Ontario Energy Board | **Commission de l'énergie de l'Ontario**

EB-2009-0377

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

AND IN THE MATTER OF the Independent Electricity System Operator Fiscal 2010 Fees Submission for Review.

BEFORE: Gordon Kaiser
Vice-Chair and Presiding Member

DECISION AND ORDER

[1] This Decision concerns the Application of November 2, 2009 by the Independent Electricity Systems Operator (the "IESO") for approval of its 2010 fees submission by the Board pursuant to sections 18 and 19 of the *Electricity Act*.

[2] On March 2, 2010, the settlement proposal attached as Appendix A was filed with the Board. The Association of Major Power Consumers in Ontario, Energy Probe Research Foundation and the Vulnerable Energy Consumers Coalition participated in the settlement conference.

The Settlement Agreement

[3] The IESO and the above intervenors agreed to a settlement of all issues including the IESO's proposed revenue requirement of $122.8 million and proposed 2010 capital expenditures of $21.6 million. The parties also agreed to a continuation of

the $1000 application fee and the proposed IESO usage fee of $0.822/MWh commencing January 1, 2010. Board staff and the other intervenors took no position.[1]

[4] The specific element of costs approved by the intervenors are as follows:

(a) Operating costs of $124.8 million for the year 2010 including $91.5 million for OM&A costs, and $33.3 million for pension, amortization and interest costs. Approximately $2.0 million of this cost will be recovered from other sources leaving a revenue requirement of $122.8 million.

(b) A capital expenditures envelope of $21.6 million for capital plans.

(c) Capital expenditures of $13.5 million for the Enhanced Day-ahead Commitment (EDAC) project for 2010 within the capital expenditures envelope.

[5] One of the issues in this proceeding was the financial consequence of the IESO's investment in Asset Backed Commercial Paper ("ABCP") and the impact on the IESO's operating costs and IESO's 2010 revenue requirements. The IESO now estimates that the cost consequences are approximately $12.5 million of which approximately $8.5 million has been recovered to date. The remainder will be recovered in the following years. In 2010 the company will recover $300,000. That amount will be offset against interest income with the result that the IESO's revenue requirement increases by $300,000.

[6] Another issue in the proceeding was the IESO's process for the recovery of its smart metering costs and whether the IESO has received Ontario Energy Board approval of a fee mechanism to recover smart metering entity costs.

[7] The IESO has advised that as of the end of September 2009 it incurred a total of $38.5 million in smart metering costs which includes the Meter Data Management Repository (MDM/R) as well as operating costs to date. The IESO indicated that an

[1] Ontario Power Authority, Ontario Power Generation Inc, Shell Energy North America (Canada) Inc. and The Society of Energy Professionals

application for recovery of smart metering costs will be made to the Board by the end of April. The actual costs, as of the end of February 2010 are $40.6 million.

[8] The Board accepts the settlement agreement as filed and appreciates the effort of the intervenors and the applicant in reaching this settlement.

Congestion Management Settlement Credits

[9] The Board in this proceeding asked the IESO to address the level of Congestion Management Settlement Credits ("CMSC") it was paying to exporters. This concern resulted from the January 2010 Report of the Market Surveillance Panel (the "MSP") which recommended at page 104 as follows:

> ***Recommendation 3-4 (from January 2010 MSP report)***
>
> The Panel recommends that, for the purposes of calculating congestion management settlement credit (CMSC) payments, the IESO should revise its constrained on payment calculation using a replacement bid (such as $0/MWh) when market participants (both exporters and dispatchable loads) bid at a negative price. This would create more consistent treatment with generators and importers that are constrained off.

[10] This follows a similar recommendation of the IESO made in its January 2009 report, where the MSP stated:

> ***Recommendation 3-2 (from January 2009 MSP Report)***
>
> In an earlier report, the Panel encouraged the IESO to limit self-induced congestion management settlement credit (CMSC) payments to generators when they are unable to follow dispatch for safety, legal, regulatory or environmental reasons. The Panel further recommends that the IESO take similar action to limit CMSC payments where they are induced by the

generator strategically raising its offer price to signal the ramping down of its generation.

[11] The costs connected with CMSC payments are substantial. To the extent those costs are artificial and result from importers, exporters and generators gaming the system there is a serious concern. When the Board began reviewing the IESO's current fee application it was not clear what, if any remedies, were being proposed to deal with the issue. Accordingly, the Board in the technical conference asked the IESO to answer certain questions. Those questions and answers are attached to this Decision as Appendix B.

[12] The IESO in response to the Board produced a panel of witnesses: Brian Rivard, Darren Finkbeiner, Nicholas Ingman, and Susan Nicholson, at the oral hearing dealing with the settlement agreement. Brian Rivard and Darren Finkbeiner addressed questions regarding CMSC payments.

[13] The IESO estimates that over the period May 2002 to October 2009 the total CMSC payments to all generators and intertie traders in the Ontario market was approximately $1 billion dollars. The total CMSC payments on the Minnesota and Manitoba interties was $167 million or 17 % of the total CMSC payments. $130 million was paid for constrained off imports and $37 million was paid for constrained on exports. These two interties represented only 7% of Ontario's aggregate intertie capability before the new Quebec intertie came into service in July 2009. Accordingly, the Northwest CMSC payments are very high relative to the total area as indicated in Table 3-10 below. The constrained off costs relate largely to imports, while the constrained on costs relate largely to exporters.

	Northwest							Ontario[82]		
	Constrained Off			Constrained On						
Year	Generators	MBSI	MNSI	Generators	MBSI	MNSI	Total	Constrained Off	Constrained On	Total
2002*	24	9	2	1	0	0	36	39	107	146
2003	6	9	8	3	0	0	26	68	42	110
2004	20	3	1	0	0	0	24	55	25	80
2005	48	17	6	0	0	6	77	121	81	202
2006	16	9	0	1	0	2	28	62	41	103
2007	14	13	2	2	0	4	35	68	39	107
2008	16	30	3	1	1	16	67	98	53	151
2009**	7	15	3	1	2	6	34	61	45	106
Total	151	105	25	9	3	34	327	572	433	1,005
Claw-back							10			28
Net CMSC							317			977

*from May to December 2002
** from January to October 2009

Reference: *Market Surveillance Panel Monitoring Report on the IESO-Administered Electricity Markets,* January 2010.

[14] The MSP noted that had CMSC payments to exporters been calculated on the basis of a replacement bid of $0/MWh when exporters bid below that level the total savings to Ontario consumers would have been $3.5 million during the period November 2006 to October 2009.

[15] The January 2010 MSP report recognizes that replacing for CMSC purposes the participants negative bid with $0/MWh is a short term solution. The MSP also noted:

> Although the Panel believes that an ideal long-term solution is a locational marginal pricing regime, a hybrid regime that includes a uniform price to loads but locational marginal pricing for generator and intertie traders, could also improve market efficiency. This could likely be implemented using a single schedule that reflects system constraints, with the load price being calculated as province –wide average of locational supply-side prices. A locational marginal price for generators and traders would force them to bear the risk of a negative locational price and thus remove their incentives to bid below their incremental cost or opportunity cost.

[16] Essentially the IESO has agreed with the MSP that there is a problem and the solution may be to calculate the CMSC payment on the basis of a replacement bid of $0/ MWh when exporters bid below that level. The IESO has also agreed to study the possibility of a longer term solution involving locational marginal pricing and possibly the hybrid regime suggested by the MSP.

[17] The IESO intends to incorporate its recommendation in a market rule amendment which will ultimately come to the IESO Board in September 2010. After approval by the IESO Board the Ontario Energy Board will have an opportunity to review it.

[18] The proposed steps in the market rule amendment process are as follows:

1. April 14, 2010 – the IESO will include the rule amendment on the forward agenda for the technical panel meeting;

2. May 11, 2010 – the IESO will introduce the rule amendment at the technical panel meeting plus possible discussions and draft rule changes;
3. July 6, 2010 or August 17, 2010 – the IESO will present the rule amendment (with any changes) to the technical panel meeting;
4. September 2010 – the IESO will present the rule amendment to the IESO board for approval.

[19] In addition to addressing the MSP recommendation in the January 2010 report, the IESO has also outlined in this hearing its response to the MSP recommendation regarding CMSC in the 2009 report that the IESO take similar action to limit CMSC payments where they are induced by the generator strategically raising its offer price to signal the ramping down of its generation.

[20] The IESO is currently formulating a rule amendment (MR-00252) to limit self induced CMSC payments to generators in the circumstance where generators strategically raise their offer price to signal the ramping down of their generation. Generators earn CMSC for ramp injections, and the IESO is not able to recover self induced CMSC. The rule amendment is currently the subject of the IESO's Stakeholder Engagement process. The IESO will seek IESO Board approval in September 2010.

[21] Given the response to Board staff interrogatories at the technical conference and the evidence in the hearing, the Board is confident that the IESO is moving in a timely and responsive manner to deal with this problem. Under the circumstances the Board does not believe it is necessary to grant conditional approval of the settlement agreement. The Board appreciates the responsive manner in which the IESO is dealing with this matter and expects to be advised of any delays.

Cost Awards

[22] A decision regarding cost awards will be issued later. Eligible parties may submit cost claims by April 14, 2010 in accordance with the Board's Practice Direction on Cost Awards.

[23] The IESO will have until April 28, 2010 to object to any aspect of the costs claimed. Any party whose cost claim is objected to will have until May 5, 2010 to respond as to why their cost claim should be allowed. Copies of all submissions must be filed with the Board and served on the IESO.

THE BOARD ORDERS THAT:

1. The 2010 revenue requirement of the IESO is set at $122.8 million and approved capital expenditures at $21.6 million;

2. The usage fee will be $0.822 per MWh as of January 1, 2010;

3. The application fee is set at $1000; and

4. a rebate will be granted to market participants in 2010 of any accumulated surplus in the manner proposed in the IESO's 2010 Fees Submission.

DATED at Toronto on April 1, 2010

ONTARIO ENERGY BOARD

Original signed by

Kirsten Walli
Board Secretary

APPENDIX "A" TO

DECISION AND ORDER

BOARD FILE NO. EB-2009-0377

DATED April 1, 2010

SETTLEMENT AGREEMENT

STIKEMAN ELLIOTT

Stikeman Elliott LLP Barristers & Solicitors

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

Direct: (416) 869-5688
E-mail: gzacher@stikeman.com

BY EMAIL & REGULAR MAIL

March 2, 2010
File No.: 101926.1054

Kirsten Walli
Board Secretary
Ontario Energy Board
PO Box 2319
2300 Yonge Street
Toronto, ON M4P 1E4

Dear Ms. Walli:

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

I enclose for filing the Settlement Proposal agreed to between the IESO and all intervenors who participated in the Settlement Conference on February 25, 2010 (the "Intervenors").

As stated in the Settlement Proposal, the IESO and Intervenors agreed to a settlement on all issues contained in the Issues List and the Intervenors agreed to the IESO's proposed revenue requirement, capital expenditures and fees.

The IESO respectfully requests that the Board accept the Settlement Proposal and approve the IESO's proposed revenue requirement, capital expenditures and fees as set out in its Fiscal Year 2010 Fees Submission for Review.

Yours truly,

Glenn Zacher

/sc
Encl.
cc: Board Staff
Registered Intervenors and observers

TORONTO
MONTREAL
OTTAWA
CALGARY
VANCOUVER
NEW YORK
LONDON
SYDNEY

INDEPENDENT ELECTRICITY SYSTEM OPERATOR (IESO)

FISCAL YEAR 2010 FEES SUBMISSION FOR REVIEW

SETTLEMENT PROPOSAL

EB-2009-0377

This Settlement Proposal is filed with the Ontario Energy Board ("the OEB" or "Board") for consideration in the determination of the Independent Electricity System Operator ("the IESO") Fiscal Year 2010 Fees Submission for Review, EB-2009-0377 (the "IESO's 2010 Fees Submission"). A Settlement Conference was conducted on February 25, 2010 pursuant to Rule 31 of the OEB's *Rules of Practice and Procedure* (the "*Rules*") and the OEB's *Settlement Conference Guidelines*. This Settlement Proposal arises from the Settlement Conference and was prepared in accordance with Rule 32 of the Rules.

The following parties (the "Parties") participated in the Settlement Conference:

- The IESO;
- Association of Major Power Consumers in Ontario("AMPCO");
- Energy Probe Research Foundation (Energy Probe); and
- Vulnerable Energy Consumers Coalition ("VECC").

This Settlement Proposal addresses all issues on the Board-approved issues list (the "Issues List"), namely:

1. Operating Costs
2. Capital Spending
3. Methodology for Calculating Usage Fee
4. Smart Metering Entity
5. Reliability
6. Green Energy and Green Economy Act (GEGEA) Initiatives

The Parties accept the IESO's evidence on all of the issues and have agreed to a settlement on all of the issues.

OEB Staff is not party to this Settlement Proposal and therefore takes no position on any issue.

A Technical Conference was held on January 29, 2010 and Board Staff and intervenors examined panels of IESO witnesses on the matters contained in the Issues List; the Technical Conference was transcribed. There were no undertakings for the IESO from the Technical Conference.

At the Technical Conference, OEB Staff introduced and marked as an exhibit (TC.1) questions relating to the recent MSP Monitoring Report. Prior to the Settlement Conference, the IESO filed answers to Board Staff's questions stating, inter alia, that the IESO was developing a market rule amendment to address the MSP's specific recommendation relating to CMSC payments to exporters and dispatchable loads. The IESO agrees that it will continue to update OEB Staff and intervenors on the progress of this market rule amendment.

On the basis of the IESO's 2010 Fees Submission, pre-filed evidence, and additional evidence provided at the Technical Conference, the Parties agree to the approvals sought in the IESO's 2010 Fees Submission, including, the IESO's proposed 2010 revenue requirement, capital expenditure requirement, usage fee and application fee.

In accordance with Rule 32 of the Board's Rules and the *Board's Settlement Conference Guidelines*, this Settlement Proposal outlines the Parties' agreement and provides a direct and transparent link between each issue and the evidence in the record. The Parties further agree that the evidence is sufficient to support the Settlement Proposal and that the quality and detail of this supporting evidence will allow the Board to make findings on the issues.

IESO 2010 Revenue Requirement, Proposed Expenditures and Fees

The Parties agree to the IESO's 2010 proposed revenue requirement of $122.8 million and proposed 2010 capital expenditures of $21.6 million.

The Parties agree to the continuation of the $1,000 application fee and proposed IESO usage fee of $0.822/MWh commencing January 1, 2010 (to be charged in the manner provided in the IESO's 2010 Fees Submission).

The following general evidence, in addition to the specific evidence cited under the issues below, supports this agreement:

- Exhibit A, Tab 1, Schedule 1, IESO's 2010 Fees Submission
- Exhibit B, Tab 1, Schedule 1, 2010-2012 Business Plan
- Exhibit B, Tab 2, Schedule 1, Letter to Minister of Energy and Infrastructure dated October 01, 2009
- Exhibit TC.3, Letter from Minister of Energy and Infrastructure dated November 16, 2009
- Exhibit B, Tab 3, Schedule 1, Supplemental Financial Information
- Exhibit B, Tab 4, Schedule 1, Methodology for Calculating 2010 Usage Fee and Process for Rebating any Revenue Surplus
- Exhibit TC.2, Updated Financial Evidence
- Final Transcript for January 29, 2010 Technical Conference

1.0 Operating Cost

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

The Parties accept that the evidence set out below supports the IESO's projected OM & A costs as being appropriate and reasonable:

- Exhibit B, Tab 1, Schedule 1, 2010-2012 Business Plan, pages 10-17, 20-27
- Exhibit B, Tab 3, Schedule 1, Supplemental Financial Information
- Exhibit TC.2, Updated Financial Evidence
- Exhibit TC.6, Answers by IESO to pre-filed Questions of OEB and VECC
- Final Transcript for January 29, 2010 Technical Conference, pages11-19

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

The Parties accept that the evidence set out below supports the IESO's projected staff costs and strategy for setting compensation levels as being appropriate and reasonable:

- Exhibit B, Tab 1, Schedule 1, 2010-2012 Business Plan, page 15
- Exhibit B, Tab 3, Schedule 1, Supplemental Financial Information, page 11
- Exhibit TC.2, Updated Financial Evidence
- Exhibit TC.5, Table of Average Wage Costs
- Exhibit TC.6, Answers by IESO to pre-filed Questions of OEB and VECC
- Exhibit TC.7, IESO Organization Pre-reorganization Chart
- Exhibit TC.8, Current IESO Organization Chart
- Final Transcript for January 29, 2010 Technical Conference, pages 20-33, 44-54

1.3 What are the financial consequences of the IESO's investments in ABCP on the IESO's operating costs and its 2010 revenue requirements and have these costs been appropriately incorporated in the 2010 fees submission?

1.4 Is the IESO's policy for treatment of ABCP investments going forward appropriate and reasonable?

With regards to Issues 1.3 and 1.4, the Parties accept that the evidence set out below confirms that: (i) the financial consequences of the IESO's investments in ABCP on the IESO's operating costs and its 2010 revenue requirements have been appropriately incorporated in the IESO's 2010 fees submission; and (ii) the IESO's policy for treatment of ABCP investments going forward is appropriate and reasonable:

- Exhibit B, Tab 1, Schedule 1, 2010-2012 Business Plan, pages 11and13
- Exhibit B, Tab 3, Schedule 1, Supplemental Financial Information, pages 2 and 3
- Exhibit B, Tab 6, Schedule 1, Asset Backed Commercial Paper
- Exhibit TC.6, Answers by IESO to pre-filed Questions of OEB and VECC
- Final Transcript for January 29, 2010 Technical Conference, pages 33-43

2.0 Capital Spending

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

2.2 Is the EDAC project on budget and schedule?

With regards to Issues 2.1 and 2.2, the Parties accept that the evidence set out below confirms that: (i) the IESO's proposed 2010 capital expenditures on the enhanced day-ahead commitment (EDAC) project are reasonable; and (ii) the EDAC project is on budget and schedule:

- Exhibit B, Tab 1, Schedule 1, 2010-2012 Business Plan, pages 11, 16, 23 and 25
- Exhibit B, Tab 3, Schedule 1, Supplemental Financial Information, pages 16 and 17

- Exhibit B, Tab 5, Schedule 1, Status of Enhanced Day-Ahead Commitment Project

- Exhibit TC.9, Written Response to OEB pre-filed Question 17

- Final Transcript for January 29, 2010 Technical Conference, pages 54-62, 64-65

2.3 Are the IESO's proposed capital expenditures, other than EDAC, appropriate and reasonable?

The Parties accept that the evidence set out below supports the IESO's proposed capital expenditures, other than EDAC, as being appropriate and reasonable:

- Exhibit B, Tab 1, Schedule 1, 2010-2012 Business Plan, pages 16, 23-27

- Exhibit B, Tab 3, Schedule 1, Supplemental Financial Information. Pages 7-10

- Exhibit TC.2, Updated Financial Evidence

- Final Transcript for January 29, 2010 Technical Conference, pages 62-72

3.0 Methodology for Calculating Usage Fee

3.1 Are the methodologies for calculating the 2010 usage fee and process for rebating surpluses appropriate and reasonable?

The Parties accept that the evidence set out below supports the IESO's methodologies for calculating the 2010 usage fee and process for rebating surpluses as being appropriate and reasonable:

- Exhibit B, Tab 1, Schedule 1, 2010-2012 Business Plan, pages 10-13

- Exhibit B, Tab 4, Schedule 1, Methodology for Calculating 2010 Usage Fee and Process for Rebating any Revenue Surplus

- Exhibit B, Tab 3, Schedule 1, Page 1, Supplemental Financial Information

- Exhibit TC.2, Updated Financial Evidence

- Final Transcript for January 29, 2010 Technical Conference, pages 7, 10-11

3.2 Is the forecast Market Demand and methodology appropriate and have the impact of Conservation or Demand Management initiatives been suitably reflected?

The Parties accept that the evidence set out below confirms that the IESO's forecast Market Demand and methodology are appropriate and that the impact of Conservation and Demand Management initiatives have been suitably reflected:

- Final Transcript for January 29, 2010 Technical Conference, pages 6-11

4.0 Smart Metering Entity

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

4.2 Is the IESO's proposal and timing for recovery of its smart metering costs through a separate regulatory mechanism appropriate and reasonable?

4.3 Has the IESO in its role as the Smart Metering Entity, received Ontario Energy Board approval of a fee mechanism to recover Smart Metering Entity costs incurred, and has the Smart Metering Entity filed a separate fees submission to recover these costs?

With regards to Issues 4.1, 4.2, and 4.3, the Parties accept that the evidence set out below confirms that: (i) the IESO's process for separating costs associated with its role as the Smart Metering Entity from costs associated with its role in operation of the provincial electricity grid and managing the wholesale electricity market are reasonable; (ii) the IESO's proposal and timing for recovery of its smart metering costs through a separate regulatory mechanism is appropriate and reasonable; and (iii) the IESO is preparing applications, including an SME fee proposal, and intends to file these applications with the OEB by the end of the first quarter of 2010:

- Exhibit B, Tab 1, Schedule 1, 2010-2012 Business Plan, pages 9, 18-19, 28-30
- Final Transcript for January 29, 2010 Technical Conference, pages 74-76

5.0 Reliability

5.1 Are the IESO's proposed 2010 measures to address reliability appropriate and cost-effective?

The Parties accept that the evidence set out below supports the IESO's proposed 2010 measures to address reliability as being appropriate and cost-effective:

- Exhibit B, Tab 1, Schedule 1, 2010-2012 Business Plan, pages 1-2, 5, 23-27
- Final Transcript for January 29, 2010 Technical Conference, pages 77-92

6.0 Green Energy and Green Economy Act (GEGEA) Initiatives

6.1 Is the IESO proposal to address GEGEA initiatives appropriate and cost-effective?

The Parties accept that the evidence set out below supports the IESO's proposal to address GEGEA initiatives as being appropriate and cost-effective:

- Exhibit B, Tab 1, Schedule 1, 2010-2012 Business Plan, pages 1-9, 23-27
- Exhibit TC.7, IESO Organization Pre-reorganization Chart
- Exhibit TC.8, Current IESO Organization Chart
- Final Transcript for January 29, 2010 Technical Conference, pages 93-99

APPENDIX “B” TO

DECISION AND ORDER

BOARD FILE NO. EB-2009-0377

DATED April 1, 2010

QUESTIONS FROM BOARD STAFF AND RESPONSES FROM THE IESO REGARDING CMSC PAYMENTS

January 28, 2010

Questions for IESO at Technical Conference
Relating to MSP Monitoring Report on the IESO-Administered Electricity Markets for the Period from May 2009 - October 2009
(and previous MSP reports)

1) The MSP has released (or is about to release today) its most recent monitoring report on the IESO administered markets. This report highlights the significant levels of Congestion Management Settlement Credits or CMSC payments which total over $1 billion since market opening. While CMSC payments are an integral part of the current Ontario market design, the panel reports that many of these are constrained off payments – ie., payments for generators or importers not to generate or import. In many cases these payments appear to be inappropriate or unwarranted especially in the North West region of the province and particularly as concerns export and import transactions.

   Are these issues being addressed in current IESO market evolution and market rule amendment activities? Please provide an update on what actions, if any, the IESO has been taking in this area and what actions it plans to take.

2) Related to the above question, the MSP report indicates that at the Minnesota intertie there are cases where the intertie is import-congested in the unconstrained sequence when in fact there is no actual power being imported. Please explain why this situation is arising and whether or not it is leading to significant costs being borne by Ontario ratepayers. Please also explain any plans or actions, if any, the IESO is taking in regards to the situation.

3) The MSP report indicates that at the Manitoba intertie there are significant cases of constrained-off imports Manitoba to Ontario resulting in CMSC payments to Manitoba Hydro totaling approximately $80 million over the last 7 years – while Ontario has received no power in return. The report also indicates that over the same time frame Manitoba Hydro has been paid about $3 million for constrained-on exports from Ontario to Manitoba. Please explain how these patterns of payments are arising and any actions or plans the IESO has in this regard.

4) With reference to the MSP report of November 2008 to April 2009 (released July 31, 2009) Appendix 4A (pages 264-272): This appendix contains a list of recommendations that the MSP has made to the IESO. Please indicate whether the IESO responses therein are still current, and, if not please provide any more up-to-date information.

Questions for IESO at Technical Conference
Relating to MSP Monitoring Report on the IESO-Administered Electricity Markets for the Period from May 2009 - October 2009
(and previous MSP reports)

Please find below, the IESO's written responses to the Board's questions concerning the recent MSP report.

It is the IESO's position that Congestion Management Settlement Credits (CMSC) are a component of electricity market design and are not relevant for the purposes of the IESO's current fees proceeding. CMSC payments do not impact on the IESO's costs except indirectly insofar as devoting additional work on the matter of CMSC payments or market evolution in general would require additional resources and costs.

CMSC is an important issue and, as detailed below, it has and is continuing to be addressed through market evolution activities including work with the IESO's Market Assessment Unit (MAU), which assists the MSP, and through the market rule amendment process. It is the IESO's position that these are the most appropriate forums in which to address this issue. That being said, the IESO has addressed Board staff's specific questions and would be pleased to meet with members of the Board to discuss this subject in more detail or other market design issues.

1) The MSP has released (or is about to release today) its most recent monitoring report on the IESO administered markets. This report highlights the significant levels of Congestion Management Settlement Credits or CMSC payments which total over $1 billion since market opening. While CMSC payments are an integral part of the current Ontario market design, the panel reports that many of these are constrained off payments – i.e., payments for generators or importers not to generate or import. In many cases these payments appear to be inappropriate or unwarranted especially in the North West region of the province and particularly as concerns export and import transactions.

   Are these issues being addressed in current IESO market evolution and market rule amendment activities?, Please provide an update on what actions, if any, the IESO has been taking in this area and what actions it plans to take.

   <u>IESO Response</u>

   Background — CMSC payments are an integral part of the current Ontario electricity market design which is based on a uniform pricing/two schedule system in contrast to a locational based pricing model. CMSC payments are paid for numerous reasons including, ramp rate limitations, transmission limitations, locational reserve requirements, and when facilities are dispatched out of merit for regulatory, safety and equipment related concerns.

In the context of the Ontario market design, CMSC payments are integrated with other fundamental components of the market and serve a number of purposes, including

- Pricing (A) – CMSC encourages generators to offer the full capacity of their generation resources notwithstanding transmission constraints that limit the quantity that would ordinarily be scheduled. Without CMSC, these same generators would likely change their offering behavior to offer only the quantities that they would reasonably expect to be scheduled. This would reduce generation supply offered into the market and would have an upward (or in the case of loads and exports downward) pressure on price.

- Pricing (B) – The IESO currently employs a 3X (formerly, 12X) ramp rate methodology. The effect of this is that price is not representative of the marginal cost of certain resources when they are ramping up or down. Constrained-on and off payments are accordingly made to those quick-ramping marginal suppliers (i.e., gas generators, some hydro) whose offer prices are not affected by the 3X ramp rate.

- Resource Funding – CMSC currently provides revenue streams necessary for certain resources to remain commercially viable. For instance, there are certain resources that are located in areas that are bounded by transmission constraints and that frequently experience oversupply/undersupply. The commercial viability of these resources could be jeopardized if they were frequently constrained off/on without any compensation or with reduced compensation. Any reduced compensation would likely need to be replaced through other mechanisms such as OPA contracts.

- Dispatch Compliance – CMSC payments encourage market participants to comply with IESO dispatch instructions. Without CMSC, generators that are constrained off due to transmission limitations would be incented to continue to run in order to receive (higher than cost) uniform market clearing prices. Absent CMSC, compliance with dispatch instructions would need to be regulated through a punitive enforcement system. CMSC therefore contributes to reliability and lower compliance costs.

Given this integration of CMSC with other components of the market, any elimination, reduction or other change in CMSC may have consequences in other areas. Similarly, elimination or reduction in the amount of CMSC paid out could save consumers CMSC-related costs, but add to consumer costs in other areas (e.g., MCP, OPA contract costs). For these reasons, changes to CMSC cannot be addressed in isolation from other fundamental aspects of the market.

It should be noted that the IESO agrees that a locational based pricing system is more efficient than the current uniform pricing/two schedule system and, as the market and sector evolve, the IESO will consider whether transitioning to a locational based pricing system is advisable (see below).

Actions taken and planned to address CMSC — While CMSC is an integral part of the Ontario market, the IESO continually and actively monitors the nature and extent of CMSC payments to ensure that they continue to be appropriate and warranted in light of changes to the market and the sector. The IESO does this through the MAU (which assists the MSP), consultation with the MSP itself, market evolution activities and ongoing stakeholder consultation. Where the IESO identifies problems or improvements that can be made (or problems or improvements are identified and brought to the IESO's attention by others), the IESO makes changes through the market rule amendment process or through changes in its market manuals and/or procedures.

Some of the changes the IESO has made since market opening to address CMSC include:

- Limiting generator/import offers for the purpose of CMSC to $0 (June 2003);
- Introducing dispatchable load "self-induced" CMSC clawback provisions (January 2004);
- Moving the market schedule from 12X ramp rate multiplier to a 3X. (September 2007); and
- Transactional coding changes removing CMSC payments for certain causal events (November 2009).

Recently, the IESO proposed a generator "self-induced" CMSC claw back initiative. This is currently going through the stakeholder process prior to a planned Market Rule amendment submission. The purpose of this planned amendment is to eliminate CMSC payments currently being made to generators for operating restrictions within their control and not the result of transmission limitations or other intended CMSC casual events.

The MSP, through the IESO's discussions with the MAU is aware of this initiative.

With regard to Board staff's specific question as to whether the IESO is taking steps to address the issues referenced in the recent MSP report, the answer is yes - work is currently being undertaken. Prior to the release of the MSP's recent report, the IESO discussed with the MSP/MAU the specific matter of increasing CMSC payments to exporters and dispatchable loads who bid at negative prices and potential solutions. The frequency and magnitude of these payments in the Northwest has increased as load has declined and Ontario exports have increased. Some of the potential solutions discussed with the MSP/MAU are in the process of being incorporated in a rule amendment submission. Similar to the limitation placed on generators/imports, the IESO intends to bring forward rules that will limit the CMSC calculation for exports and dispatchable loads to $0.

It should be noted, as discussed above, that CMSC is integrated with other aspects of the market and the proposed changes to CMSC payments to exporters/dispatchable loads may have potentially adverse consequences. These will need to be assessed in considering and formulating the rule amendment in order to ensure that the objective of reducing the magnitude of these specific CMSC payments does not trigger other substantial costs or unduly undermine market efficiency or reliability.

Market Evolution – More generally the IESO will be initiating longer term market evolution considerations during 2011 which, in light of recent changes to the sector, may include consideration of additional changes to CMSC, including constrained off limitations, locational pricing opportunities and other matters.

2) Related to the above question, the MSP report indicates that at the Minnesota intertie there are cases where the intertie is import-congested in the unconstrained sequence when in fact there is no actual power being imported. Please explain why this situation is arising and whether or not it is leading to significant costs being borne by Ontario ratepayers. Please also explain any plans or actions, if any, the IESO is taking in regards to the situation.

IESO Response

The above noted references in the MSP report require some background explanation and clarification.

The referenced section of the MSP report describes a condition where the economic offers from Minnesota exceed the transmission interface capability and thus create congestion in the uniform market schedule. Simultaneously the constrained scheduling system recognizes a constrained transmission interface in Ontario and limits actual flows to 0 MW. In these circumstances, the transmission rights (TR) market will pay TR rights holders when there is congestion in the uniform market schedule regardless of the real-time flows from the constrained sequence. For example, a TR rights holder would be paid "congestion rent" even though 0 MW actually flowed. This is how the TR market is designed to function and, in response to Board staff's specific question, this situation has no impact on Ontario ratepayers.

The TR market is a 'closed' design which is entirely funded by TR rights auction proceeds, and it is designed so that these proceeds are sufficient to fund congestion rents. Specifically, the market is designed so that over time the offset of TR auction revenues and congestion rents maintains a rolling balance of approximately $20 million. Over time, non-TR market participants (and ratepayers) are therefore not exposed to TR market costs. Similarly, the reference at p. 96 of the MSP report to "paying less rebate to Ontario consumers" is not a potential consequence of the current TR market design. As noted, the market is designed to maintain a rolling balance of $20 million and to not rebate any surplus to Ontario consumers.

3) The MSP report indicates that at the Manitoba intertie there are significant cases of constrained-off imports Manitoba to Ontario resulting in CMSC payments to Manitoba Hydro totaling approximately $80 million over the last 7 years – while Ontario has received no power in return. The report also indicates that over the same time frame Manitoba Hydro has been paid about $3 million for constrained-on exports from Ontario to Manitoba. Please explain how these patterns of payments are arising and any actions or plans the IESO has in this regard.

IESO Response

The constrained-on and off payments referenced above are a result of congestion in Northwestern Ontario – specifically, oversupply that requires constraining-on dispatchable loads/exports or constraining-off generation/imports.

In the circumstances noted, and assuming the export limit on CMSC is $0, constraining on exports at one cent is, in fact, cheaper for Ontario consumers than paying constrained off payments to generators or importers at an offer price of $0. The IESO as indicated earlier is expecting to introduce rules limiting the export/dispatchable load CMSC calculation to $0. It is worth noting that at present it is our understanding that much of this CMSC has been recovered through the local market power mechanisms.

4) With reference to the MSP report of November 2008 to April 2009 (released July 31, 2009) Appendix 4A (pages 264-272): This appendix contains a list of recommendations that the MSP has made to the IESO. Please indicate whether the IESO responses therein are still current, and, if not please provide any more up-to-date information.

IESO Response

The IESO formally responds to all MSP recommendations, typically within 4-6 weeks of each report, and at the same time updates the responses to the previous recommendations. The IESO responses to the referenced recommendations are up to date.

Further, all recommendations are considered and, if accepted, prioritized along with all other IESO initiatives. Based on this prioritization and resource availability, the IESO then implements the recommendations.