

2.2 Are the IESO's proposed 2010 capital expenditures on the enhanced day-ahead commitment (EDAC) project reasonable?

3.0 Smart Metering Initiative

3.1 Is the IESO's process for separating costs associated with its role as the Smart Metering Entity from costs associated with its role in operating the provincial electricity grid and managing the wholesale electricity market reasonable?

4.0 Reliability

4.1 Are the IESO's proposed 2010 measures to address reliability cost effective?

5.0 Green Energy and Green Economy Act (GEGEA) Initiatives

5.1 How is the IESO proposing to address GEGEA initiatives in a cost effective manner?

EB-2009-0377

ONTARIO ENERGY BOARD

IN THE MATTER OF sections 18 and 19 of the *Electricity Act, 1998;*

AND IN THE MATTER OF a Submission by the Independent Electricity System Operator to the Ontario Energy Board for the review of its proposed expenditure and revenue requirements and the fees which it proposes to charge for the year 2010 in connection with the IESO-controlled grid and IESO-administered markets.

IESO 2010 FEES SUBMISSION FOR REVIEW

November 2, 2009

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Counsel for the IESO

ONTARIO ENERGY BOARD

IN THE MATTER OF sections 18 and 19 of the *Electricity Act, 1998;*

AND IN THE MATTER OF a Submission by the Independent Electricity System Operator to the Ontario Energy Board for the review of its proposed expenditure and revenue requirements and the fees which it proposes to charge for the year 2010 in connection with the IESO-controlled grid and IESO-administered markets.

SUBMISSION FOR REVIEW

1. On September 11, 2009, the Board of Directors of the Independent Electricity System Operator (respectively the "IESO Board" and the "IESO") approved the 2010 - 2012 Business Plan for the IESO (the "Business Plan").

2. On October 1, 2009, the IESO submitted the Business Plan to the Minister of Energy and Infrastructure for approval pursuant to section 19.1 of the *Electricity Act,* 1998 (the "Act") and on October 23, 2010, the Business Plan for the fiscal year 2010 was deemed approved pursuant to section 19.1(3) of the Act.

3. The IESO hereby submits its proposed expenditure and revenue requirements and proposed fees for 2010 to the Board for review and approval pursuant to section 19(1) of the Act.

4. Under section 19(2) of the Act, the IESO is seeking the following approvals from the Board:

- Approval of its proposed 2010 revenue requirement of $122.8 million;

- Approval of its proposed 2010 capital expenditure envelope of $21.6 million for capital plans;
- Approval for the continuation of the $1,000.00 application fee; and
- Approval of a usage fee of $0.822/MWh to be paid commencing January 1, 2010. The IESO usage fee is paid by all market participants on energy withdrawn from the IESO controlled grid (including scheduled exports). If necessary, pending approval, the IESO proposes to continue to charge the 2009 usage fee ($0.822/MWh) to market participants from January 1, 2010 until the end of the month in which Board approval is received for the 2010 usage fee, and seeks authorization to charge (or rebate to) market participants the difference between the 2009 and 2010 usage fee, if any, based on their proportionate quantity of energy withdrawn (including scheduled exports) for that period, directing such charges (or rebates) to market participants in the next billing cycle following the month in which that approval is received.

5. In conjunction with these approvals, the IESO is also seeking authorization to rebate, in 2010, the amount of any accumulated surplus from the 2009 fiscal year remaining in its deferral account in excess of $5.0 million (the IESO is forecasting a small deficit for 2009 of $0.3 million and so no rebate in respect of the 2009 year is anticipated). The IESO is also seeking authorization to rebate, in 2011, the amount of any accumulated surplus from the fiscal 2010 year remaining in its deferral account in excess of $5.0 million. The foregoing surpluses, if any, will be rebated to market participants based on each market participant's proportionate quantity of energy withdrawn from the IESO controlled grid (including scheduled exports) for 2009 and

2010 respectively. The IESO is seeking approval to refund the final amounts based on the IESO's audited financial statements as approved by the IESO Board for the fiscal years 2009 and 2010, and to direct the rebate to market participants in the next billing cycle following the months in which the 2009 and 2010 financial statements are approved.

6. Smart Metering Entity ("SME") costs, including both IESO internal and contracted expenses, will be recovered through a separate regulatory mechanism from the IESO usage fee that is charged to wholesale market participants. The IESO is therefore not seeking to recover any costs relating to performing its role as the SME in this proceeding.

7. The IESO is not proposing an increase in its volume-based usage fee from 2009 levels, despite lower revenues due to a forecast reduction in electricity demand and changes in workload resulting from the *Green Energy and Green Economy Act*. The IESO has also implemented a new organizational structure that will better and more efficiently position the IESO to deliver on its core responsibilities in the changing electricity sector.

8. The Business Plan sets out the strategic business objectives and priorities for the IESO over the planning period, including:

- Delivering safe and reliable electricity service and supply;
- Adapting and designing new tools, processes and capabilities to maintain reliability in response to fundamental changes to the power system, including the addition of distributed and intermittent energy sources, the

incorporation of smart grid technologies, the expansion of conservation and demand management initiatives and the continued reduction in the use of coal;

- Developing internal tools, processes and capabilities to facilitate the implementation of the *Green Energy and Green Economy Act*;
- Re-prioritizing and re-organizing internal staff levels and processes, as may be necessary, to efficiently meet the IESO's evolving objectives; and
- Promoting more effective relationships with customers and stakeholders.

9. The Business Plan identifies the opportunities and challenges that lie ahead and the initiatives the IESO has planned to meet these opportunities and challenges and further its strategic objectives.

10. Supporting this Submission is the IESO's pre-filed evidence which includes:

i) The Business Plan;

ii) The IESO's letter to the Minister of Energy and Infrastructure, dated October 30, 2009,;

iii) Supplemental financial information on projected 2009 financial results and the financial outlook for 2010-2012;

iv) Methodology for calculating the 2010 usage fee and process for rebating revenue surpluses; and

v) Status reports on the Enhanced Day-Ahead Commitment project and the IESO's Asset Backed Commercial Paper investments.

The IESO may amend its pre-filed evidence from time to time, prior to and during the course of the Board's proceeding. In particular, should the IESO identify a material change to its 2010 fees Submission the IESO will update its pre-filed evidence and may also amend its Submission to update the requested usage fee. Furthermore, the IESO may seek to have additional meetings with Board Staff and intervenors in order to identify and address any further issues arising from this Submission, with a view to an early settlement and disposition of this proceeding.

11. The IESO proposes the following title for this proceeding: *Independent Electricity System Operator Fiscal Year 2010 Fees Submission for Review.*

12. The persons affected by this Submission are all market participants as defined in Chapter 2, section 2.1.1 of the *Market Rules for the Ontario Electricity Market,* who participate in the electricity markets administered by the IESO. The IESO communicates regularly with its participants by way of the IESO's website and e-mail. Consistent with the means of notification requested and approved by the Board for the 2008 and 2009 fee Submissions, the IESO proposes that notice of this application be given by the following means:

i) Posting this application, including the pre-filed evidence on the IESO's website on the "Regulatory Affairs" pages;

ii) Posting an announcement, in English and French, on the "Participant News" page, which will be e-mailed to all market participants and interested parties who are registered to receive IESO news and other communiqués; and

iii) Delivering a copy of this Submission, including the pre-filed evidence to all registered observers and intervenors in the IESO's 2008 and 2009 Fees Submission for Review.

13. The IESO requests that a copy of all documents filed with the Board by each party to this proceeding be served on the IESO and the IESO's counsel in this proceeding, as follows:

(a) The IESO: Mr. Nicholas Ingman
Manager, Government and Regulatory Affairs
Independent Electricity System Operator

Address for personal service: 655 Bay Street, Suite 410
Toronto, Ontario M5G 2K4

Mailing address: 655 Bay Street, Suite 410
P.O. Box 1
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Telephone: (416) 506-2821
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(b) The IESO: Mr. Biju Gopi
Senior Regulatory Analyst, Regulatory Affairs
Independent Electricity System Operator

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(c)	The IESO's counsel:	Mr. Glenn Zacher Stikeman Elliott LLP
	Address for personal service:	5300 Commerce Court West 199 Bay Street Toronto, Ontario M5L 1B9
	Mailing address:	5300 Commerce Court West 199 Bay Street, Toronto, Ontario M5L 1B9
	Telephone: Fax: E-mail:	(416) 869-5688 (416) 947-0866 gzacher@stikeman.com

DATED at Toronto, Ontario, this 2nd day of November, 2009.

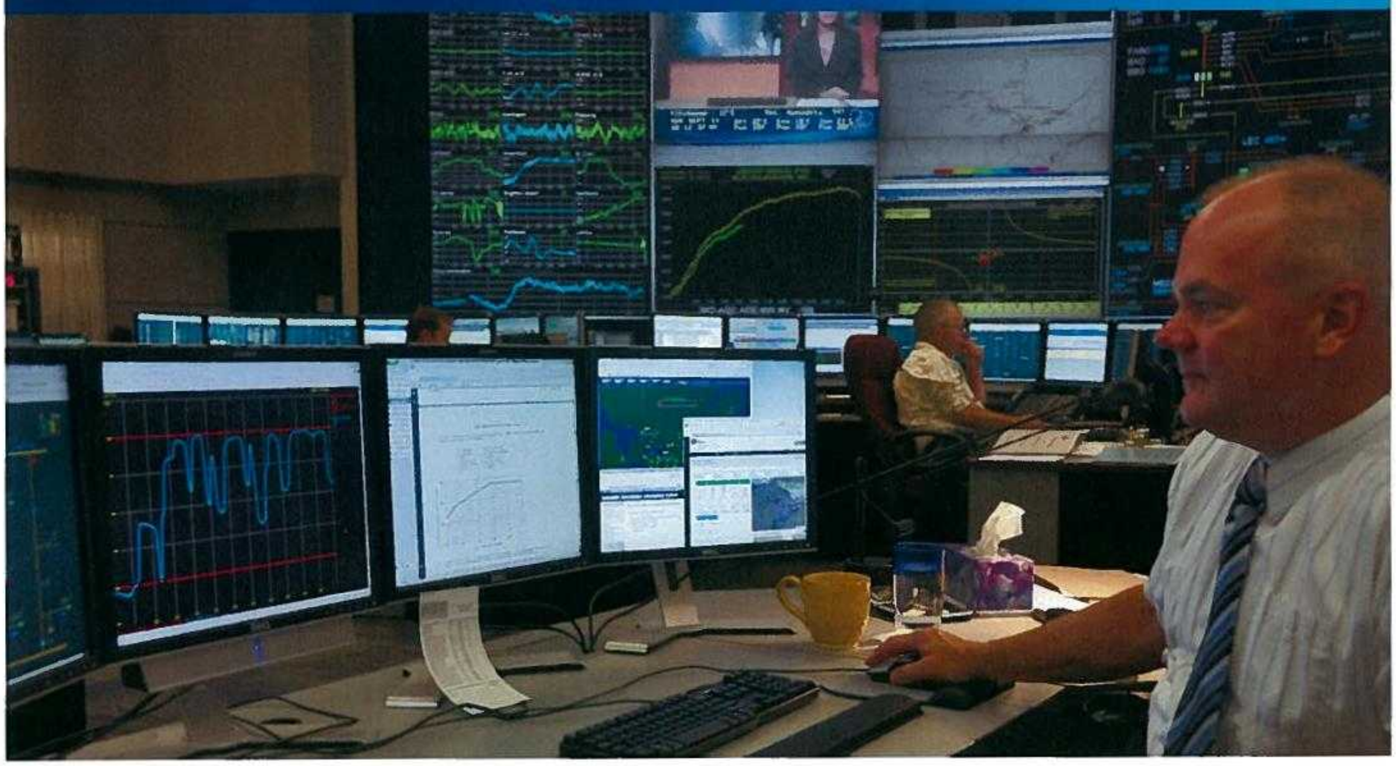
INDEPENDENT ELECTRICITY SYSTEM OPERATOR.

By its counsel in this proceeding
Glenn Zacher

EXHIBIT LIST

Exhibit	Tab	Schedule	Description
A – ADMINISTRATION			
A	**1**	**1**	Submission for Review
A	**2**	**1**	Exhibit List
B – PRE-FILED EVIDENCE			
B	**1**	**1**	2010-2012 Business Plan
B	**2**	**1**	Letter to the Minister of Energy and Infrastructure dated October 1, 2009
B	**3**	**1**	Supplemental Financial Information — Projected 2009 Financial Results and Financial Outlook 2010 to 2012
B	**4**	**1**	Methodology for Calculating 2010 Usage Fee and Process for Rebating any Revenue Surplus
B	**5**	**1**	Status of Enhanced Day-Ahead Commitment Project
B	**6**	**1**	Status of IESO's Asset Backed Commercial Paper Investments
			Appendix A – Summary of IESO Treatment of Asset Backed Commercial Paper Investments

2010 – 2012 BUSINESS PLAN



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Power to Ontario. On Demand.

CONTENTS

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On Demand.

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October 1, 2009

The Honourable George Smitherman
Deputy Premier, Minister of Energy and Infrastructure
900 Bay Street, 4th Floor, Hearst Block
Toronto, Ontario M7A 2E1

Dear Minister Smitherman,

Re: IESO 2010-2012 Business Plan

I am pleased to provide you with the IESO's Business Plan for the 2010-2012 planning period. Under the *Electricity Act, 1998*, the IESO is required to submit its Business Plan to you for approval prior to making application to the Ontario Energy Board for approval of next year's proposed expenditures, fees and revenue requirements.

Our Business Plan addresses the need to advance the implementation of the Green Energy Act while continuing to meet our ongoing primary objectives to provide a safe and reliable supply of electricity to the province and efficiently manage the IESO administered markets. In support of these objectives, we will continue to work closely with stakeholders and government to ensure that we are well positioned to meet the challenges ahead.

At the same time, we recognize the impact of the current economic conditions on our customers and the need to effectively manage our own costs and target efficiencies across the company. As a result of these efforts, our 2009 operating costs are projected to be 4.2% below last year's approved budget.

I am also pleased to report that we will not be requesting an increase in our operating costs or usage fees for 2010 and our usage fee will continue to be $0.822/MWh or less than one tenth of one cent per kilowatt-hour.

We have briefed staff within your Ministry on the Business Plan and I would be pleased to answer any questions you might have.

Yours truly,

Paul Murphy

Encl.

Paul Murphy
President and CEO
paul.murphy@ieso.ca
d 416 506 2810
f 416 506 2849

Supplemental Financial Information

Projected 2009 Financial Results

2009 Projected Operating Results

Overall, the IESO is projecting a deficit of $0.3M for 2009 which will reduce the accumulated operating surplus from $5.0 million to $4.7 million by year-end.

Consistent with the OEB's decisions in past fee submissions, the IESO proposes to rebate any accumulated surplus over $5.0 million to market participants; however, given the projected deficit, the IESO is not projecting a rebate to market participants in 2010.

Usage Fees

The projected usage fee revenue for 2009 is $122.8 million, approximately $1.9 million less than budget. This variance is a result of a projected decrease in Ontario demand. The current forecasted energy volumes for Ontario demand and exports for 2009 are 149.4 TWh; 2.3 TWh lower than the energy levels used for budgeting. The following table outlines these variances:

TWh	2009 Projected[1]	2009 Budget	Projected Variance
Ontario Demand (net of line losses)	137.3	145.0	(7.7)
Exports	12.1	6.7	5.4
Total	**149.4**	**151.7**	**(2.3)**

As outlined in the table, the projected variance in usage fee revenues is a result of lower domestic demand which is partially offset by higher projected exports.

[1] The 2009 projected energy volumes represent actual volumes to the end of July 2009 and forecast volumes for August through December 2009 based on the IESO's 18-month outlook released May 25, 2009.

Market-Related Interest Income

Market-related interest income represents interest earned on funds in the IESO-administered markets settlement clearing bank accounts. There are two ways that interest on market funds is earned:

- In the settlement of the market, funds collected from owing market participants (i.e., buyers) are paid to receiving market participants (i.e., sellers) two business days later. In the period between receipt and disbursement of market funds, the monies are invested.
- Market participants make periodic prepayments and the IESO invests these monies.

The IESO invests real-time energy market funds in highly rated, liquid, short term investments. In previous years these investments included notes known as asset-backed commercial paper (ABCP). Since August 2007 there has been a liquidity crisis in the Canadian market for ABCP which has impaired the value of the IESO's ABCP holdings and hence, the market-related interest income earned by the IESO.

It is the IESO's view that by the end of 2009, the trading value of ABCP investments will be lower than if they traded in the medium to long-term. The IESO estimates that they will trade no higher than 45% of their principal amount of $23.1 million at year end.

In addition, interest being paid on overnight investments is much lower than was assumed in the 2009-2011 Business Plan. In that plan, the IESO forecast an average return of 4.75% on investments in 2009, whereas the most recent outlook is for an average return of approximately 0.54% over the year.

As a result of these lower interest rates and the impairment in the value of ABCP investments, the projected 2009 closing balance for market-related investment income is negative. The following table summarizes the components of the market-related investment income for 2009 (in $ millions):

Actual non-ABCP investment income in 2007	4.1
Actual non-ABCP investment income in 2008	2.7
Actual ABCP investment income in 2008	0.6
Projected non-ABCP investment income in 2009	0.2
Projected ABCP investment income in 2009	0.4
Projected loss in ABCP value at the end of 2009	(12.5)
Closing balance for market investment income	(4.5)

Since the closing accumulated balance is less than zero, no revenue is expected to be recognized for 2009.

Operating, Maintenance & Administration (OM&A) Program Costs

Overall, the total OM&A program costs are projected to be $2.6 million, or 2.8%, below budget. The following table outlines the projected costs relative to budget.

($ millions)	2009 Projected	2009 Budget	Projected Variance
Staff Costs	62.8	64.5	(1.7)
Computer Support, Maintenance & Equipment	9.2	9.8	(0.6)
Contract Services & Consultants	7.8	8.0	(0.2)
Administration	7.5	7.6	(0.1)
Telecommunications	3.2	3.2	-
Total OM&A Program Costs	**90.5**	**93.1**	**(2.6)**

Staff Costs

Staff costs are expected to be $1.7 million lower than planned. This is due to lower post employment benefits, excluding pension costs ($0.4 million), and further reductions ($1.3 million) from hiring lags and management's successful attainment of cost savings consistent with Ministry targets.

Computer Support, Maintenance and Equipment Costs

Reductions in computer support, maintenance and equipment costs are the result of decreases in the amount of equipment under contract, merging of existing contracts and negotiation of new contracts, as well as a focused effort to minimize support hours.

2009 Projected Balance Sheet

The following chart shows a summarized projected balance sheet as at December 31, 2009, compared to the 2009 budget.

($ millions)	2009 Projected	2009 Budget	Projected Variance
Cash, Cash Equivalents and Temporary Investments	2.0	2.2	(0.2)
Accounts Receivable and Short-term Prepaid Expenses	17.1	20.5	(3.4)
Current Assets	**19.1**	**22.7**	**(3.6)**
Property and Equipment	77.7	86.9	(9.2)
Long-term Investments	17.6	19.6	(2.0)
Prepaid Pension Expense	3.6	-	3.6
Total Assets	**118.0**	**129.2**	**(11.2)**
Accounts Payable, Accrued Liabilities and Accrued Interest	22.4	20.1	2.3
Debt	39.0	45.5	(6.5)
Accrued Pension Liability	-	6.3	(6.3)
Accrual for Employee Future Benefits other than Pension	50.8	51.4	(0.6)
Total Liabilities	**112.2**	**123.3**	**(11.1)**
Accumulated Operating Surplus	4.7	5.0	(0.3)
Accumulated Market-related Penalties and Fines	1.1	0.9	0.2
Total Liabilities and Surplus	**118.0**	**129.2**	**(11.2)**

Accounts Receivable and Short-term Prepaid Expenses

Accounts receivable and short-term prepaid expenses are projected to be $17.1 million at the end of 2009, $3.4 million below budget. This variance is primarily due to $nil market-related interest income for 2009.

Total Property and Equipment

Total property and equipment at the end of 2009 is projected to be $77.7 million, $9.2 million below budget. This variance is mainly due to 2009 capital spending which is projected to be $10.3 million below budget, partially offset by lower than the budgeted amortization of $1.5 million.

Prepaid Pension Expense

Prepaid pension expense at the end of 2009 is projected to be $3.6 million, or $9.9 million higher than the budgeted accrued pension liability of $6.3 million. This variance is due to the higher than expected pension contributions in the year ($17.3 million). The contribution is based on the January 1, 2008 IESO Pension Plan actuarial valuation plus an additional contribution of $8.4 million. In addition, the 2009 pension expense is projected to be approximately $1.3 million lower than budget. This reflects an increase in the discount rate (determined by reference to high quality long-term corporate bonds). The actual discount rate utilized in calculating the 2009 pension expense was 6.1%, as compared to 5.5% assumed in the 2009 – 2011 Business Plan.

Debt

Total debt is projected to be $6.5 million less than budget, due to the reduced level of capital spending in the year.

2009 Capital Expenditures

For 2009, the IESO forecasts that expenditures on capital initiatives will total $12.6 million, an amount that is approximately $10.3 million below the approved budget. As outlined in the following table, this is primarily due to a $9.5 million variance relating to the Enhanced Day-Ahead Commitment project.

($ millions)	2009 Projected	2009 Budget	Projected Variance
Enhanced Day-Ahead Commitment	6.4	15.9	(9.5)
On-Line Limit Derivation	1.4	0.8	0.6
Enrolment Automation Project	0.2	0.6	(0.4)
Outage Management Replacement	0.1	0.4	(0.3)
NERC – CIP Program	-	0.2	(0.2)
NERC Standards Compliance Monitoring Tool	0.1	0.1	-
Other Capital Initiatives	4.4	4.9	(0.5)
Total Capital	**12.6**	**22.9**	**(10.3)**

Given the ongoing need for reprioritization of capital projects, the IESO does not use the business planning process as a mechanism for capital project approval. Rather, through business planning, an appropriate capital envelope is established for future years and each individual project is approved by the appropriate level of IESO management. The following section outlines the variances between the business plan capital project assumptions and projected capital expenditures.

2009 Key Capital Initiatives

<u>Enhanced Day-Ahead Commitment</u>

The IESO Board of Directors approved management's recommendation to proceed with the enhanced day-ahead commitment processes (EDAC) in September 2008.

Capital work began in the first half of 2009, with the IESO working with stakeholders to finalize the process details based on a market design that was finalized in February 2009.

The spending variance of $9.5 million is a result of the changes in the schedule for this project. The current project schedule shows market trials commencing early in 2011. The total approved capital spend remains unchanged at $26.5 million with projected expenditures of $6.4 million, 13.5 million and $6.6 million in 2009, 2010 and 2011 respectively. The project costs and the timing remain subject to some variability depending on the final design.

The project is expected to deliver:

- Improved efficiency of unit commitment to reduce the overall cost of supplying market demand;
- Improved operational signals to generators, which, among other things, should result in improved coordination of gas and electricity markets; and
- Support for the anticipated changes in Ontario's electricity sector without inhibiting future market evolution initiatives.

On-Line Limit Derivation

The On-Line Limit Derivation project will be undertaken in several stages over the business planning period for a total projected capital cost of $6.3 million. The project will mitigate identified risks in the Resource Integration and Operations business units, and essentially replaces much of the manual development of system operating limits with automated tools. This project will acquire or develop the tools to facilitate on-line limit derivation in both the on-shift and back office environments. The new systems will be fully integrated into the existing suite of tools.

The 2009 projected variance reflects a shift in timing of costs from 2008.

Enrolment Automation Project

The Enrolment Automation Project is comprised of three separate projects which will improve how the IESO manages customer information: Customer Information and Data Efficiency; Customer Process Automation; and Customer Interface. The first project will develop a new Customer Data Management System (CDMS) that will immediately replace some of the end user built data repositories and eventually replace the existing Participant Lifecycle (PLC) system. The PLC system is the primary repository of market participant data at the IESO used for providing data critical to market systems. The remaining two projects will address the handling of customer process information currently stored in other IESO registration databases, as well as moving business processes to a central web interface allowing IESO staff and customers to better manage customer information.

The 2009 projected variance reflects a shift in timing on project delivery to 2010.

Outage Management Replacement

The scope of the Outage Management Replacement project identified in 2009 capital plan has been reduced in scope and will include the key functionality that will enable market participants to submit and review their outage information via the IESO portal. This functionality will reduce IESO effort to process outages for market participants that do not use the automated interface.

NERC CIP – Program

NERC Reliability Standards CIP-002 through CIP-009 provide a cyber security framework for accountability, identification and protection of critical cyber assets to support reliable operation of the Bulk Electric System. Although $0.2 million was budgeted in 2009, no capital spending was required on this project

NERC Standards Compliance Monitoring Tool

The NERC Standards Compliance Monitoring Tool is required to ensure that compliance with NERC reliability standards is monitored, auditable and effective. This tool is needed in advance of the associated NERC audit in 2011. The expected cost of the tool is $0.1 million in 2009 and $0.2 million over the business planning period.

Financial Outlook 2010 - 2012

Total Costs: 2009-2012

($ millions)	2009 Projected	2010 Budget	2011 Plan	2012 Plan
OM&A Program Costs	90.5	91.5	91.4	93.8
OM&A Pension Costs	10.8	11.3	14.1	16.5
Amortization	20.9	21.0	17.8	16.9
Net Interest	2.6	1.0	1.5	2.0
Total Costs	**124.8**	**124.8**	**124.8**	**129.2**

OM&A Program Costs

($ millions)	2009 Projected	2010 Budget	2011 Plan	2012 Plan
Staff Costs	62.8	62.6	61.9	64.0
Computer Support, Maintenance & Equipment	9.2	9.7	10.0	10.2
Contract Services & Consultants	7.8	8.1	8.5	8.3
Administration	7.5	7.8	7.7	7.8
Telecommunications	3.2	3.3	3.3	3.5
OM&A Program Costs	**90.5**	**91.5**	**91.4**	**93.8**

In 2010, OM&A program costs are budgeted to increase slightly compared to the 2009 projection, and remain relatively flat in 2011. Increases in 2012 are due to inflation.

Staff Costs

The IESO continues to be a staff-intensive business. Over the planning period, staff costs represent approximately 50% of the total costs and 68% of the total OM&A program costs. This excludes OM&A pension expense, which although categorized separately nonetheless relates to regular staff. Factoring in the pension expense, staff-related costs account for roughly 60% of total costs in each year of the planning period.

The IESO recognizes the impact of the declining economic conditions on customers and stakeholders and has proposed no fee increases for 2010. In order to achieve this, IESO budgeted staff levels will be reduced with resources reallocated to areas of increased focus reflecting changes in the electricity sector. The recent IESO organizational realignment paves the way for this new approach.

Over the business planning period, 12 staff positions will be removed across the business in 2010, with a further 30 positions removed in 2011.

Computer Support, Maintenance & Equipment

Computer support, maintenance and equipment costs are projected to increase in 2010 by $0.5 million and to continue increasing slightly over the planning period. These costs include increasing annual support and maintenance fees for the market and operating systems, annual license renewals, as well as computer leases and consumables.

Contract Services & Consultants

Contract services and consultants are projected to vary slightly in each of the planning years due mainly to different audits and reviews planned over the period. The majority of these costs are recurring annual expenses such as insurance, Board, Panel and Committee member remuneration, audit and accounting fees, legal services, human resources services, communication products & services, government relations functions and OEB fees.

Administration[2]

Membership costs are budgeted to increase in 2010 by $0.3 million and to remain relatively flat thereafter. The increase is primarily due to higher NPCC/NERC memberships.

All other administration costs are expected to increase by less than the cost-of-living.

Telecommunications

Telecommunication costs are budgeted to increase slightly over the planning period to reflect anticipated inflationary increases.

OM&A Pension Expense

Pension expense represents the actuarially estimated cost of providing pension benefits to IESO employees, using cost calculation methods that are prescribed by the Canadian Institute of Chartered Accountants (CICA) and assumptions that reflect current long-term bond yields and management's best estimates for the future. This expense reflects the proper charge for pensions in the financial statements, in accordance with Canadian

[2] Administrative expenses include memberships, rent, utilities, materials and supplies, rental facilities, building services, and property taxes.

Generally Accepted Accounting Principles (GAAP). Three factors that have a large influence on this expense are:

- The institutional arrangements in place;
- Pension plan investment performance, and
- Critical assumptions used.

Institutional arrangements

In terms of institutional arrangements, the IESO has its own pension plan. Therefore, the pension expense charged through the usage fee is directly impacted by many variables, including fund performance and interest rate assumptions. Some organizations are part of a larger pension plan and their pension expense represents their required contributions to that plan. Those contribution levels are impacted by plan performance and changes to assumptions; however, the rate of change in annual pension expense is likely to be lower than that of an individual plan sponsor, like the IESO.

Pension plan investment performance

With respect to pension plan investment performance, over the period 2002 through 2008, the plan earned an average annual return of 2.2%. These returns have not met management's annual long-term assumed rate of return of 6.75%.

In recognition of the long-term nature of the obligations and the desire for a "smoother" pension expense such that large fluctuations in the usage fee are mitigated, the IESO uses a smoothed value of assets in calculating the pension expense.

Critical assumptions

The assumed long-term rate of return on plan assets is 6.75% per annum.

Pension liability — the pension liability represents the actuarially estimated, present value liability of the pension promises accrued to date for IESO employees and retirees. This estimate is impacted by factors including:

- Pension plan benefit provisions;
- Long-term interest rates;
- Plan membership;
- Mortality assumptions; and
- Other demographic and economic assumptions and experience.

The pension expenses are not the result of new or additional employee benefit levels. Increased benefit levels have not occurred in the past few years. In fact, changes have been made to reduce employer-paid pension benefits.

Long-term obligation — since this is a long-term obligation, there is an assumption made as to what interest rate to use to present-value the obligation. That interest rate is referred to as the discount rate and, according to Canadian GAAP, that rate should reflect the yields on high quality corporate long bonds in effect at the time of measurement.

Measurement date — the measurement date is September 30. For planning purposes, the discount rate in effect at the beginning of the planning process is used, and is then, subject to materiality considerations, revised on the measurement date. Over the last few years, long-term discount rates have dropped significantly; however, as of April 30, 2009 the discount rate was 6.4%, slightly higher than the 2008 discount rate of 6.1%. This slight increase in discount rate has served to slightly reduce the pension expense; however, other changes in assumptions offset this reduction.

Listed below is a table showing the actual historical discount rates:

	2004	2005	2006	2007	2008
Actual Discount Rate (as of September 30th)	6.25%	5.1%	5.0%	5.4%	6.1%

Legislative requirement — there is a legislative requirement of all pension plan sponsors to undertake a complete actuarial valuation of the plan at least every three years. This valuation helps ensure appropriate funding of the pension promise. In 2008, the IESO undertook an actuarial valuation, which presented an opportunity for a true-up of the plan's demographic status to that assumed by the actuaries between valuations. There will be no further true-ups until the next valuation date which is scheduled for 2011.

The following table summarizes the details of the change in projected pension expense in 2010 from 2009.

($ millions)	Current Service Costs	Interest on Benefit Obligation	Expected Return on Assets	Amortization of Experience	Total
Projected 2009 Pension Costs	7.1	23.1	(20.5)	2.8	12.5
Expected Developments	0.5	0.2	(0.4)	0.4	0.7
Fund Performance	-	-	0.4	1.0	1.4
Change in Discount Rate	(0.7)	0.2	-	(1.3)	(1.8)
Budgeted 2010 Pension Costs	**6.9**	**23.5**	**(20.5)**	**2.9**	**12.8**

Looking at 2011 and 2012, based on an assumption of no change in long-term discount rates and investment returns of 6.75% per annum, the pension expense is expected to increase to $14.1 million and $16.5 million respectively.

Capital Spending

Over the planning period, the IESO intends to make business and tool improvements estimated to total:

- $21.6 million in 2010;
- $21.0 million in 2011; and
- $19.2 million in 2012

This total three-year spending level of $61.8 million includes an anticipated $20.1 million on EDAC over the planning period. The remaining spending level for the planning period is $41.7 million, or an approximate average of $13.9 million per year.

Given the ongoing need for changes and reprioritization, the business planning process is not used as the mechanism for capital project approval. Rather, through business planning, an appropriate capital envelope is established for future years. This practice is consistent with prior years. As well, the IESO recognizes the need for robust disclosure of information about the projects for which this capital funding will be utilized.

The IESO employs an approach to capital budgeting for the planning period that includes two distinct groupings of capital projects – "key" capital initiatives and "other" capital initiatives. Key capital initiatives represent the most critical capital projects over the planning period that the IESO believes must be completed within the timeframe identified in the following table. The other capital initiatives are also necessary projects, however, these are projects that lend themselves to more flexibility in planning or delivery so timing is not as critical, or they are lower priority than some key initiatives. Stakeholders should expect that the IESO will deliver the key capital initiatives as scheduled and, over the life of the plan, will deliver the other capital initiatives.

Ultimately, the IESO believes that this is a prudent and reasonable manner in which to budget its capital expenditures.

The following table provides additional information on the capital plan.

($ millions)	2009 Projected	2010 Budget	2011 Plan	2012 Plan
Key Capital Initiatives				
Enhanced Day-Ahead Commitment	6.4	13.5	6.6	-
On-Line Limit Derivation	1.4	1.3	1.4	1.8
Enrolment Automation	0.2	0.6	0.1	-
Outage Management Replacement	0.1	0.1	-	-
NERC Standards Compliance Monitoring Tool	0.1	0.1	-	-
Enhanced Forecasting for GEGEA Initiatives	-	0.3	0.8	0.6
Other Capital Initiatives	4.4	5.7	12.1	16.8
Total Capital Spending	**12.6**	**21.6**	**21.0**	**19.2**

The planned capital spending level of $21.6 million in 2010 represents a $9.0 million increase from the 2009 projected level of $12.6 million, primarily as the result of a shift in EDAC spending.

Key Capital Initiatives

A number of the key capital initiatives within the planning period were started or already underway in 2009 and hence the descriptions for EDAC, On-Line Limit

Derivation, Enrolment Automation, Outage Management Replacement and NERC Standards Compliance Monitoring Tool are found earlier in this document.

Enhanced Forecasting for Green Energy and Green Economy Act (GEGEA) Initiatives

Additional tools and services are required to improve the forecasting of available energy from renewable intermittent sources and the impacts of resource variability on demand. The expected cost of these tools and services is $1.7 million over the planning period.

Other Capital Initiatives

Throughout the planning period, based on shifting priorities, opportunities, and challenges, the actual plan may differ from that outlined in this plan. Within the IESO, all capital projects require Business Unit Leader, President and CEO, or Board of Directors approval as appropriate.3

Asset Service Lives

As part of the business planning process, the service lives used in the amortization of capital assets are reviewed. The IESO reviews existing assets against the proposed capital plan, and also reviews service life changes that are needed during the year. This is done to see if there is a need to reduce existing service lives because of early replacement or to see if there is a need to increase or extend asset lives, due to prudent asset management.

[3] Business Unit Leaders can approve capital projects up to $0.5 million, President & CEO can approve capital projects up to $4.0 million, and the Board of Directors approves all capital projects in excess of $4.0 million.

The following table outlines the amortization expense over the planning period:

($ millions)	2009 Projected	2010 Budget	2011 Plan	2012 Plan
Existing Assets In-Service	20.6	19.0	10.4	2.6
New Capital	0.3	2.0	7.4	14.3
Total Amortization	**20.9**	**21.0**	**17.8**	**16.9**

Net Interest Expense

The interest expense over the planning period is largely based on the financing strategy outlined below.

Financing Strategy

The note payable to the Ontario Electricity Financial Corporation (OEFC) due May 1, 2009 was repaid on May 1, 2009.

In April 2009, the IESO executed a new note payable with the OEFC in the amount of $78.2 million, repayable in full by May 1, 2011. The note payable to OEFC is unsecured, bears interest at a per annum rate equal to the yield earned on ninety-day Province of Ontario treasury bills on the quarterly reset date plus 25 basis points.

On April 30, 2009, the existing corporate credit facility with a Canadian chartered bank expired and the IESO entered into a revised agreement with that bank. Under the terms of the new unsecured credit facility, the bank will make available to the IESO an amount of up to $60.0 million. This credit facility expires on April 30, 2010.

The assumed average interest rate on the total debt is 0.82%, 1.75%, and 2.15% for 2010, 2011 and 2012 respectively.

The IESO maintains two separate lines of credit: a $60.0 million corporate credit facility and $100.0 million for market settlement needs. The cost of these lines of credits, aside from any interest on drawn amounts, includes stamping fees and a standby charge. In total, the annual cost is approximately $0.8 million in each of the planning years.

For each large and enduring project, interest is capitalized on funds expended before the project is placed in-service. Over the planning period this includes EDAC. The resulting capitalized interest is $0.1 million in 2010 and $0.2 million in 2011.

Methodology for Calculating 2010 Usage Fee and Process for Rebating any Revenue Surplus

Year 2010 Regulatory Approvals — IESO Usage Fee

This document briefly explains how the IESO calculated the proposed 2010 usage fee and it forecasts the usage fee for 2011 and 2012. It also explains how the IESO proposes to rebate any revenue surplus.

Revenue Sources

There are two sources of revenue for 2010:

- Cost recovery for services; and
- Revenue from IESO fees

Cost Recovery for Services

The IESO will recover the costs of services that are directly attributable to market participants, such as training and assessments, as well as the costs of services provided to the Ontario Power Authority. The estimated total revenues from such cost recovery services in 2010 are $2.0 million.

Revenue from IESO Fees

The OEB approved the IESO's fee structure in 2000. This fee structure, which has been in effect since market opening, includes an application fee of $1,000 per application, plus a $/MWh usage fee. The revenue from application fees is expected to be negligible in 2010.

Usage Fee

There are three basic steps involved in calculating the usage fee:

The first step is to identify the projected revenue required by the IESO to operate its business.

Revenue Requirement Calculation for IESO Usage Fee			
($ millions)	**2010**	**2011**	**2012**
Overall Revenue Requirement	124.8	124.8	129.2
Less: Other Revenues • Cost recovery for services	2.0	2.1	2.1
Revenue Requirement to be recovered by IESO Usage Fee	122.8	122.7	127.1

The second step is to estimate the charge determinant. The charge determinant is the total forecast AQEW (Allocated Quantity of Energy Withdrawn) and SQEW (Scheduled Quantity of Energy Withdrawn (i.e. scheduled exports) in TWh:

Year	**18-Month Outlook Demand Forecast (TWh)**	**-**	**Transmission Line Losses (TWh)**	**+**	**Exports (TWh)**	**=**	**Market Demand (TWh)**
2010	142.5	-	3.1	+	10.0	=	149.4
2011	142.3	-	3.1	+	10.1	=	149.3
2012	141.4	-	3.1	+	10.2	=	148.5

The third step is the usage fee calculation, which entails dividing the forecast Revenue Requirement by the forecast Market Demand:

Year	Revenue Requirement To Be Recovered ($ million)	÷	Market Demand (TWh)	=	Usage Fee ($/MWh)
2010	122.8	÷	149.4	=	0.822
2011	122.7	÷	149.3	=	0.822
2012	127.1	÷	148.5	=	0.856

Implementation of 2010 usage fee

The requested usage fee for 2010 represents no change from the approved 2009 usage fee.

Rebate of Deferral Account Balance Surplus

The 2009 projected outlook is for a deficit of $0.3 million which, when added to the $5 million surplus in the IESO's deferral account, would result in an accumulated surplus of $4.7 million. The IESO is therefore projecting no rebate in 2010. If, however, the IESO does realize a surplus in excess of $5 million, the IESO proposes that the excess be rebated to market participants based on their proportionate amount of energy withdrawn from the IESO controlled grid during 2009, following approval of the audited 2009 financial statements by the IESO Board of Directors.

As requested in the IESO's rate application, the IESO is also seeking authorization to rebate, in 2011, the amount of any accumulated surplus from the fiscal 2010 year remaining in its deferral account in excess of $5 million. This amount would also rebated to market participants based on their proportionate amount of energy withdrawn during 2010, following approval of the audited 2010 financial statements by the IESO Board of Directors.

Status of Enhanced Day-Ahead Commitment Project

This document briefly summarizes the background leading to the adoption of the Enhanced Day-Ahead Commitment (EDAC) project, the current status of the project and the approved course of action for moving forward.

IESO Stakeholder Engagement of Day-Ahead Mechanisms and Approval of EDAC

In September 2006 the IESO initiated Stakeholder Engagement Plan (SE-21) to explore and understand stakeholders' interests and priorities in evolving the electricity market as it relates to day-ahead mechanisms. Through this engagement, the IESO and stakeholders considered a number of options for day-ahead mechanisms and the IESO undertook a detailed cost-benefit analysis of these options. The selected option, EDAC, was approved by the IESO Board on September 5, 2008. In making its decision, the Board considered stakeholder feedback and advice from the Stakeholder Advisory Committee.

This EDAC project incorporates 24-hour optimized unit commitment, inclusion of exports, three-part offers, and refined cost guarantees for generators and imports. Background detail about the project — e.g., stakeholder processes, day-ahead mechanisms considered, cost benefit analysis undertaken — can be found at: http://www.ieso.ca/imoweb/edac/edac.asp

Market Design

The first major effort undertaken by the IESO following IESO Board approval in September 2008 was the development of the EDAC Market Design. This process was done in consultation with stakeholders and it resulted in approval of the final EDAC Market Design by the IESO Board on February 4, 2009.

The Market Design establishes the processes and outcomes required to implement EDAC. It also provides the foundation for developing market rules and constructing the Detailed Design documentation required for procurement.

While no significant design issues were identified through stakeholder activities, stakeholders did, in several areas, require the IESO to demonstrate that design principles were complete and would produce the desired outcomes. This resulted in additional work and improvements with respect to settlement equations (to ensure that the settlements principles can be implemented without adverse consequences) and the efficient modelling of combined cycle generation in the process.

Participants in the stakeholder processes supported the final Market Design document, while emphasizing the need to ensure that the desired outcomes are not compromised as the project is implemented.

Development of Market Rules

Market rules development is proceeding in three groups: enabling rules, 'EDAC engine' requirements, and settlement requirements. The first two groups of rules were considered together by the IESO Technical Panel and were approved by the IESO Board on September 15, 2009. These first two groups of rules provide the necessary grounds to proceed with detailed design of the largest cost element of the project, the 'EDAC engine'. They also provide the foundation for the more orderly development of settlement rules based on a fixed set of 'EDAC engine' requirements and the completed Market Design.

The current work plan calls for settlement rules development to be completed by the end of 2009 with review and approval by the Technical Panel in January 2010 and IESO Board shortly thereafter.

Detailed Design

With the completion of the EDAC Market Design, the IESO launched a second major effort to plan and estimate the schedule, costs, and resources required to complete the Detailed Design stage of the project.

The IESO's planning and estimation activities have revealed several important linkages between various areas of detailed design which have affected the overall delivery schedule. Specifically, there are dependencies between detailed process design, documentation and market rule development which reduce the ability to conduct activities in parallel. This has added several months to the project schedule. As well, some additional work will be required on design aspects of combined cycle gas unit modelling. This could add some cost and time to this aspect of the project.

The Detailed Design phase of the project is expected to be largely complete in early 2010.

Project Schedule and Cost

Based on a review of costs, the schedule for procurement and the status of the Detailed Design Stage, the IESO has established a revised timeline and costs estimates for the project.

The current project schedule calls for market trials to commence in mid 2011. The total approved capital currently remains unchanged at $26.5 million with projected expenditures of $6.4 million, $13.5 million and $6.6 million in 2009, 2010 and 2011 respectively. The current design achieves the benefits identified in the original cost/benefit analysis. The project costs and the timing remain subject to some variability depending on the final design.

Status of IESO's Asset Backed Commercial Paper Investments

The following is a status report on the IESO's current asset backed commercial paper investments. A more detailed account of the IESO's asset backed commercial paper investments and the restructuring of the Canadian asset backed commercial paper market is set out in the evidence filed as part of the IESO's 2009 fees case, a copy of which is attached hereto as Appendix A.

Background

For the purposes of its own operations and that of the IESO-Administered Markets, the IESO invests funds in highly rated, liquid, short term investments. In 2007, some of those short-term investments were in notes known as non-bank sponsored asset-backed commercial paper (ABCP). Specifically, the IESO invested the following in ABCP notes:

- Corporate investments: $1.4 million
- Real-time market investments: $23.1 million
- Transmission Rights market investments: $35.0 million

In August of 2007, a liquidity crisis threatened the Canadian market for ABCP. This crisis was triggered primarily by a loss of confidence among investors related to the news of widespread defaults on U.S. sub-prime mortgages. As uncertainty spread through the market, investors stopped purchasing ABCP notes and existing note holders were unable to rollover their maturing notes. As a result of this lack of liquidity, the issuing ABCP trusts did not redeem their notes at maturity.

The liquidity crisis could have triggered a sell-off of the assets at significantly depressed prices. However, by agreement among major Canadian participants, this market was frozen by a standstill agreement pending an attempt to resolve this crisis through a restructuring of the affected ABCP notes. The Pan-Canadian Investors Committee was formed and it filed a Plan of Compromise and Arrangement ("the Plan") under the *Companies' Creditors Arrangement Act* which was sanctioned by the Ontario Superior Court in June 2008 (subsequent appeals to the Ontario Court of Appeal and Supreme Court of Canada were dismissed). The Plan was structured to preserve the underlying long-term value of the assets while building and restoring confidence in the market.

In the fourth quarter of 2008, Canadian and international credit markets continued to experience significant volatility. Market conditions worsened and credit spreads widened. As a result of the widening of credit spreads, some parties to the Plan became concerned about implementation of the Plan because of potential margin calls and lower investment values of the restructured ABCP notes (a widening of credit spreads means that investors command a higher rate of interest on investments of the same risk class than previously). In response to these developments, amendments were negotiated to the Plan. The amendments were sanctioned by the Ontario Superior Court of Justice and implemented in January 2009.

In brief, the amendments to the Plan included additional margin funding facilities to be provided by the federal government, provincial governments and a few of the larger note holders. In addition, an 18 month moratorium (in effect until July 2010) on collateral calls combined with the move to spread-loss triggers on the new notes make the likelihood of short-term collateral calls more remote than under the

original Plan structure. These modifications and improvements to the Plan made it more robust and should add stability to the restructured notes.
The restructuring was implemented in January 2009 and the IESO received their restructured ABCP notes at that time.

As noted previously, a result of the widened interest rate spreads was a reduction in the market value of some ABCP investments, including some investments held by the IESO. Specifically, as of December 31, 2008, the real-time and the transmission rights market investments were estimated to have a market value of approximately 63% and the corporate investments were estimated to have a market value of 29% of their initial investment amount. Currently, the IESO is forecasting a market value of the real-time investments of 45%, a market value of the transmission rights investments of 45%, and a market value of the corporate investments of 22%.

Going Forward

Real-time Market Investments

The IESO had $23.1 million of real-time market funds invested in ABCP. As a result of the estimated valuations discussed above, the IESO recognized zero market related investment income in 2008 and is forecasting zero market related investment income for 2009.

Due to expected low rates of return on non-ABCP market investments, it is forecast that insufficient investment income will have been earned since 2007 to fully offset losses on the real-time ABCP investments. Accordingly, no market-related investment income is forecast for 2010.

Corporate and Transmission Rights Market Investments

The IESO also has corporate investments of $1.4 million in ABCP. As of the end of 2008, the IESO had estimated a market value of 29% of the initial purchase price of these corporate ABCP investments. As a result of final restructuring changes and the deterioration in the credit markets discussed above, the IESO is estimating a further reduction of 7% in market value, thereby resulting in an estimated market value equal to 22% of the initial investment. This reduction in value increases the forecast net interest expense for 2009.

Investment returns on transmission rights market investments remain with the transmission rights accounts and do not impact the corporate financial results and the IESO's fee application.

APPENDIX A

Asset Backed Commercial Paper

Background

Asset-backed commercial paper (ABCP) is a sophisticated form of liquid, primarily short term, investment in which a note is issued by a trust based on pools of assets, or collateralized by the cash flows from a specific pool of underlying assets, which provide security for the repayment of the notes. ABCP was a significant financial instrument in Canadian financial markets, with an established track record, and a broad range of highly rated products. The trusts issuing ABCP would use the proceeds of sale of the ABCP notes to fund the purchase of assets which would generate income to service (pay interest on) the ABCP notes.

Governments, universities, pension funds, agencies, corporations and individual investors regularly purchased ABCP notes as an effective, secure, highly liquid vehicle for short term investments. These notes typically had very short term maturity dates, ranging from a matter of days to less than one year, on which the trust would redeem them; there was also an active secondary market. Rather than liquidate the underlying trust assets to fund the redemption of ABCP notes as they matured, the trusts would largely rely on the sale of new notes to fund the redemption of maturing notes. The new notes in turn were secured by the underlying trust assets. To the extent that there was a general disruption of the market for ABCP notes, such that they could not sell new notes in sufficient quantities to fund their obligations to redeem maturing notes, the trusts had arrangements to draw upon liquidity facilities, a form of line of credit, from major financial institutions.

In August 2007 there was a general disruption of the $35 billion non-bank Canadian ABCP market as a result of concerns that the trusts which issued the ABCP were exposed through their trust assets to US sub-prime mortgages. In particular, the concern was that the assets held by the trusts to secure their ABCP notes had lost a significant percentage of their value because of the decline in the value of their investments in US sub-prime mortgages. Though actual exposure to US sub-prime mortgages was quite limited, given that most of the trusts were prevented by confidentiality provisions from disclosing their specific asset holdings to the market at large, the uncertainty over this exposure led to a market disruption.

The markets for these notes which, as noted above, are widely held by governments, universities, pension funds, agencies, corporations, and individual investors lost liquidity – no one would purchase new ABCP notes - as concerns mounted that the value of the trust assets was impaired. At the same time the trusts were unable to draw upon liquidity facilities to allow them to fund their current obligations as liquidity providers claimed that it was not a general disruption in the market for ABCP, a prerequisite to drawing on the liquidity facilities, but was a disruption limited to non-bank ABCP. As a result of the lack of buyers for ABCP notes and the inability to access liquidity facilities, the trusts which had issued ABCP notes were unable to redeem them when they matured, and the market froze.

In response to this, the finance industry backed the adoption of the "Montreal Accord" to implement a standstill agreement to facilitate an organized industry response to the lack of liquidity and avoid triggering a series of defaults. The Montreal Accord led to the establishment of the Pan-Canadian Investors Committee (Committee), chaired by Mr. Purdy Crawford, a pre-eminent member of the Canadian legal and financial communities, and assisted by Ernst & Young, JPMorgan, and external legal advisors. The Committee worked to develop and implement a restructuring of these notes which was fair and equitable for all investors and would provide transparency regarding the value of the underlying assets to promote liquidity and market value of the restructured notes.

The Committee made an application for approval of a Plan of Compromise and Arrangement (the Plan) under the *Companies Creditors Arrangement Act*. The Plan itself, like the current ABCP financial instruments, is complex and a detailed discussion of its attributes is beyond the scope of this summary. Simply, it will result in a pooling of trust assets, and the issuance of new notes with much longer maturity dates. Noteholders overwhelmingly voted to approve the proposed restructuring and the Plan was ultimately sanctioned by Mr. Justice Campbell of the Ontario Superior Court of Justice on June 5, 2008. A subsequent appeal to the Ontario Court of Appeal by certain noteholders was dismissed with the Court of Appeal concluding that the Plan was fair and reasonable in all the circumstances. Applications for leave to appeal to the Supreme Court of Canada were dismissed on September 19, 2008 and the restructuring of the affected notes may proceed. More detailed information regarding the restructuring plan is available through the Monitor's web site at: http://documentcentre.eycan.com/pages/Overview.aspx?SID=35

Following the dismissal of the application for leave to appeal the Committee has continued its work to implement the restructuring Plan. The size and scope of the restructuring is unprecedented in Canadian history. While it is our expectation that the restructuring will be implemented before year end, given the size and scope there is some uncertainty at this time regarding the details of the restructuring including when the restructured notes will be issued. Moreover, there remains considerable uncertainty regarding the market value of the ABCP notes, particularly in the shorter term. It is not anticipated that by the end of 2008 there will be a liquid market for the restructured notes, nor that there will be readily available pricing/valuation information. It is expected that to the extent market prices are disclosed, they will initially be depressed. The IESO's expectation is that following the restructuring, some ABCP noteholders will quickly move to sell their restructured notes for the following reasons:

- Certain noteholders are restricted from holding investments with durations longer than one year and thus must sell the restructured notes because of the restructured notes' longer term to maturity;
- The restructured notes may no longer meet required credit ratings for certain noteholders; and
- Some of the noteholders have an immediate need for cash in their business.

It should be noted that none of the above conditions apply to the IESO.

Though the value of the underlying assets is not independent of global financial market forces, the underlying assets continue to be highly rated with limited exposure to US sub-prime mortgages.

IESO Investments

<u>Summary of IESO's ABCP Investments</u>

The IESO has investments of $59.5 million in ABCP. The investments were made in accordance with approved IESO policy in that the ABCP investments had a credit rating of R1 High, the highest rating available for any short-term investment (e.g. Government of Canada paper is rated R1 High). The ABCP notes were issued by a number of different trusts and they relate to IESO accounts as follows: $1.4 million for corporate, $23.1 million for real-time market and $35.0 million for transmission rights market. Through its ongoing cash flows and/or borrowings on either the corporate $60 million credit facility or the market $100 million credit facility, the IESO has sufficient liquidity to clear corporate and market accounts as required.

IESO Disclosure and Reporting of ABCP Investments

In September 2007, the IESO exchanged information and discussed the details of its holdings with OEB staff in Regulatory Compliance. The IESO provided updates to OEB staff through February 2008, at the time of finalizing the 2007 results and the treatment of ABCP within the IESO accounts.

The IESO brought the matter to the attention of market participants in a notice on September 27, 2007. Since that time, related disclosures have been included in the IESO's publicly issued financial statements and an update was provided to market participants on July 17, 2008. Copies of the foregoing notice and update are attached as Appendix A to this document. The IESO's 2007 financial statements are attached as Appendix B to this document.

Treatment of IESO's ABCP Investments in 2008 Fees Submission Proceeding

At the time of the initial 2008 rate application, there was considerable uncertainty regarding the value of the ABCP investments. Accordingly, the projected 2007 results, which were included in the 2008 application (EB-2007-0816, Exhibit B, Tab 1, Schedule 1, pages 20, 22, 25), did not reflect any gains/losses associated with the ABCP investments. The matter of the IESO's investment in ABCP and the potential implications for its 2008 revenue requirement was included as an issue on the Board-approved Issues List and was addressed by the IESO at the February 11, 2008 Technical Conference. Specifically, the IESO advised intervenors that:

- No market-related interest (including non-ABCP related investments) income was recognized in 2007 since the real-time market ABCP investments remained illiquid at the end of 2007;
- The IESO took a provision of $0.7 million, or 50%, of the initial $1.4 million corporate investment in ABCP; and

- The IESO recorded an overall deficit of $4.3 million in 2007 resulting in an accumulated surplus balance of $0.7 million, and consequently no impact on the requested 2008 revenue requirements or proposed fees.

The matter of the IESO's investments in ABCP was also addressed before the Board. In its decision, the Board accepted the IESO's proposed fee reduction on the basis that there was no evidence that the proposed fee reduction, in combination with the financial consequences of the IESO's ABCP investments, would likely result in an accumulated deficit by the end of 2008.

Treatment of Investment Returns within the IESO Accounts

The IESO 2009-2011 Business Plan is included in the application as Exhibit B, Tab 1, Schedule 1.

<u>Corporate Investments</u>

Investment returns (income or losses) on corporate investments flow directly through the IESO's financial results as the income or losses are earned. Investment income serves to reduce the revenue requirements to be recovered by the IESO usage fee, and vice versa for investment losses.

In 2007, based on discounted cash flow modelling, the value of the corporate ABCP holdings was estimated to be 50% of their initial investment. This estimate reflects the fact that a material portion of the underlying assets within these ABCP investments have exposure to sub-prime mortgages in the U.S. As there is insufficient information to support a revision at this time, no change to this provision has been projected for 2008.

The attached 2007 financial statements (Appendix B) reflect the 50% provision (i.e., $666,260)[1] within the 'interest and investment income' amount of $97 thousand (page 9 – statement of operations, other comprehensive income/(loss) and accumulated surplus), the 'long-term investments' balance of $16,718 thousand at the end of 2007 (page 10 – statement of financial position, page 18 - note on long-term investments) and 'provision for other than temporary losses on long-term investment' (page 11 – statement of cash flows).

Within the 2009-2011 Business Plan, investment income on corporate investments is included in the 'net interest' amounts. Therefore, the actual 2007 'net interest' amount of $4.9 million (page 26 of the Business Plan) includes the $666,260 provision associated with the corporate investments in ABCP.

Real-time Market Investments

Investment returns (income or losses) on real-time market investments flow through the IESO's financial results as market-related interest income. However, only accumulated investment income, and not losses, are recognized in the IESO results on an annual basis. Should there be an accumulated loss at the end of a year, as was the case at the end of 2007, no market-related investment income is recognized in the year. Market-related interest income serves to reduce the revenue requirements to be recovered by the IESO usage fee.

In 2007, because of the illiquid ABCP real-time market investments which had uncertain market value, no market-related investment income was recognized in the year. At this time, there remains considerable uncertainty as to the value of these investments. The 2009 rate application assumes that the real-time ABCP investments will be restructured

[1] The face value of the corporate investments was $1.35 million; a 50% discount on the investment adjusted for the then current rate of exchange amounted to $666,260

prior to the end of 2008 but that there will not be a liquid market established or readily available pricing/valuation information on the ABCP investments by the end of 2008. Given this uncertainty, the IESO has assumed a December 31, 2008 market value of no more than 60% of the initial real-time market ABCP investments. Consistent with the practice of other noteholders, the IESO has developed a pricing model based on discounted cash flows. Though this analysis indicates a market value that is higher than 60%, given the expected depressed nature of the initial market/sales, as discussed above, the IESO has assumed an initial lower market value.

Therefore, for 2008, it is anticipated that the real-time market ABCP investments of $23.1 million will have a market value on December 31, 2008 of no more than $13.9 million, or some $9.2 million lower than the initial investment. The actual and projected investment income on non-ABCP investments for 2007 and 2008 total $7.2 million; therefore, the net return is projected to be a loss of $2.0 million. Accordingly, no market-related interest income is projected to be recognized in 2008.

For 2009, the IESO has assumed that the ABCP market recovers somewhat by the end of 2009 and the real-time market ABCP investments pay interest of $0.6 million and have a market value of 70% of their original purchase price, an amount closer to the IESO's discounted cash flow model results. Therefore, the provision against the initial $23.1 million investment would be $6.9 million. The IESO is also budgeting that a further $2.7 million of interest will be earned in 2009 on other real-time market investments. Therefore, the accumulated interest income not yet recognized will total $10.5 million, an amount that would exceed the budgeted $6.9 million ABCP loss by $3.6 million. Accordingly, the IESO has budgeted market-related interest income of $3.6 million for 2009.

The 2007 financial results recognize zero revenue for market-related interest income within the 'other revenue' balance of $2,143 thousand for 2007 (page 9 – statement of operations, other comprehensive income/(loss) and accumulated surplus, page 17 - note on other revenue). Within the 2009-2011 Business Plan, market-related interest income is presented as its own revenue class. Therefore, the actual 'market-related interest income' amount was nil for 2007 (page 23); the projected 'market-related interest income' is nil for 2008 (pages 12, 14, 15); and, the budgeted 'market-related interest income' is $3.6 million for 2009 (pages 23, 24, 25).

Transmission Rights Market Investments

Investment returns (income or losses) on transmission rights market investments remain with the transmission rights accounts and do not impact the IESO corporate financial results. Any surpluses in the transmission rights clearing account may be distributed to market participants, as was the case when the IESO distributed $57 million in 2007/2008. Conversely, market participants may be responsible for funding deficits.

Treatment of ABCP Investments Going Forward

While the IESO believes that its projections are reasonable, there remains uncertainty as to the future value of the ABCP investments. Should the value of the real-time market investments in ABCP prove to be worth less than the assumed 70% of the initial investment this would serve to reduce or eliminate market-related interest income in 2009 and possibly in future years. Similar to other variances against approved budget, this variance would be absorbed within the approved accumulated surplus/deficit (the approved regulatory deferral account) and addressed, if required, within the 2010 and possibly subsequent rate applications.

With the support of external expertise, the IESO has developed a confidential ABCP Investment Policy which outlines the IESO's strategy for the prudent management of the restructured notes including the necessary approvals for divestiture of any of the restructured notes. This policy, approved by the IESO Board of Directors on October 6, 2008, will continue to be refined as further and better market information becomes available.