

IESO Stakeholder Advisory Committee
Minutes of Meeting
January 23, 2006
10:00am

Advisory Committee Members in Attendance:

Mr. Brian Bentz (representing Distributors)
Mr. Bruce Boland, Chair (representing Generators)
Mr. Bruce Campbell (representing IESO)
Mr. Bruce Lourie (representing Environmental)

Mr. Chuck Stradling (representing Commercial Consumers)
Mr. Daniel Whyte (representing Generators)
Mr. John LeMay (representing Wholesale Consumer Market Participants)
Mr. Matthew Picardi (representing Marketers/Brokers)
Mr. Mike Humphries (representing Embedded Industrial Consumers)
Mr. Paul McMillan (representing Marketers/Brokers)
Mr. Steve Dorey (representing Transmitters)
Ms. Julie Girvan (representing Residential Consumers)

Advisory Committee members absent:

Mr. Don Thorne (representing Distributors)

Invited Guests:

Ms. Glenna Carr, Chair IESO Board of Directors
Mr. Dave Goulding, IESO
Mr. Paul Shervill, V.P. Electricity Sector Development OPA

Presenters:

Mr. Harry Chandler (IESO)
Mr. Ken Kozlik (IESO)

Administration & Introduction:

Mr. Boland advised that he would act as chairman for the morning sessions and that Mr. Humphries would act as chairman for the afternoon sessions. Mr. Boland updated the agenda noting that the "Constrained off Congestion Management Settlement Credit

(CMSC) payments to importers and exporters” item would not be going before the Board on February 3rd.

Evolution of Vision for the Ontario Electricity Market

Mr. Boland explained that the agenda team had intended that this initial discussion of a market vision would explore and discuss ideas which members would then take back to their constituencies to discuss further. It was expected that in 1 to 2 months the members would come back to the issue for a more definitive discussion and work towards a common vision or at a minimum a number of shared ideas. Before opening the floor to a general discussion Mr. Dorey, in his capacity as the former Executive Director of the Electricity Conservation & Supply Task Force, provided an overview of the conclusions of the Task Force to establish a context for the discussion, followed by a brief presentation by Mr. Kozlik on the Evolution of the Vision for the Ontario Electricity Market.

Mr. Bentz expressed the view that the key to evolving to what the Task Force recommended is having a plan in place to mitigate but not shield the large group of residential consumers from price volatility. Mr. Dorey said that the Task Force recognized that the market power mitigation scheme was intended to provide transitory protection but was so far after the fact, that it did not effectively cushion the impacts in a timely manner. The Task Force concluded that a blended price structure, in conjunction with regulated OPG assets, could expose consumers to the real cost of power and mitigate the variability in the cost of power. The Task Force did not specifically address the transition from a regulated structure to a fully competitive market for all types of generation (baseload, intermediate and peaking).

In response to questions Mr. Kozlik said that the forward price curve needs to be visible through the public trading of products and price exploration. By moving from a central procurement model, to a structure where electricity consumers and suppliers can conveniently address their future price risks through forward contracts, a more appropriate sharing of all risks will result. In relation to risk for small consumers Mr. Boland suggested that there are two models for managing that risk: regulation by the OEB; or the market, perhaps through the use of Load Serving Entities (LSE's). Both can work, the question is which would be cheaper and more effective to deliver? Does a long-term market vision require moving away from a uniform clearing price to locational market pricing?

Mr. Picardi noted that it is not simply an issue of managing price volatility, for example you could have avoided natural gas price volatility by locking in at a high price. Consumers should have the option to manage volatility by contracting with someone as well as the option to do nothing. Mr. Humphries said that you need to know what the

supply mix is in order to understand the price risk. Without knowing the supply mix and market forces, retailers will offer contracts with significant risk premiums; the question is what risk do you want to manage and how.

Mr. Bentz said that from a distributor's perspective consumers do not like price increases, but they dislike non-predictable price increases even more. If you put a plan in place which exposes consumers to price volatility, they must be educated up front to avoid a tidal wave of complaints. If you adopt an open market which leads to price volatility, do stakeholders and government have the stomach to ride out price volatility? Mr. Boland commented on the problem of information asymmetry for small consumers; it was questionable whether small consumers obtained value for signing with retailers and giving up their entitlement to a rebate because they did not understand the value of the rebate. Ms. Girvan said that we are a long way from facilitating retail competition on the residential side; most people do not understand how electricity is priced today. She noted that on the gas side there are quarterly adjustments to gas prices, though it has taken a long time to get there. If a fundamental building block of a market is retail competition, we have failed to properly educate the public.

Mr. Whyte commented on the US experience supporting the conclusion that the margin on electricity prices was not large enough for most residential consumers to take action to manage that risk. Mr. Lourie said that small business and consumers do not manage risk but assume that the government is. The government must understand that small business and consumers expect government to manage risk. While Mr. Lourie is fully supportive of competitive markets, government needs to know that they must manage risk; if not, governments will resort to regulation to manage the risk in a competitive market. The average customer simply wants to avoid wild fluctuations in price.

Mr. Shervill said that people do care about prices. If you are pursuing a competitive market, there must be a purpose or good ascribed to the competitive market for the user of energy. You cannot pursue competition for its own sake. In 2002, we failed to mitigate price volatility for small consumers and we must find a way to mitigate volatility for them. Mr. Humphries distinguished public expectations for electricity and gas prices based on the degree of government intervention on the type of supply.

Mr. LeMay said that government action has led to significant uncertainty regarding supply, and price. Mr. Boland said that it is hard to know if you have regulatory stability until you have had it for an extended period of time.

Mr. Bentz said that at present consumers value reliability and consistency of bills. The advent of smart meters will facilitate educating consumers to value the commodity more. Mr. Picardi said that, given the need for price increases to support the significant investment required, there must be significant education of consumers that prices will be going up, whether they are regulated or not. Mr. Bentz added that it is necessary to

package price increases as being required for environmental reasons, and reliability, not just generator profits.

Mr. McMillan said that a successful market is fundamentally about 3 things: 1) pricing the product correctly (retail has never been priced right); 2) the price is the price and you have to be able to live with it (you must avoid future price shocks being associated with a move to a competitive market by correctly pricing now and through education); and 3) you need sufficient products out there to allow consumers to protect themselves.

Mr. Dorey noted that the list of consumer concerns (environment followed by reliability and then price) was not met by the initial market model. One needs to ask how a new market model would address these expressed consumer concerns. Mr. Boland said that OPG's research showed that the number one concern of consumers was reliability, followed more or less evenly by environment and cost; the industry wants to provide customer choice, but do customers want it? Mr. Whyte added that we may all believe in these concerns but the real question is who is responsible for ensuring that these concerns are addressed; markets or government? A driver of price volatility is consumption volatility; with smart meters indicating the price of power being consumed, consumers will reduce their consumption.

Mr. Campbell suggested that the range of concerns identified can be addressed by a number of different mechanisms, ranging from central command and control through to the establishment of regulatory standards which may be met by market mechanisms.

The floor was then opened up to other participants. Mr. Gregg said that the objectives of reliability, affordability and environmental responsibility can be met by market mechanism, but only if there is a solid foundation for the market: adequate capacity, supply, transmission and non-market power. Mr. Shervill noted that the gas market is working, but it took 20 years to get there; you cannot expect to get to the end state of an efficient electricity market in 1 or 2 years. Mr. Bettle asked if consumers can have confidence that the 2,500 MW Clean Energy Supply (CES) contracts will not distort the IESO-administered markets. Mr. Shervill said that the OPA inherited them from the government, but they are working hard to find more market based solutions. New procurement contracts will be designed to reduce reliance on OPA procurement contracts and get the contracts back into the market.

Mr. McMillan said that the CES contracts: will not allow one to sell against the contract because you still settle in real time; will impact the real-time price as a result of gas-fired generation acting based on the same gas price signal; will not address significant variations in balancing provisions leading to different types of exposures; will impact risk management, depending upon the day and circumstances; a binding day-ahead market which also tied into the import and export of both commodities would provide better management of gas balancing and electricity risk. Mr. Campbell commented that

the CES contracts contemplated a move to day-ahead markets. The IESO will monitor market behaviour, but will not monitor compliance with CES contract terms. Mr. McMillan noted that in bidding CES contracts, one had to build in a risk premium in the absence of a Day-Ahead Market (DAM).

Mr. Hunt said that consumer education is critical for future success by providing clear answers to consumer's concerns. This should be accomplished through communication to consumer advocates and media.

Mr. Dorey noted that non-gas generation assets are capital intensive, suppliers want long-term fixed-price contracts (as do most consumers), yet the model we have is one in which the market is driven by a spot market price which nobody pays or receives. Mr. Picardi said that it is always a question of what point in time you are at; if you have excess supply and a large portfolio of fixed contracts, at some point, spot market prices will drop below the fixed contract prices and people will want out from these contracts and to buy from the spot market. It was these very circumstances that led to deregulation in many places. We must also be careful of characterizing those that support Locational Marginal Pricing (LMP) as doing so simply for the sake of having a market because it misses the point of the debate; the real question is whether LMP will deliver better results than a regulated system that does not have locational price signals. Even under LMP certain constraints will continue to exist because it will show where it makes economic sense to make investments to resolve them, and where it does not. . Mr. LeMay said that LMP is a political question, and Mr. Bentz commented that LMP would make winners and losers, depending upon specific circumstances and as such it would be difficult to implement without socializing those costs. This was followed by a discussion of LSE's on a geographical and financial basis. It was noted that some Local Distribution Companies (LDC's) are stronger candidates for becoming LSE's than others; this debate would also be complicated by certain municipalities claiming geographic ownership.

Mr. Adam White said that gas competition occurred because of regulatory forbearance which is not happening in Ontario's electricity sector. He asked when the appropriate conditions for competition would exist, given that the government had created the crisis by prescribing certain types of generation and now trying to procure generation to address the crisis they created. Mr. Heaton said that any plan for the market must recognize the likelihood of government intervention, that we must educate smaller consumers who do not care, and that you need price transparency to encourage participation.

Mr. Boland said that one of the key issues is how to move the electricity file away from government – which has a 4-year horizon – vs. the electricity industry which needs to operate on a 20 year horizon. If you want to get government out of the picture, the industry must agree on a path forward, assist the government to do this. There are two

fundamental visions: 1. deal with what we have (task force report) and 2. true market visions (IESO and OPA). No one suggested an integrated utility. It was suggested that the members revisit this debate between the two visions after working with their respective constituencies.

Market Vision Summary: Mr. Humphries said that we need to understand government intentions to develop a viable vision. Mr. Lourie expressed the need to discuss what makes the most sense from a broad public perspective as a proxy for what the government would do, using it as a framework of regulation to protect broader public interest in a competitive market. Mr. Boland asked if the industry can get a unified vision or direction to get ahead of the government and then get their buy in. Mr. Whyte said that sectors of the industry should approach the government and sell a message; from a generator perspective, government should be told that liquidity is back in generation and the decision as to where to spend that money (\$400B) is dependent upon regulatory certainty. Mr. Picardi said that more certainty from government is essential to develop the vision. Mr. Dorey commented that political uncertainty is not entirely random; any model being proposed must address the political imperatives within the political timeframe. Mr. Bentz and Mr. Humphries noted that while the industry needs to work towards a consensus, it is not an advocate on behalf of the IESO. The Advisory Committee is to provide advice and counsel to the IESO.

Mr. Boland suggested working on an action plan with the agenda group to build on the initial discussion.

IESO Senior Management Update

Bruce Campbell provided an update to the Advisory Committee on the Board's approval of Day Ahead Commitment Process (DACP). The Board shared the Committee's concern that DACP not become a resting place and strongly supported and directed management to advance work on DAM, 12x ramp rate, and inter-tie pricing as quickly as reasonably possible. The Board also supported the principle of transparency in day-ahead forecast in relation to DACP.

Upcoming items include items which are or soon will be stakeholdered with stakeholder engagement plans being developed. Mr. Campbell invited the members to advise their constituencies. DACP market rules have been approved by the Technical Panel (TP) and are going to the Board on February 3rd, and stakeholder plans for DACP implementation have been posted. The draft stakeholder engagement plan for the 12x ramp rate has been posted for comment; this issue has not been through the TP. The stakeholder plan for inter-tie transactions in the calculation of the Ontario clearing price is expected to be posted in March as work proceeds on the other items. Constrained off Congestion Management Settlement Credits (CMSC) Payments to Importers and Exporters had been scheduled to go to the Board on February 3rd; in the course of stakeholder engagement

activities it became apparent that further discussions with stakeholders were required and it will now go to the April Board. In response to questions regarding stakeholder engagement, Mr. Campbell confirmed that these initiatives would proceed on the basis of a clear stakeholder schedule. He also clarified that implementation would depend upon the specific solution developed and the amount of work required to implement that solution; there is no plan to delay implementation. If implementation is easy, these initiatives could be implemented with DACP or shortly thereafter.

Items on February 3rd Board Agenda

Emergency Load Reduction Program

Mr. Campbell explained the rationale for name change from “Demand Response” to “Emergency Load Reduction”; the change was initiated at the request of building and office management market participants to facilitate tenant participation. No change in program content as a reliability program. Emergency Load Reduction Program (ELRP) is early in the emergency operating state control actions before 1) request for environmental variance, 2) emergency energy purchases, or 3) voltage cuts.

ELRP may be implemented in very specific areas, for example downtown Toronto, or in larger zones, regions as required. Standby fee paid for firm commitment to load reduction with financial consequences for non-compliance. Measurement of reduction will be undertaken using a protocol similar to TDRP process. In response to a concern that the program might be gamed, e.g. increasing consumption prior to accepting cuts which return to normal consumption, the IESO noted that the details of the program are still under development and are subject to continued stakeholder engagement.

The program is open to market participants and is to be settled as part of the IESO settlements process. No change is contemplated to the IESO synchronization process for generators. It is noted that certain LDC’s are considering initiatives to permit remote control/operation of back-up generators.

If the program had been available in prior years, it is estimated that it would have cost approximately \$3 million during summer 2005 and near zero in 2004. Program has potential to offset costs of \$90,000 per public appeal, and emergency energy purchases in 2005 of approximately \$1 million.

Given assumptions regarding impact and effectiveness of program, stakeholders requested an assessment of program benefits based on 2006 performance; the IESO undertook to review program effectiveness. The Advisory Committee endorsed the program subject to its concerns being communicated to the Board: potential gaming needs to be addressed and benefit of the program reassessed based on 2006

performance. It is expected that market rules in support of this initiative will be on the April Board agenda.

Real-Time Inter-tie Transaction Failures Integration with Day-Ahead Commitment Process

Discussion

Mr. Chandler provided an overview of the issue. Through collaboration with stakeholders, the IESO reassessed the market compliance approach to real-time inter-tie failures. The market compliance approach has not been particularly effective in addressing failed inter-tie transactions. It was proposed that this issue should be addressed through a market mechanism which imposes a charge for non-compliance which was within market participant control. This approach is comprehensive, market based, and integrated with the DACP. The market rules for this initiative are going to the TP on January 24th and are scheduled to be on the February 3rd Board agenda.

Committee members commended the approach as a well thought out proposal. What will be the impact of revenue loss when financial penalties are no longer imposed? It is estimated to be limited (\$500,000), but in any event fines are placed in segregated account for use in specific Board approved customer education programs to avoid any incentive for IESO to impose fines to offset other expenses.

Applaud move, but fundamental problem is protocol/seams issues with surrounding jurisdictions; the transaction failure rate problem has existed since market opening. The Market Surveillance Panel (MSP) has not addressed the issue of inter-regional trade protocol in detail but DACP will assist by addressing some of the seams issues. There are limits on the exercise of discretion in determination of whether failure was a result of market participant vs. matters outside of their control. Stakeholders worked with IESO to develop a list of factors which cause failure and which are outside of market participant control. IESO needs to continue work on market seams issues with New York. While continuing to work on seams issues, in recognition of the complexity of developing technical/ process solutions which work for two markets/systems, IESO is taking steps to mitigate impact of seams.

DACP will address certain seams issues for imports and supports change in compliance approach to failed imports. Concern was expressed that exports, in the absence of a fully operational DAM, continue to face seams issues. Material differences in treatment of imports and exports will continue until a comprehensive DAM implemented. In reply, IESO staff noted that it is useful to have symmetry between imports and exports, that the failure of exports does not have the same impact on reliability in Ontario but do have an impact on inter-connected jurisdictions. Concern was expressed regarding double jeopardy of market participants regarding failed exports. Claim that adjustment factor –

whereby penalty for failed import is adjusted to reflect difference between real time and DACP – only addressed over estimate of demand and does not deal with double jeopardy issue. Suggest that if each jurisdiction only addressed failed imports, there would be no problem with double jeopardy over failed exports.

Subject to continued work on seams/export related concerns, the Advisory Committee supported the program.

Other Business

Mr. Boland reported on correspondence from Ms. Carr in response to the Advisory Committee request to provide advice to the Board on the appointment of a replacement for Mr. Goulding, and for direct input into the Board on key issues. In her letter Ms. Carr noted that, while the Board had accountability for the appointment of a successor such that it would not be appropriate for the Advisory Committee to participate directly, the Board would be glad to receive advice on selection criteria. It was proposed that Mr. Boland would suggest some initial ideas to be discussed and work with a small group of 3 or 4 to provide advice on selection criteria.

On the second issue, Ms. Carr replied to the Advisory Committee request to provide direct advice to the Board rather than just through written feedback. The Board values the input of the members, has agreed to hear directly from the Advisory Committee and will set time aside at its meetings. Mr. Boland suggested that the Chair and Vice-Chair, along with 1 or 2 other members if they represent divergent opinions, would attend. He suggested that the Advisory Committee avoid weighting the representation and invited feedback on the issue.

Ontario Power Authority (OPA)

Members of the Advisory Committee advised that they have been approached by the OPA as part of its stakeholder engagement process. Mr. Lourie advised that many of the market vision topics discussed this morning are more associated with the OPA than the IESO itself. Mr. Boland asked the Committee members to consider whether they were prepared to play a broader role and deal with the OPA or should there be a separate OPA stakeholder process. Ms. Emay Cowx of the OPA said that, while the OPA was doing stakeholdering on individual project initiatives, the OPA Board indicated that it was lacking in overall industry knowledge and enquired about the utility of the IESO Stakeholder Advisory Committee. She extended an invitation to the Committee from the OPA Board to appear before it on March 2nd.

Mr. Campbell said that the OPA was interested in assessing the value of the Advisory Committee process given its identical legislative objective. The IESO advised the OPA that the IESO needs the Advisory Committee to be involved in decisions that the IESO

Board needs to make as a priority, and that in some areas of common interest, such as market vision, it would be appropriate for the OPA to participate and benefit from the Committee discussion to avoid duplication. This led to the invitation by the agenda team to Mr. Shervill to attend the Advisory Committee meeting discussion regarding the development of a market vision. In the absence of concern regarding his attendance, Mr. Campbell would recommend Mr. Shervill's continued attendance.

Regarding attendance at the OPA March 2nd meeting, there was a full discussion. Ms. Cowx said that the OPA was interested in hearing what the Advisory Committee considered its role as an IESO Advisory Committee; what the Committee hoped to achieve; and at a high level their 3 top critical expectations for the OPA. Concern was expressed by some members that the Advisory Committee lacked the resources to put the material together, that it was an IESO stakeholder group, not an OPA stakeholder group, that it was premature, and that in 45 minutes the SAC could only describe process issues. Given an apparent split in the committee, the members were polled for their comments.

After a full discussion it was agreed that though it was premature for the Advisory Committee to comment on specific positions, there was value in conveying to the OPA Board the complexity of the issues, that the Advisory Committee had just been established and was starting to address these issues, that it welcomed the invitation and opportunity to work with the OPA and had invited the OPA to the market evolution discussion and would like to keep the door open. Mr. Boland, Mr. Humphries and two other members will attend the OPA meeting.

It was also noted that the Ministry of Energy had been invited to participate in the SAC meeting but had been unable to attend today.

Advisory Committee Meeting Schedule for 2006

Given the opportunity for Advisory Committee members to meet directly with the Board, it was agreed that future meetings will be scheduled earlier. This will enable the committee to consider the issues in a timely manner in advance of Board meetings. Half of the meetings are to be scheduled for downtown Toronto, and half near the airport. Specific dates and locations will be confirmed by Stakeholder engagement staff.

The meeting adjourned at 3:15 pm.