

2007-2009 BUSINESS PLAN



Power to Ontario. On Demand.

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THE 2007-2009 BUSINESS PLAN

The Independent Electricity System Operator's (IESO) system and market operations expertise was again severely tested during 2006. Reliably meeting record demands for electricity, incorporating new supply and transmission enhancements into the bulk electricity system, introducing new market mechanisms, accurately settling Ontario's \$13 billion electricity market and identifying areas of concern to continued reliability of the power system were prominent among the IESO actions during the year.

Continuing to successfully deliver on its core responsibilities is the IESO's focus over the next three years, while at the same time recognizing the need to manage the financial impact of its operations on the province's electricity customers.

A new record for peak demand of 27,005 megawatts (MW) was set on August 1, 2006, more than 800 MW higher than the record set in the previous summer. Reliability was maintained throughout the high demand periods of the summer as a result of strong performance from Ontario-based generators, additional domestic supply in service, completion of a number of transmission enhancements, the introduction of new market mechanisms including a Day Ahead Commitment Process (DACP) and through continued cooperation with neighbouring jurisdictions.

Ontario's electricity infrastructure continues to face significant challenges over the next three years. The IESO will continue to play a key role in meeting those challenges and supporting the Government's desire to meet Ontario's energy needs in ways that are of benefit to the environment and reduce the province's environmental footprint.

To better identify and encourage resolution of emerging reliability concerns, the IESO introduced a new semi-annual report in 2006, the Ontario Reliability Outlook, which will report on the progress of the inter-related generation, transmission and demand management projects underway to meet future reliability requirements.

The IESO will ensure that its activities are coordinated with the Ontario Power Authority (OPA) where appropriate to achieve efficiencies in the provision of service.

The IESO's customer focussed approach will remain a priority as the organization works with participants to help them successfully operate in Ontario's electricity market. The new stakeholder engagement process implemented in late 2005 demonstrates the importance that the IESO places on stakeholder input and the integral role it plays in IESO decision making.

Vision:

A vibrant Ontario economy supported by a reliable and competitive electricity market.

Mission:

To act in the interests of the people of Ontario to provide reliable, competitively-priced and sustainable electricity service.

Over the next three years, the IESO will continue to support the evolution of the existing wholesale electricity market to best address the needs of Ontario's electricity customers.

Of particular note, in the third quarter of this year, the IESO and the Ministry of Energy entered into an agreement that will see the IESO support one of the provincial government's largest electricity initiatives, the Smart Metering Initiative (SMI) by coordinating and project managing implementation activities.

The IESO's 2007-2009 Business Plan has been developed to meet a number of strategic business priorities discussed with stakeholders and approved by the IESO Board. They include:

- Delivering a reliable supply of electricity on demand;
- Providing value in the IESO's services and products;
- Developing Ontario's electricity market through evolution of the IESO-administered markets;
- Responding to the needs and concerns of stakeholders; and
- Earning the trust of all stakeholders as a just administrator and capable advisor.

Throughout 2006, the IESO has continued to demonstrate prudent financial management. Its usage fee was reduced by more than five per cent this year along with a rebate to customers of \$13.6 million. That sound fiscal approach will continue throughout the 2007-2009 Business Planning period with a further 10 per cent reduction in the usage fee in 2007 and a projected rebate to customers next year of \$11.9 million of the accumulated surplus for 2006. Total operating costs, which have been reduced each year since 2003, are also expected to drop in 2007.

Debt repayments will continue as will prudent management of the IESO's capital program. The activities outlined in the Business Plan will also be undertaken with no increased head count for 2007.

In total, electricity customers can expect savings of approximately \$96 million through reduced fees and refunds — \$22 million in 2006 and a further \$74 million from 2007 to 2009.

The 2007-2009 Business Plan:

- Communicates the objectives and priorities of the IESO;
- Identifies the opportunities and challenges to the business over the planning period;

In total, electricity customers can expect savings of approximately \$96 million through reduced fees and refunds — \$22 million in 2006 and a further \$74 million from 2007 to 2009.

- Serves as the IESO's submission to the Minister of Energy and the Ontario Energy Board (OEB) in its application for approval of the upcoming year's revenues and expenditure requirements and the fee it proposes to charge;
- Provides a view of the estimated resource requirements of the business over the coming three years;
- Establishes the approved budgets for the upcoming year, including the Business Unit Operations, Maintenance and Administration (OM&A), head count budgets and the corporate capital budget; and
- Provides cash flow information to support appropriate debt financing or debt repayments, and capital outlays.

The IESO incorporates and aligns its business planning within the framework of risk management, the setting of objectives, decision making, and other IESO management responsibilities. It considers external, strategic, operational, and financial risks and opportunities across the IESO and their potential impact on achieving its corporate objectives. This process enables Management to determine and validate the appropriate actions and initiatives to be undertaken given the risk profile, the business environment and the IESO's corporate objectives and priorities.

As an independent body the IESO must continue to be dedicated to maintaining strong corporate governance. Compliance with regulations, laws, and policies are at the forefront of its practices. Such a commitment requires allocation of the necessary amount of time and resources while allowing the flexibility to respond to shifting priorities. The IESO will continue to optimize the use of both its financial and human resources to provide the electricity sector with trusted services while demonstrating appropriate accountability, comparability, transparency and value.

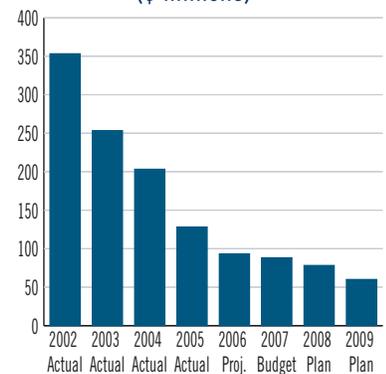
FINANCIAL OVERVIEW

The IESO's fiscal management continues to be based on a simple objective – to demonstrate continued prudent financial management while achieving the legislated objectives, including supporting the staged evolution to a more competitive market.

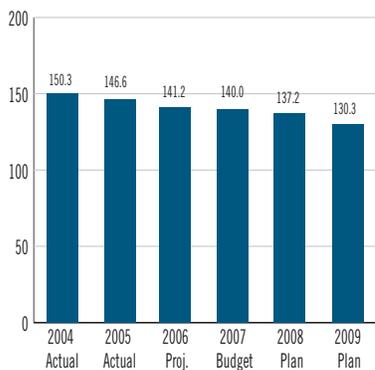
The IESO believes it continues to be successful in achieving this objective, demonstrated through the following:

- Effective management of its debt through repayment and restructuring:
 - By the end of 2006, \$260 million (over 70 per cent) of the debt load will have been repaid since 2002;
 - A plan to repay a further \$33 million over the planning period; and

Total Debt - year end
(\$ millions)



Total Costs: 2004 - 2009
(\$ millions)



- Refinancing of provincial debt with a less expensive and more flexible credit facility.
- Prudent management of its capital program:
 - Investment only in projects deemed necessary and cost effective following the challenge and approval of an appropriate business case;
 - Taking a “total cost of ownership” view — ensuring minimal overall costs are achieved over the life of the asset through the optimal trade-off between capital and OM&A program costs;
 - The application of a consistent project management regime that is independent of those responsible for project delivery; and
 - The “harvesting” of assets. Although the replacement of assets is planned according to expected life cycle, actual replacement only takes place when there is a real need and after alternatives are investigated to prolong asset life. This is being done for the Energy Management System (EMS) and Market Information System (MIS) applications.
- Active management of its OM&A costs in a challenging time:
 - No increased headcount proposed for 2007, following a modest headcount reduction in the 2006 plan; and
 - Successful management of a complex business with increasing information technology (IT), governance, security, and system operations demands.
- Overall, this has resulted in the following positive results:
 - A usage fee that continues to be reduced — a reduction of over five per cent in 2006 and a further reduction of over 10 per cent planned for 2007;
 - Total operating costs that have reduced each year since 2003, including a further planned reduction in 2007; and
 - A rebate to IESO customers of \$13.6 million in 2006 and a planned rebate of a further \$11.9 million in 2007.
- A portion of the fiscal results of the IESO have, at times, been a result of circumstances, both positive and negative that are beyond the IESO’s control to manage. Examples include the increasing energy volumes which are the base for the IESO usage fees and the significant increase of pension costs over the last five years as a result of changes in long-term interest rates and poor equity market returns during the early part of the millennium.
- However, a large part of the IESO’s successes has been Management’s continued focus and attention to fiscal matters. Examples of this include the active repayment and restructuring of debt, prudent capital spending, and the constant reprioritization of work to enable a staff complement that has remained largely fixed over the last couple of years. All the while, the electricity and corporate landscape has presented increased challenges for the IESO on many fronts.

Challenges include the largest physical infrastructure change in the history

of the sector which is expected to last for at least 15 years; increased scrutiny, oversight/regulation and compliance demands in the domain of power system operations; growing demands within all areas of governance, related to both the IESO and its pension plan; and physical and cyber security demands that continue to grow at a rapid pace.

- IESO management also recognizes stakeholders' interest in the comparison of the IESO's costs and operations against those of its counterparts. The IESO remains committed in that domain and significant progress was made in 2006 through the issuance of a revised uniform system of accounts by the U.S. Federal Energy Regulatory Commission (FERC). In 2007, the IESO expects to have the information necessary to undertake that desired comparison in a much more meaningful way.
- As well, there continues to be the risk that, over the planning period, the IESO costs will need to be paid over a smaller volume as a result of successful conservation efforts and increases in embedded generation.

Overall, the IESO's strong fiscal performance has been recognized by its customers through their positive rating of the IESO in the area of financial management in the 2005 customer survey. The strong financial outlook for 2007 has served to further support management's pride in this area and is expected to further increase the level of stakeholder satisfaction and confidence in the IESO's management of its finances.

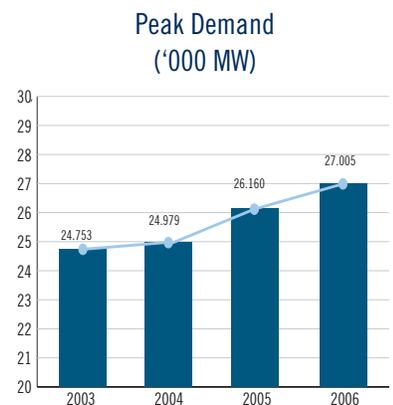
RELIABLE ELECTRICITY SUPPLY ON DEMAND

At the core of the IESO's legislated mandate is its responsibility for the reliable operation of Ontario's integrated power system. Through the development and adherence to a proper set of operating limits the IESO helps to protect Ontarians and the inter-connections from unacceptable and potentially widespread outages.

Continuing to do so is an imperative for the IESO. Most of the stakeholder advice received was very supportive of this as a priority and more specifically as the IESO's highest priority. The IESO's expertise in maintaining reliability has been recognized in successive audits of its role as a Reliability Coordinator by the North American Electric Reliability Council (NERC). As well, the IESO's structure of integrated market and dispatch functions has been identified as a model for other Reliability Coordinators in North America.

Achievements in 2006:

The hot, humid weather conditions in the summer of 2006 presented a number of challenges for the IESO. Several heat waves severely strained the power system with record demands for electricity being set.



On August 1, a new peak demand record of 27,005 MW was set, more than 800 MW higher than the 26,160 MW record that occurred in the summer of 2005.

In response to the difficulties experienced in the electrical system in the summer of 2005, the IESO pursued a number of initiatives that were placed into service in the summer of this year. These actions included:

- Improving the dispatch processes;
- Implementing a Day-Ahead Commitment Process;
- Implementing an Emergency Load Reduction Program; and
- Improving inertia transaction protocols.

These actions, in conjunction with other changes within the integrated power system including new supply and transmission enhancements, enabled Ontario to reliably manage the high demands for electricity experienced during the summer of 2006.

Following the organizational realignment in 2005, the IESO's first Ontario Reliability Outlook was published in February 2006 and highlighted a number of reliability issues such as the supply to central Toronto and reliability requirements related to the coal replacement program. Actions were subsequently taken by the relevant authorities. The second issue of the Ontario Reliability Outlook, issued in June 2006, highlighted the changed nature of Ontario's consumption patterns and the need to maintain the operation of the coal generating facilities beyond the announced shut-down dates in order to ensure reliable supply.

In addition, the IESO has also been able to leverage its relationship with the OPA to develop an External Project Tracking Tool to better monitor the progress of projects affecting Ontario power system infrastructure and the impact of schedule changes on forecast reliability. This has been useful to identify emerging issues.

The Challenge Ahead:

The power system that the IESO will operate in the future will be dramatically different from today. The expected effort to support these changes has not decreased and may be greater than originally anticipated particularly in respect to the technical, analytical, and training support many of these new and modified generation and transmission facilities will require for proper incorporation. A relatively few existing resources that have similar operating characteristics and a common operator are to be replaced with many dozens of resources with new and varied characteristics and multiple controlling participants. This will have a large and enduring impact across the entire organization.

In response to difficulties experienced in the summer of 2005, the IESO pursued a number of initiatives:

- Improving the dispatch process
- Implementing a DACP
- Implementing an ELRP
- Improving inertia transaction protocols

In addition to this, change in overall governance of reliability is continuing both in North America and internationally. The introduction of the Electric Reliability Organization (ERO) will require IESO involvement to help develop, review and properly implement modified and new standards and their associated compliance measures. Existing and new market participants will need to understand how the ERO and regional standards affect their obligations and how they will be measured. As well the IESO will continue to champion the Ontario perspective including identifying and effectively presenting Ontario's market concerns and interests.

Plan of Action:

Over the business planning horizon, the IESO will, in addition to its ongoing work programs:

- Maintain a close working relationship with the various bodies that impact reliability in Ontario, including the OEB and the OPA;
- Maintain and enhance its technical capabilities needed to address Ontario's supply mix, transmission and demand profile changes;
- Ensure it has sufficient capability to conduct the connection and reliability assessments required for expected changes to the Ontario power system;
- Further establish itself as the lead representative and standard setting body in providing Ontario representation to interjurisdictional organizations such as NERC and the Independent System Operators (ISO) and Regional Transmission Operators (RTO) Council (IRC);
- Continue to develop and declare reliability standards to be applied in the planning and operation of Ontario's changing electricity system; and
- Ensure the right information is provided to the right consumers at the right times to facilitate their effective use of the market, and that load response is used as effectively as possible in cases of emergency conditions on the power system.

In support of its reliability objective and the above actions, the IESO's planned capital expenditures/additions include the following:

- Energy Management System and Market Information System Upgrade;
- Energy Modelling Tools;
- On-line Limit Derivation;
- Meter Data Repository;
- Back-Up Operating Centre Relocation and Configuration;
- Facility Outage Management System; and
- Participant Lifecycle System Replacement.

The larger of these projects are described in more detail in Appendix 3.

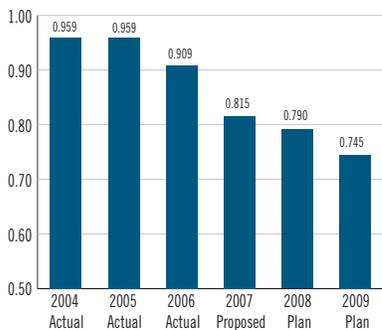
The introduction of the Electric Reliability Organization (ERO) will require IESO involvement to help develop, review and properly implement modified and new standards and their associated compliance measures.

PROVIDING VALUE IN THE IESO'S PRODUCTS AND SERVICES

The ongoing satisfaction with and support for IESO activities and initiatives is dependent on the IESO's ability to provide continuing value to customers and stakeholders. This continues to be one of the IESO's primary objectives.

The value of the IESO is best regarded through the identification of the multitude of products and services that it offers on an ongoing basis. These products and services enable Ontario to benefit from the economic dispatch of resources to satisfy electricity demand. Many of the IESO's products and services are required to prepare for and to support the real-time operation and settlement of the IESO-controlled grid and the IESO-administered markets. The IESO provides round the clock operation and support of the integrated power system and the IT infrastructure to support continuous market and system operations. It is responsible for all of the "bid to bill" processing associated with the IESO-administered markets and a variety of adjustments required by regulation.

IESO Fee
(\$/MWh)



Overall, the IESO provides:

- Scheduling and Dispatch Services;
- Metering Services;
- Market Settlement Services;
- Connection Assessments;
- Reliability Assessments;
- Information Services (which range from demand forecasting to post market summaries);
- Market Participant Training;
- Emergency Preparedness Services;
- Ancillary Service Contracting; and
- Market and Compliance Monitoring.

In addition and in conjunction with these, the IESO serves as the Reliability Coordinator for Ontario.

Achievements in 2006:

In 2006, the IESO reduced its fees by over five per cent to \$0.909 per megawatt hour (MWh) and provided a rebate to customers of \$13.6 million.

Through a regular review and realignment of activities the IESO has been able to meet increased demands without increases in resources in many areas of the business. For example, many new analysis activities are being undertaken by the same number of system operations staff. Duplication has been eliminated within the market entry process and procedures and a number of related functions have been amalgamated within Market Facilitation to achieve greater efficiency. Other efficiency and productivity improvements have provided the IESO with the capacity to supply new products such as the semi-annual release of the Ontario Reliability Outlook in addition to the quarterly 18-Month Outlooks and meet an increased demand for Connection Analysis and Assessment work and assessments for the OPA.

Further achievements include:

- Championed a reserve sharing arrangement within the Northeast Power Coordinating Council (NPCC) that reduced Ontario's operating reserve requirements by 50 MW and is saving Ontario consumers approximately \$9 million per year (\$36 million before the global adjustment);
- Reduced the amount of Automatic Generation Control carried on the system while remaining within required NERC Control Performance Standards yielding a savings estimated to be in the order of \$1 million/month;
- Undertook a review to ensure the amount of collateral provided by all participants is appropriate. This will best ensure that the IESO is maximizing the value of the service provided in the establishment and monitoring of prudential requirements in the market;
- Restructured its corporate credit facility in 2006. The IESO was able to achieve increased flexibility and lower interest costs;
- Outsourced, where prudent, its IT development and maintenance activities, reduced hardware and reduced software licence service contracts. Telecom contracts have been renegotiated. There are no plans to reduce headcount at this time, but active performance management is being conducted across the business to ensure that productivity is maintained or improved.

Cyber security risk has been reduced from a security perspective via a concerted company wide effort to meet and/or exceed audit and compliance requirements. This has taken place through capital security projects (NERC 1300, IT Security Software) and coordinated efforts between business units to address findings from previous audits.

Significant projects that were either initiated or completed during 2006 include:

- Central Alarm Management;
- Market Participant Interface Modernization;

Through a regular review and realignment of activities the IESO has been able to meet increased demands without increases in resources in many areas of the business.

- Security Software Enhancements (including NERC Cyber Security);
- Real Time Web Interface Upgrades;
- Windows Server Infrastructure Replacement;
- Physical Security Upgrades;
- Back-up Infrastructure Enhancements; and
- Telecom Expansion.

The Challenge Ahead:

The impending infrastructure change is expected to impact almost all aspects of the IESO’s business — forecasting and assessment, market entry (registration, authorization and training) — through increased demand for service.

While the IESO’s rate of attrition remains below industry norms, a substantial “bow wave” of employees are eligible to retire over the planning period. Consequently, various initiatives and programs to support resourcing at the IESO are being developed and implemented to ensure that the company has the skilled, competent and motivated workforce needed to efficiently and effectively deliver a reliable supply of electricity to Ontarians. Meeting the need for new skilled resources may become increasingly difficult as similar demographics affect other electricity related sectors and as growth in electricity generation and transmission intensifies.

Staff costs are a significant component of the IESO’s costs. Benefit costs, most notably pensions, have increased significantly and the IESO will need to continue to manage the large cost associated with staff as noted in the financial outlook section of this Business Plan.

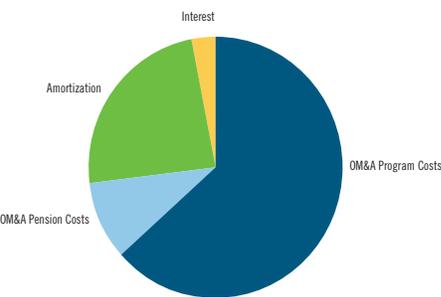
Overall, from a cost perspective, the IESO must continue to act in a manner that maintains stakeholders’ high confidence in the IESO’s ability to manage the financial aspects of its business. This must include meaningful comparisons to other ISOs/ RTOs.

Not unique to the IESO, the control standards associated with external audits (NERC, settlement and financial) continue to increase. This places pressures for additional resources to support this demanding new environment.

With respect to physical security, the IESO is exposed to the same heightened risks experienced across the industry and will need to continue to take actions consistent with those of similar organizations.

A number of the IESO’s IT systems are approaching their respective end-of-service

2007 IESO Cost Breakdown



life and it will be important to carry out the planned upgrades and replacements to ensure ongoing maintainability.

Plan of Action:

For 2007, the IESO is proposing to reduce the fee it charges to market participants by over 10 per cent. This represents a tangible and direct increase in value for money as the products and services delivered by the IESO continue to either grow or are increasingly demanding to deliver.

The IESO's fiscal management practices will continue to be based on the objective of demonstrating prudent financial management while achieving the IESO's objects as outlined in legislation, and supporting the staged evolution to a more competitive market. In doing so, the IESO will be able to continue to provide benefits to its direct and indirect customers in excess of its costs to consumers – which currently amount to about six per cent of the non-commodity charges (excluding distribution) or about one per cent of the total physical market charges.

However, driving to provide best value to the industry is not restricted to simply minimizing costs of the IESO. The IESO must ensure that its services and products are meeting customer needs. The IESO must also be open to pursuing opportunities to build on its core strengths when and where advantageous to the electricity sector. Similarly, where the delivery of a service involves more than one organization (e.g. the IESO and the OEB, the IESO and the OPA, or the IESO and Hydro One), the objective is to create an overall benefit for Ontarians.

Over the Business Plan horizon, the IESO will continue to focus on delivering value through a number of specific initiatives. These include:

- Working with others in the industry to develop a more streamlined OEB approvals process for transmission infrastructure investments. For its part, the IESO has and will continue to ensure that it has sufficient capability to conduct the assessments that it must undertake as the Ontario power system undergoes major transitional changes over the next decade and beyond.
- Completing a cost comparison exercise against other ISOs/RTOs that will improve disclosure and transparency of costs and allow more meaningful cost comparisons to other North American ISOs. Data collection through the FERC which began in the latter part of 2006, will allow for more meaningful comparisons to be undertaken in 2007 and beyond.
- Ensuring that the IESO is providing the highest value service in terms of operating the system, the IESO will continue to revise and improve staff training programs to accommodate changes in the modes of job performance for system operators brought about by the continually evolving electricity

The IESO must ensure that its services and products are meeting customer needs.

The IESO has entered into an agreement with the Ministry of Energy to coordinate and project manage implementation activities for the provincial government's Smart Metering Initiative.

industry in Ontario and North America.

- Maintaining and improving where appropriate good governance practices and ensuring that internal products and services are provided to best ensure the IESO is effectively and efficiently run, has an appropriate financial control framework, and meets its statutory or other financial requirements.
- Improving demand response by ensuring that the right information is provided to the right consumers at the right times to facilitate their effective use of the IESO-administered markets.
- Completing the review of prudential requirements.

Much of the IESO's capital program is aimed at the IT infrastructure challenges identified above. Specific projects include:

- Outbound Report Management System Upgrade;
- Unix Server Infrastructure Refresh;
- Completion of Windows Refresh Program;
- Customer Information System; and
- Application Changes / Vendor Change Requests.

The larger of these projects are described in more detail in Appendix 3.

Smart Metering Initiative

The IESO has entered into an agreement with the Ministry of Energy to coordinate and project manage implementation activities for the provincial government's SMI.

The purpose of the SMI is to deliver a smart metering infrastructure to all Ontario small volume consumers that can be used effectively to encourage conservation and demand side management.

Specifically, the IESO is responsible for the delivery of the meter data management/ meter data repository functionality (MDM/R), including all interfaces between the MDM/R and local distribution companies' (LDC) smart metering and customer information systems.

It is intended that the IESO will obtain funding for the acquisition and deployment of the MDM/R and that this funding together with the IESO internal and contracted expenses will be recovered through a defined regulatory mechanism. This mechanism will be independent of the IESO's current fee structure and of the revenues derived from the wholesale market as outlined in this Business Plan document. In the interim, all related costs are being segregated in a deferral account on the balance sheet and are not material to the organization.

DEVELOPING ONTARIO'S ELECTRICITY MARKET

Ontario's electricity market is a means to promote economic efficiency in this important sector by pricing and supplying electricity in a competitive manner and publishing the results for all to see. Competitive markets also promote reliability. How the electricity market today is shaped to attain this can have a lasting impact on how the province meets its needs for sustainable and reliable electricity service. To this end, the IESO is committed to working towards making today's hybrid market structure work in the broad regional market within which Ontario resides. The IESO will also make use of the flexibilities and opportunities it offers to build towards a future where the Government and consumers assume a smaller share of the financial and development risks that are better borne by those best able to manage such risks.

Achievements in 2006:

The IESO has been working to ensure that the market evolves in a manner that: encourages reliable supply; encourages improved economic efficiency; and is consistent with a long-term vision that is supported by stakeholders. In 2006, the IESO responded to a variety of operational and stakeholder concerns by placing its highest priority on resolving immediate reliability-based market issues before proceeding with significant market evolution programs.

Consequently, much of 2006 was focused on the implementation of the Day-Ahead Commitment Process (DACP) and the development and implementation of the Emergency Load Reduction Program (ELRP), both by the summer of 2006. The introduction of the DACP, with its day-ahead reliability guarantees, has contributed to maintaining the reliable operation of the IESO-controlled grid while the ELRP has created incentives for Ontario consumers to help address the reliability needs of the province under emergency operating conditions. As well, the IESO has followed through on assurances made to market participants to address specific long-standing real-time pricing issues.

As of August 1, 2006 the IESO Board had approved 20 market rule amendments, 13 of which were associated with the implementation of the DACP and the ELRP. The other rules addressed the need for settlement charges for intertie transaction failures, to permit more flexibility for generators with multiple connection points (Aggregation) in their use of replacement energy offers, and to reduce a development hurdle identified for small, renewable generation facilities that may respond to the OPA's Standard Offer Program (SOP) for small, renewable generation facilities.

Together these efforts create the reliable platform necessary to address some major market evolution initiatives – initiatives that the IESO and its stakeholders have start-

In 2006, the IESO responded to a variety of operational and stakeholder concerns by placing its highest priority on resolving immediate reliability-based market issues.

ed to examine. By the end of 2006, the IESO is expected to have:

- Addressed specific real-time pricing issues;
- Initiated Day-Ahead Market consultations; and
- Investigated the implications of locational pricing for the Ontario electricity market.

While all future market evolution initiatives are designed to provide improvements over the status quo and will represent valuable additions when implemented, they must also be constructed such that they will provide enduring value for years to come. Hence, it is important that, through discussion with stakeholders, there continues to be a broad definition of the longer-term market that will best meet Ontario's needs. Working with the OPA, the IESO has encouraged industry-wide discussion about a long-term vision for the electricity market. This "vision" underpins the market evolution initiatives of the IESO and provides a context for the actions and initiatives being pursued by the OPA as it develops its Integrated Power System Plan (IPSP).

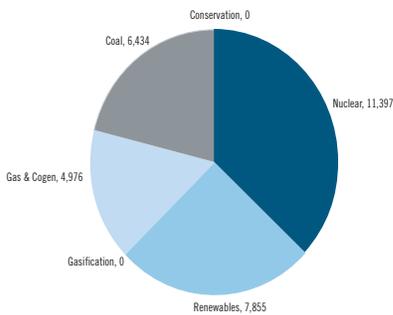
The Challenge Ahead:

Generally, stakeholders remain convinced that in the long term, a market driven, competitive electricity sector where buyers and sellers are able to enter into transactions that address their needs is the best way to create an efficient and reliable electricity industry that meets the needs of all Ontarians.

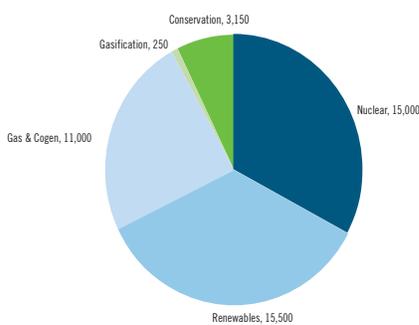
Today a "hybrid system" exists in Ontario's electricity sector. A significant proportion of electricity suppliers within Ontario are either operating under regulated prices or hold contracts that guarantee the supplier a financial outcome; guarantees that are backed by a regulated call on the rate base through the Global Adjustment. While some of these arrangements are long-term and will continue to provide consumers with value for years to come, others are in place for only three to five years. Going forward, the OPA has been assigned the role of ensuring that sufficient capacity will be available to Ontario in the future by striking procurement contracts in the absence of market-based investments. Concurrently, the OPA is preparing its initial IPSP for regulatory review.

The OPA will clearly play a major role in ensuring that sufficient generating capacity is developed in Ontario to meet needs in the short-term. Over time, the IESO and the OPA will work together, with the support of stakeholders, to create the industry structure needed to make market-based investments the norm, reducing the need for central procurement to backstop the industry. This will equip the sector to evolve towards a self-sustaining market-based vision over time. All the while, each enhancement will have to be developed in a way that meets the increased expectations of

2005 Supply Mix (MW)



2025 Supply Mix (MW)



market participants for clear, focussed, substantive and well-documented business analyses.

All of this must be accomplished while recognizing the competing pressures on the IESO's and market participants' time and resources as they each respond to a number of ongoing initiatives. Initiatives such as Ontario Power Generation's (OPG) generation regulation consultation and proceedings; the Hydro One transmission rate consultation and proceedings; the OPA's IPSP consultation and proceedings; and the ongoing processes for upgrading of reliability standards, will all demand significant attention from all corners of the industry. Consequently, the IESO's efforts to enhance the market will need to be managed in light of these demands.

Plan of Action:

As identified in the IESO's 2006 Business Plan, following the resolution of a number of immediate market issues over this past year, the focus of the IESO's market evolution efforts will shift to developing the necessary market conditions that could facilitate a liquid, competitive, electricity market that provides the necessary signals for future investments. This effort will be closely coordinated with the OPA, to ensure an efficient, viable and integrated transition.

At the core of the IESO's Business Plan is the implementation of a set of progressive enhancements. The first key enhancement continues to be the development of a DAM.

There are several factors that clearly speak to the need for the Ontario electricity industry to develop a DAM. Electricity suppliers and consumers alike are hungry for better forward prices so they can reap the efficiency gains that are just not available with today's real-time-price-only system. Many efficiency gains can be realized by implementing better day-ahead coordination. Suppliers cite examples such as increased coordination of gas and electricity markets, improved start-up scheduling, and better management of hydroelectric utilization as areas which can benefit from better day-ahead signals. Consumers are looking for the ability to lock in a price for their electricity that they can then use to plan their business or personal activities, and not be subject to the price risks inherent in real-time operation. The IESO also sees significant operational and potential reliability benefits from a DAM particularly in the area of transaction scheduling with the electricity markets outside of Ontario. As well, the DAM would provide an ability to address some fast-approaching operational challenges that will be brought about by the changing operational characteristics of the Ontario generation fleet.

A major stakeholder initiative involving significant consultation from which stakeholders will help inform the IESO Board of the best DAM design for Ontario will be

The focus of the IESO's market evolution efforts will shift to developing the necessary market conditions that could facilitate a liquid, competitive, electricity market that provides the necessary signals for future investments.

required. A strong DAM design should permit the IESO to consider changes to the existing real-time pricing construct. For example, concurrently, the IESO and stakeholders will be examining the feasibility of incorporating some form of locational pricing in Ontario. All of this work is anticipated to culminate with DAM implementation in 2008, and will be the major market-evolution focus for the IESO over the first two years of the Business Plan.

It is recognized that successful development of an open electricity market cannot be achieved by the IESO in isolation but requires complementary and aligned actions by the OPA and the support of stakeholders in Ontario's electricity sector. It will be important for the two organizations to continue to work together and support one another to ensure that short and medium term plans harmoniously integrate with longer term plans and are clearly communicated to stakeholders. Also recognized are the key roles that the Ministry of Energy and the OEB have in defining the future structure of the Ontario industry. The key DAM activities, along with other core initiatives by year over the current business planning horizon are listed below:

2007:

- DAM design approved by IESO Board.

2008:

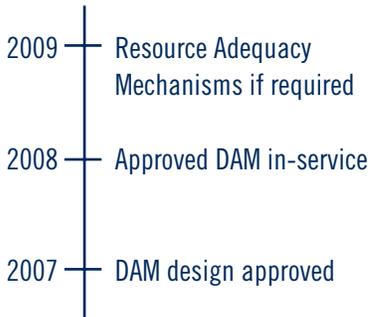
- Approved DAM in-service; and
- Reliability/Resource Adequacy market mechanisms to be examined and discussed with stakeholders and the OPA for recommendation to the IESO Board.

2009:

- If required, Reliability/Resource Adequacy market mechanism designed and implemented.

Clearly, advancements toward a common market vision will require a strong involvement of the consumer side of the market. The IESO will continue to encourage demand response, through initiatives such as: education and more focussed information for all consumers to understand the implications of their actions; review and development of additional measures to improve emergency demand response effectiveness; working with the OPA's Conservation Bureau to ensure coordination and operational feasibility of various economic-based programs, which they are responsible for; and contributing to the development of the government's Smart Metering Initiative (SMI) which promises to enable significant system and market benefits.

The above market evolution initiatives must be approached with a realization of the broader picture across the industry. The IESO will always be factoring in the influences from parallel activities such as:



- Ongoing regulatory proceedings and decisions that have a significant role in the evolution and development of electricity markets;
- The continuing work of the OPA as they explore and develop proposals for load serving entities and as they evolve their generation procurement initiatives, both of which must be compatible with, and supportive of the advancement of competitive electricity markets; and
- Various ongoing efforts to create convenient forward contracts that are fungible, and that converge to a commodity price that is transparent and reflective of actual supply/demand balances.

In summary, the IESO is committed to advancing the current hybrid market and evolving Ontario's electricity market. The development of a DAM will be the focus of the majority of the IESO's efforts over the term of this Business Plan, and all of the IESO's evolution initiatives will be working towards its key longer-term goals: Specifically, the IESO must:

- Enable forward contracting between individual consumers or their agents, and suppliers so that such contracts become the dominant force in rationalizing investment in new supply. Success of industry efforts to create load serving entities will be central to accomplishing this goal;
- Ensure that an effective and credible market solution will ensure continued reliable supply thereby enabling the transition from centralized capacity procurement mechanisms conducted by the OPA to an investment regime driven by forward contracting and appropriate market mechanisms; and
- Continue to contribute to the industry's efforts to resolve other key issues that range from price determination to enhanced demand responsiveness.

RESPONDING TO THE NEEDS OF STAKEHOLDERS

The IESO operates in an environment where its decisions and actions can often impact on, and can be subsequently challenged through regulatory avenues by stakeholders. The environment is also one wherein the stakeholder community that the IESO serves can and often does encompass a variety of divergent views and needs.

The IESO's actions and decisions must be receptive to views and opinions of its stakeholders, and the process of arriving at these decisions must be accommodating of this. Thus, stakeholder engagement, the process by which stakeholder views and requirements are identified and factored into decisions, is integral to IESO decision-making.

The stakeholder community that the IESO serves can and often does encompass a variety of divergent views and needs.

The need to obtain and consider stakeholder input in a meaningful way will remain an integral part of the IESO's business strategy and business activities going forward.

Achievements in 2006:

The IESO has made significant changes to improve stakeholder input into its decision-making process.

The IESO's commitment to an effective stakeholder engagement process has been demonstrated by:

- The adoption of and adherence to a set of stakeholder engagement principles;
- The creation and operation of the IESO's Stakeholder Advisory Committee (SAC); and
- The establishment of a dedicated unit in the IESO with the express mandate to enhance the capability of the organization to gather and integrate stakeholder views and requirements into IESO decision-making.

The IESO's efforts to improve stakeholdering were recognized in the 2005 customer survey. The annual independent survey of market participants indicated that the IESO market participant relationship has stabilized since market opening. Taking action to customize its products and services as requested by stakeholders to satisfy their needs and address their concerns is seen as an aspect of responsiveness where the IESO's performance could be improved.

In response to the relationship findings, the IESO has developed and implemented an Executive Outreach Program that will be active through the Business Planning period. The IESO has also provided: an IESO stakeholder engagement process that adheres to the stakeholder engagement principles; and coordination of a SAC that provides valued input to IESO Board and Management decisions.

Other initiatives/achievements at the IESO in 2006 include:

- Provided effective market information and communications through both the IESO website and customized new publications for market participants and business and industry;
- Implemented a proactive customer relations strategy to better provide support for customer inquiries, issues and training needs; and
- Operated a fair, transparent and consistent stakeholder engagement process

The need to obtain and consider stakeholder input in a meaningful way will remain an integral part of the IESO's business strategy and business activities.

for important initiatives.

One of the benefits of the existing institutional structure of Ontario's electricity sector is the presence of the Market Surveillance Panel (MSP) charged with monitoring the operation of the market to identify, among other things, activities of the IESO that may have an impact on market efficiencies or effective competition. The MSP has presented analyses and recommendations regarding market operations that the IESO has addressed in one form or another. An example of this well known to market participants, is the pricing of out-of-market reserves and the virtual elimination of the associated out-of-market control actions by the IESO.

In its most recent report released in June 2006, the MSP summarized the record since market opening of efficiency distortions caused by the uniform price system and recommended that the IESO conduct a review of reform options, perhaps as part of renewed work on the development of a DAM. The SAC also suggested a review of locational marginal pricing. This is the reason that the IESO has begun a stakeholder engagement initiative to examine the implications on stakeholders and market efficiency of changing how Ontario's real-time electricity price is calculated to better reflect the impacts of the transmission system.

The Challenge Ahead:

Ontario electricity stakeholders include market participants, industry associations, neighbouring interconnected systems and markets, government, regulators and every Ontario electricity customer. As noted, this stakeholder community can and often does encompass a variety of divergent views and needs. This is compounded by the fact that the IESO is responsible for operating and maintaining a common wholesale electricity market that is open to all.

The needs and expectations of market participants have become increasingly complex and sophisticated as they have gained market experience. This creates additional responsibility for the IESO to develop new processes, expertise and skills to help customers be more successful through market participation.

Plan of Action:

The IESO is committed to maintain and evolve a fair, transparent and consistent stakeholder process directed at all stakeholders and will continue to seek out and appropriately consider stakeholder input.

The customer survey results have shown that the IESO needs to improve its customer awareness, focus and responsiveness. Having a comprehensive customer information database, would allow all staff to have information about stakeholders

Stakeholder Advisory Committee Represented Sectors:

- Generators
- Marketers/Brokers
- Commercial Consumers
- Embedded Industrial Consumers
- Wholesale Consumer Market Participants
- Residential Consumers
- Distributors
- Transmitters
- Environmental Community

Confidence in the IESO-administered markets is reinforced by the IESO's administration and monitoring of these markets in a transparent manner.

(last time visited, issues, concerns, initiatives that might interest them) at their fingertips enabling all interactions with customers to be more productive, efficient and more responsive to the customers needs. This would tie back to the IESO objective of responding to the needs and concerns of its stakeholders.

Ontarians have developed a heightened awareness of the challenges facing the province's power sector. Increased information and education efforts are required from the IESO to help all customers play a stronger role in meeting those challenges. These information and education efforts will increase over the Business Planning period in order to:

- Address the need for customers to be informed when the system is strained and recognize the actions they can take to relieve the demands on the system and avoid more significant actions;
- Promote an understanding of the changes that need to take place in the electricity system to ensure reliability in the long-term;
- Address the move to smart meters and time-of-use pricing so that customers can realize the benefits afforded to them through these initiatives, including lower bills and consumption patterns that promote increased reliability;
- Enable wholesale electricity customers to better manage their electricity costs through an improved understanding of market-based pricing and the demand-management mechanisms available through the market. As well the IESO will partner with LDCs and trade associations to provide those customers paying the wholesale price for electricity with the information and tools they need to better manage their electricity costs;
- Make more accessible the vast amount of market and system information available on the IESO website; and
- Effectively manage communications and relationships with IESO stakeholders, customers and others.

JUST ADMINISTRATOR AND CAPABLE ADVISOR

Confidence in the IESO-administered markets is reinforced by the IESO's administration and monitoring of these markets in a transparent manner. The IESO is charged with the responsibility to ensure that all participants, including the IESO, adhere to the market rules. Participants' confidence in the market is enhanced by knowing there is a level playing field and that the system operator and all participants will be held to the same standard of conduct in the market.

The IESO depends on a large number of professional staff (engineers, engineering technologists, experienced operators, IT specialists and financial specialists) to carry out its functions and is well respected by market participants for its technical and operational skill. The IESO has received its highest performance ratings for the reliable supply and delivery of electricity in Ontario.

Achievements in 2006:

Customers have indicated a strong confidence in the IESO's ability to execute settlement functions. In 2005, external auditors, Ernst & Young, affirmed the company's strength in this area by confirming that the IESO has effective and adequate controls in its settlement processes, systems and procedures.

A positive outcome of the organizational realignment completed last year is the IESO's ability to provide timely and knowledgeable technical advice, largely through the issuance of the Ontario Reliability Outlook, to external policy and decision makers.

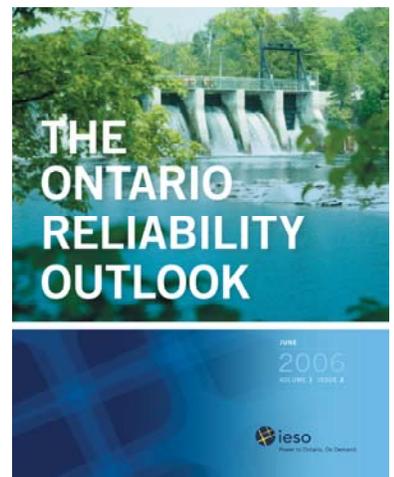
In its role as a capable advisor, the IESO has successfully coordinated its activities between the OPA and the IESO, and its support of OPA procurement initiatives. This has included: providing formal input to the OPA consultation processes, IPSP support, internal and external integrated project tracking (projects of material impact on reliability) and issue identification and management.

As well, the IESO has established relationships with proponents who have been selected as part of the government and OPA request for proposals (RFP) processes.

Of separate note is that in both of its major participant-facing activities, settlements and compliance enforcement, the IESO has continued its efforts to act as a just administrator by employing the due process provisions of the market rules in situations where there were differences of opinion.

The Challenge Ahead:

The IESO's direct and indirect support for the OPA's IPSP is expected to span, at some level, the whole of the Business Plan period and beyond, initially through technical support for plan development and stakeholdering and subsequently for regulatory review at the OEB with resulting plan modifications. With a three year IPSP cycle, the next plan preparation may well start as the previous cycle finishes. Until the OPA's IPSP is developed and approved, the IESO will remain charged with defining needed infrastructure improvements and assessing implications of initiatives outside of the IPSP process such as transmission and trade arrangements with neighbouring provinces.



The IESO will continue to strive to earn stakeholders' confidence that the IESO will provide open, impartial, and timely advice on matters within its mandate.

The regulatory working environment is also increasingly demanding and complex, with pressures from several directions. The work-load associated with Ontario regulatory proceedings continues to grow, including new applications such as OPG's generation regulation, the transmission rate proceedings and the OPA's IPSP. These will bear directly on IESO responsibilities and require significant effort to develop, support and present IESO positions. The changes taking place around the new Electricity Reliability Organization (ERO), expected to be up and running early in 2007, will necessitate the IESO assuming a greater profile with higher attendant expectations and accountabilities.

Plan of Action:

The IESO will continue to strive to earn stakeholders' confidence that the IESO will provide open, impartial, and timely advice on matters within its mandate. Further, the IESO will build on the existing structural independence provided by an independent board of directors, the independent role and instruments set out in the *Electricity Act, 1998* and the market rules.

In support of this objective, the IESO will:

- Continue to independently make available market and system operations information and analysis so that stakeholders, both government policy makers and market participants, are in a position to make decisions based on the facts;
- Continue to monitor the progress of the coal replacement program and provide timely advice and notice when circumstances are such that the units can be put on standby status and then removed from service;
- In partnerships with LDCs and trade associations, provide those customers paying the wholesale price for electricity with the information and tools they need to better manage their electricity costs;
- Focus on targeted two-way contact with customers in specific sectors through partnerships with business/trade associations in providing information and interactive forums;
- Intervene in all leave to construct applications submitted by market participants to the OEB to provide impartial assessments with respect to reliability and market impacts of proposed projects;
- Communicate openly the IESO's actions taken and concerns on all matters related to the achievement of its goals and objectives;
- Represent and advance IESO and Ontario interests in regulatory proceedings and industry developments, while anticipating and assessing policy developments that will impact the IESO-administered markets, IESO-controlled grid or the IESO's ability to fulfill its obligations; and

- Work closely with the government to contribute to and act on energy policy in a way that serves the long-term interests of Ontario, evolving pragmatically toward the vision for the electricity market.

DRIVING PERFORMANCE

To drive the achievement of its Business Plan, the IESO continues to use a balanced scorecard-like approach which assesses performance from four perspectives:

Effective Use of Funds

The IESO's corporate performance measures in this area focus on the cost-effectiveness of its total spending, the prudence of its capital spending and planning of its fee.

For 2007, corporate performance measures are proposed to be:

- Total spending (OM&A + Interest + Amortization) compared to the \$140.0 million identified in the plan; and
- The IESO usage fee developed for approval by the IESO Board for implementation in 2008 compared to \$0.79/MWh forecast in this plan;
- As well, effective management of the capital program within the proposed budget of \$20 million for 2007 along with achievement of identified project timelines and results will be assessed.

Six key projects for advancement or delivery in 2007 are expected to be specifically identified as performance expectations. They are:

- Energy Management System and Market Information System Upgrade;
- Back-Up Operating Centre Relocation;
- Facility Outage Management System;
- Unix Server Refresh;
- Windows Server Refresh; and
- DAM.

Further details of these projects are contained in Appendix 3.

The IESO's corporate performance measures focus on the cost-effectiveness of its total spending, the prudence of its capital spending and planning of its fee.

The IESO's customer focused approach advocates and addresses customer needs, provides products and services of value to customers and promotes an effective working relationship with market participants

Market Evolution

The IESO's achievement and effective management of appropriate evolution of the marketplace within the industry environment is a performance measure for 2007. Appropriate evolution encompasses changes which:

- Encourage reliable supply;
- Encourage improved economic efficiency; and
- Are consistent with a long-term vision that is coordinated with the OPA and is acceptable to key stakeholders.

In 2007, this is to result in:

- Reporting to the IESO Board in the spring and fall to provide regular, on-going assessments and evaluations of market evolution alternatives and improvements which address needed changes;
- Recommendation to the IESO Board, following stakeholder consultations, of a design of a DAM that would be operational by the end of 2008;
- Implementation of the results of a physical market prudential review whose objective is to reduce the prudential requirements of those participating in the IESO administered markets;
- If the DACP is to be continued, implementation in advance of summer 2007 of any improvements and modifications directed by the IESO Board; and
- An assessment of the 2006 ELRP provided to the IESO Board early in 2007, and implementation in advance of summer 2007 of any improvements and modifications directed by the IESO Board.

Customer and Stakeholder Satisfaction

The performance measures in the area of customer and stakeholder satisfaction encompass the IESO's customer focused approach. This approach advocates and addresses customer needs, provides products and services of value to customers and promotes an effective working relationship with market participants. In addition, this approach recognizes the need for other stakeholders, including all electricity customers, government, and large volume business and organizations to be informed and to ensure that their input is considered in IESO decision-making.

The performance expectations in regards to market participants is to consist of specific initiatives that the IESO will undertake in 2007:

- Develop customer relationship strategy and priorities;
- Respond to needs identified in the 2006 customer survey;
- Conduct a 2007 customer survey;
- Introduce product and service surveys to enhance feedback on specific initiatives;
- Provide on-going training, support and communications that meet customer needs;
- Develop a customer service index to measure IESO's responsiveness to interactions with market participants; and
- Ensure market summaries and market reports reflect changing environment and meet the information needs of stakeholders.

For other stakeholders this is to result in:

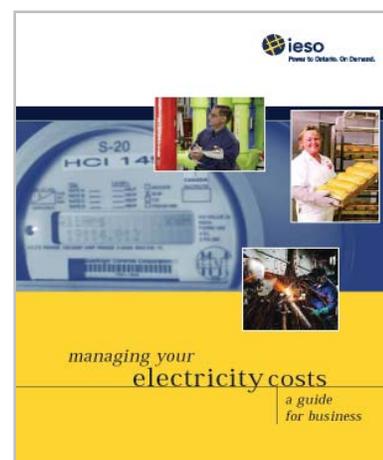
- A simple system status signal available via Internet;
- A Customer Education Program involving new partnerships and tools (publications and seminars etc.) targeted at large volume organizations;
- New partnerships to leverage market information;
- Publications and outreach activities undertaken to meet market participants' and stakeholders' needs; and
- Timely and accurate information provided to the media; and implementing Phase two of the redesign of the "Inside the Market" section of the website to profile and graph more market data.

Customer and stakeholder satisfaction in the completion of IESO initiatives continues to be assessed based on surveys, and other anecdotal evidence.

Operational Effectiveness

The IESO's corporate performance measures in the area of operational effectiveness encompass the maintenance of electrical reliability within the province of Ontario as well as the effective performance of specific market systems and processes. The latter is assessed through a suite of 23 performance standards grouped according to facilitating the electricity marketplace, providing metering, settlement and support services and ensuring systems availability.

The IESO has used the extent to which Ontario has met or exceeded the median values of NERC's control performance standards, CPS1 and CPS2, and disturbance control standard for the Eastern Interconnection Control Areas as the quantitative measures of its reliability performance. Historically, the IESO has consistently bettered these important industry standards by a significant margin. The IESO believes



that a better and more comprehensive measure of the corporation's performance in regards to reliability has been its annual reliability assessment which has been reviewed by its peers (other ISOs/RTOs). This report identifies the actions the IESO has taken within the province during the year to avert/address significant reliability events while the peer review provides an external assessment as to the appropriateness and effectiveness of IESO actions.

For 2007, a heavier reliance is to be placed on specific metrics within this assessment. Specifically, the performance expectation of the IESO's reliability related processes, actions and activities are that:

- Significant actual and potential reliability events are appropriately addressed;
- The annual Ontario system of unsupplied energy (energy which due to shortages or IESO actions could not be supplied to customers on demand) is within acceptable limits;
- System development plans, appraisals and audits are considered successful, and NERC and NPCC reliability standards related performance is acceptable; and
- IESO processes supporting Ontario electricity system development projects are assessed as efficient, effective, and timely.

PROJECTED 2006 FINANCIAL RESULTS

The second quarter projected 2006 financial results show the continued commitment of management to operate in a financially prudent manner. The 2006 projected results are better than those in the budget for the 2006 fiscal year that appeared in last year's Business Plan – largely because of successful operating and capital cost management and higher than expected fees from energy usage combined with higher interest income on market settlements.

2006 Projected Operating Results

(\$ millions)	2006 Projected	2006 Budget	Projected Variance
Usage Fees	146.8	144.0	2.8
Market-related Interest Income	4.6	2.1	2.5
Cost Recovery for Services	1.7	1.7	-
Total Revenues	153.1	147.8	5.3
OM&A Program Costs	84.8	85.9	1.1
OM&A Pension Expense	17.4	16.0	(1.4)
Amortization	31.9	37.8	5.9
Net Interest	7.1	8.1	1.0
Total Costs	141.2	147.8	6.6
Operating Surplus	11.9	-	11.9
Accumulated Operating Surplus¹	16.9	5.0	11.9

Overall, the 2006 projected operating results would result in an accumulated operating surplus of \$16.9 million by year-end. This is determined by taking this year's projected surplus of \$11.9 million and adding last year's actual accumulated surplus of \$5.0 million.

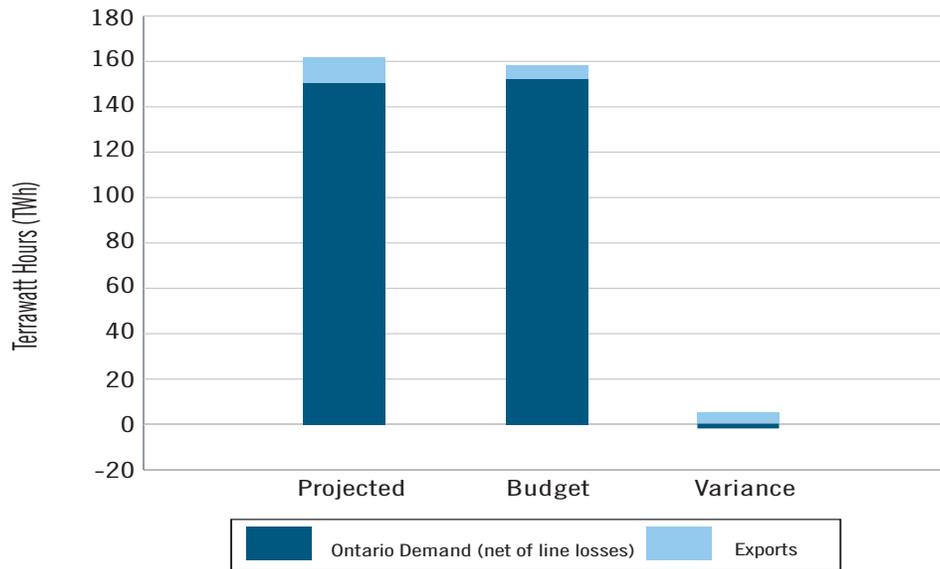
Consistent with the proposal that was accepted by the OEB in the 2006 rate application, the IESO will rebate to market participants any accumulated surplus balance over \$5.0 million. Accordingly, the IESO is projecting a rebate of approximately \$11.9 million, to be distributed to market participants in the first quarter of 2007.

Usage Fees

Projected usage fee revenue for 2006 is \$146.8 million, approximately \$2.8 million greater than budget. This variance is a result of higher projected volumes within the IESO-administered markets. The currently forecasted energy volumes for 2006 are 161.5 terawatt (TWh), or 3.1 TWh higher than the energy levels used for 2006 planning.

¹The accumulated operating surplus is presented before the rebate of any balance in excess of \$5.0 million.

The following chart outlines those variances:



TWh	2006 Projected	2006 Budget	Variance
Ontario Demand (net of line losses)	150.5	152.1	(1.6)
Exports	11.0	6.3	4.7
Total²	161.5	158.4	3.1

As outlined in the table, the projected variance in usage fee revenues is a result of higher projected exports. Domestic demand in 2006 was lower than expected.

The 2006 forecast energy volumes are based on the IESO's most recent 18-Month Outlook and represent actual volumes to the end of July 2006 and forecast amounts for August through December 2006.

Market-Related Interest Income

Market-related interest income represents the interest earned through the IESO-administered markets settlement clearing bank accounts. There are two ways that interest on market funds can accrue to this IESO account:

- In the settlement of the market, funds collected from owing market participants (i.e. buyers) are then paid to the receiving market participants (i.e. sellers) two business days later. In the period between receipt and disbursement of market funds, the monies are invested. The interest earned accrues in the settlement clearing account; and
- Market participants make periodic prepayments and the IESO invests these monies, with interest accruing to the settlement clearing account.

² Transmission line losses are taken as three per cent of the Ontario Demand Forecast. The calculation of exports for forecasting purposes is based on a three-year moving average.

The projected 2006 revenues of \$4.6 million are derived from the interest earned on the above-described funds and represent a positive variance of \$2.5 million relative to budget. This variance is a result of higher volumes of prepayments and higher interest rates.

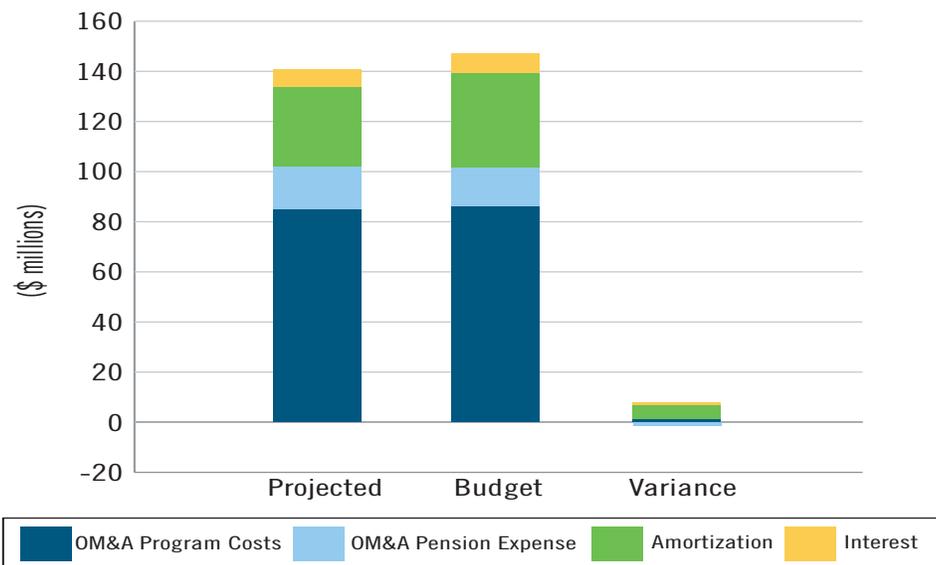
Cost Recovery for Services

Cost recovery for services represents fees the IESO charges for services provided that are charged on a cost recovery basis. In 2006, those fees are projected to be \$1.7 million and represent work on connection assessments (\$1.2 million), assessments for the OPA (\$0.3 million) and training (\$0.1 million).

Although there has been a minor shift in cost recovery activity from connection assessments to assessments for the OPA (\$0.1 million), there is no projected variance in this revenue account.

Total Costs

The following chart outlines the projected 2006 total costs, including a comparison to the OEB approved budget:



(\$ millions)	2006 Projected	2006 Budget	Projected Variance
OM&A Program Costs	84.8	85.9	1.1
OM&A Pension Expense	17.4	16.0	(1.4)
Amortization	31.9	37.8	5.9
Net Interest	7.1	8.1	1.0
Total Costs	141.2	147.8	6.6

In 2006, projected total costs are approximately \$141.2 million, an amount that is \$6.6 million, or 4.5 per cent, below the approved budget of \$147.8 million.

OM&A Program Costs

The following table outlines the projected 2006 OM&A program costs relative to budget.

(\$ millions)	2006 Projected	2006 Budget	Projected Variance
Staff Costs	58.4	58.5	0.1
Computer Support, Maintenance & Equipment	10.2	10.7	0.5
Contract Services & Consultants	7.7	7.0	(0.7)
Administration	5.5	6.3	0.8
Telecommunications	3.0	3.4	0.4
Total OM&A Program Costs	84.8	85.9	1.1

Staff Costs

Staff costs represent all operating costs associated with staffing, excluding pension expense. For 2006, staff costs are projected to be \$58.4 million, or some \$0.1 million below the approved budget of \$58.5 million. This spending level is in line with budget and reflects the fact that staff levels directed at operating activities were largely consistent with the budget, including the timely utilization of temporary or student staff resources.

Computer Support, Maintenance and Equipment Costs

Projected computer support, maintenance and equipment costs are \$10.2 million in 2006 or \$0.5 million below the approved budget. This variance is a result of lower than usual spending in services and software in areas such as, system change requests, lower priority problems and support of applications in areas such as, records management, finance and metering. In 2006, the delivery of critical IT infrastructure and other capital projects, including DACP were given incremental priority. As a result, there was a reduction in resources available for ongoing operations.

Contract Services and Consultants

Projected contract services and consultants are \$7.7 million, or about \$0.7 million above the 2006 budget of \$7.0 million. The variance is a result of numerous minor differences from the plan, including an unbudgeted executive search for the IESO President & CEO and a review of the prudential framework in the physical markets that was more comprehensive than expected in 2006.

Administration Costs

Membership fees and facility costs including rent, utilities, building services and property tax make up the majority of the administration costs. The projected administration costs are \$5.5 million, or \$0.8 million lower than the approved 2006 budget. The majority of this variance is due to a shift in timing in respect of moving the Back-up Operating Centre (BOC).

The 2006 plan assumed a relocation of the BOC during 2006 and the need for an overlap in rent for the existing and replacement facilities leases for a period of six months. The actual overlap of rent costs in 2006 will not commence until November of this year and will continue into 2007.

Other favourable administration costs variances are projected in utility costs due to provincial rebates early in the year, as well as lower than planned membership fees to the NPCC due to favourable U.S. dollar exchange rates.

Telecommunication Costs

Projected telecommunication costs are \$3.0 million, or \$0.4 million below budget, due to successful negotiation of a large discount with one of the telecom suppliers. As well, there are 60 circuits for the Hydro One Remote Terminal Units (RTUs) that are no longer necessary as Hydro One implements an alternate technology which was the subject of a recently approved exemption.

OM&A Pension Expense

The projected OM&A pension expense for 2006 is \$17.4 million or approximately \$1.4 million higher than budget. This reflects a continued decline in the discount rate (determined by reference to high quality long-term corporate bonds). As a result, the actual discount rate utilized for the 2006 pension expense was 5.1 per cent, slightly below the 5.45 per cent assumed in the 2006-2008 Business Plan.

Amortization

The projected amortization costs for 2006 are \$31.9 million, or approximately \$5.9 million lower than budget. This variance results from lower than planned capital spending in the year, combined with a revision in the service-life of the EMS/MIS asset. The projected capital spending variance in 2006 largely relates to the actual spending level on the day-ahead commitment process being much lower than assumed in the 2006-2008 Business Plan. The EMS/MIS service life extension for the remaining system assets reflects the approval in 2006 of the capital project to upgrade the existing tools thereby driving the revised service life. The details of the IESO's 2006 capital program are included later in this section.

Net Interest

Net interest expense is projected to be \$7.1 million, or \$1.0 million below the budget of \$8.1 million. This positive variance is the result of lower than planned interest expense due to the refinancing of the notes payable to the

Province of Ontario under more favourable terms, combined with the repayment of additional debt, and higher than budgeted investment income. In 2006, the IESO restructured a portion of its debt through the early repayment of its note payable to the Province of Ontario, financing it through a lower cost and more flexible credit facility with a Canadian chartered bank.

Accumulated Operating Surplus

The accumulated operating surplus at the end of 2006 is projected to be approximately \$16.9 million, resulting from:

- A projected operating surplus of \$11.9 million in the year; and
- The opening balance of \$5.0 million.

As outlined earlier in this Business Plan, a closing balance of \$16.9 million would result in a rebate to market participants in 2007 of the balance over \$5.0 million, or a projected rebate of \$11.9 million.

2006 PROJECTED BALANCE SHEET

The following chart shows a summarized projected balance sheet as at December 31, 2006, compared to the 2006 budget.

(\$ millions)	2006 Projected	2006 Budget	Projected Variance
Cash, Cash Equivalents and Temporary Investments	2.1	12.4	(10.3)
Accounts Receivable and Short-term Prepaid Expenses	22.6	18.9	3.7
Current Assets	24.7	31.3	(6.6)
Property and Equipment	121.0	119.2	1.8
Long-term Investments	11.8	11.9	(0.1)
Prepaid Pension Expense	11.7	13.6	(1.9)
Deferred Costs - Smart Metering Initiative	0.7	-	0.7
Total Assets	169.9	176.0	(6.1)
Accounts Payable, Accrued Liabilities and Accrued Interest	20.0	20.0	-
Debt	93.2	113.2	(20.0)
Rebates to Market Participants	11.9	-	11.9
Accrual for Employee Future Benefits other than Pension	36.9	36.5	0.4
Total Liabilities	162.0	169.7	(7.7)
Accumulated Operating Surplus	5.0	5.0	-
Accumulated Market-related Penalties and Fines	2.9	1.3	1.6
Total Liabilities and Surplus	169.9	176.0	(6.1)

The projected balance of cash, cash equivalents and temporary investments at the end of 2006 is \$2.1 million, or about \$10.3 million lower than budgeted. The lower projected cash balance is largely a result of the early repay-

ment of \$20.0 million in debt, partially offset by the large projected operating surplus in 2006, which will be rebated to customers in 2007.

The projected total property and equipment balance at the end of 2006 is \$121.0 million, an expected \$1.8 million above the budgeted level. This variance is due to 2006 capital spending which is projected to be \$4.0 million below budget, offset by lower than budget amortization. The projected capital project expenditures are outlined in the next section of this document.

Projected total debt at the end of 2006 is \$93.2 million, an amount that would be \$20.0 million below budget. This debt reduction continues to reflect the successful execution of the IESO's financing strategy to minimize cash balances and repay long-term debt whenever possible, even earlier than budgeted when appropriate.

Accumulated market-related penalties and fines total \$2.9 million at the end of 2006. In 2006, \$0.2 million of the funding is projected to be spent on customer education programs and an additional \$1.1 million to be spent on customer education initiatives in 2007. The projected residual balance at the end of 2007 of accumulated market fines and penalties of \$1.8 is assumed to remain in the account pending IESO Board consideration on the utilization of these funds. The next review of this account balance by the IESO Board is scheduled for November 2006.

2006 CAPITAL PROJECT EXPENDITURES

In 2006, the IESO projects that capital initiatives will total \$21.0 million, an amount that is approximately \$4.0 million below the approved budget, as outlined in the following table.

(\$ millions)	2006 Projected	2006 Budget	Projected Variance
Day-Ahead Commitment Process	2.7	6.9	(4.2)
Energy Management System/ Market Information System Upgrade	3.4	3.0	0.4
Unix Server Infrastructure Refresh	2.2	2.4	(0.2)
Application Changes/ Vendor Change Requests	0.4	2.0	(1.6)
Windows Refresh Program Stage 2 & 3	2.0	1.5	0.5
Back-up Operating Centre Relocation	1.2	1.2	-
Facility Outage Management System	1.1	0.6	0.5
Central Alarm Management System	1.0	0.5	0.5
Back-up Infrastructure Enhancement	1.3	0.3	1.0
Windows Refresh Program Stage 4 & 5	1.0	-	1.0
Other Capital Initiatives	4.7	6.6	(1.9)
Total Capital	21.0	25.0	(4.0)

As in prior years, given the ongoing need for changes and reprioritization, 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. The following section compares some of the actual results with the business plan capital project assumptions. As well, it also outlines project deliverables, achievements and challenges for the larger projects undertaken in 2006.

2006 Capital Initiatives

Day-Ahead Commitment Process

The DACP was included in the 2006 - 2008 Business Plan at an estimated cost of \$6.9 million and was combined with other reliability initiatives at a total estimated cost of \$9.0 million in lieu of a DAM implementation in the same amount. The projected spending level for DACP of \$2.7 million is \$4.2 million lower than the budgeted spending and is reflective of the preliminary nature of the initial estimate combined with the effective management of project and related costs. The resulting deliverable served to put in place a new market measure designed to reduce the failure of energy imports in real time, increase the commitment certainty for domestic generators as well as assist in more accurately determining next day energy or capacity shortfalls. This was done in a manner that struck a balance between the implementation of automated tools in necessary areas and manual business processes that resulted in lower capital costs but placed some pressure on the IESO's OM&A program costs.

Unix Server Infrastructure Upgrade

Unix Server Infrastructure Upgrade is a program that encompasses three phases. The program is expected to see capital expenditures from 2005 to 2007. Overall, this program will see the replacement and upgrade of the existing Unix server environment, an environment that hosts most of the market applications and is comprised of aging hardware. Overall, this program was estimated at a total cost of \$6.2 million in the 2006-2008 Business Plan. This program has been included at an estimated cost of \$4.2 million in this year's Business Plan. The cost estimate included in the 2006-2008 Business Plan for Phase One related to the replacement of the Oracle database servers; the replacement of the Domain Name Servers and the creation of Portal Remote Archetypes. In 2006, total projected costs are \$2.2 million, \$0.2 million lower than the business plan forecast. The overall forecast program variance of \$2.0 million and the variance of \$0.2 million are a result of more refined cost estimates and successful procurement of equipment at costs that were lower than forecast.

In 2006 as part of Phase Two there is the planned replacement of the EMS servers, the MVSTAR, IESO's settlement database application server and a number of smaller application and web servers. This is the continued replacement of aging hardware and a move to a modern Operating System that will be supported until at least 2012.

In 2007 as part of Phase Three there is the planned replacement of the Data Warehouse (SDR) and Operational Data Store (ODS), the Funds Administration servers and Market Operations System/Market Interface Manager (MOS/MIM) systems. There are a number of smaller application and web servers that will also be replaced in Phase Three. This Phase shares the same benefits as noted above of replacing aging hardware and the move to a modern operating system.

Energy Management and Market Information System Upgrade

This project serves to upgrade the EMS/MIS applications. These applications largely represent the toolset the IESO is currently using to maintain the reliability of the IESO Controlled Grid (ICG) and to operate the IESO administered markets. Having been selected in 1999 and in-service since 2001, these systems are nearing the end of their technological life. Accordingly, to ensure the applications continue to reside on reliable infrastructure, the underlying hardware for the EMS/MIS applications is being upgraded as part of the Unix Server Infrastructure Upgrade Program. The current versions of the EMS/MIS applications cannot operate on the new infrastructure. In addition, only more recent versions of this software include some functional enhancements, which are now required at the IESO.

The result of this project will be an EMS/MIS that allows hosting on current infrastructure technology, applications that include required functionality enhancements, and an increased assurance as to the reliable operation of the EMS/MIS. Accordingly, the upgrade will extend the life of the current system assets from 2008 to 2011.

Back-Up Operating Centre Relocation

The Back-Up Operating Centre Relocation was initiated in 2006, after a thorough investigation of suitable options and locations. Although a shift in project timing has occurred, moving the project back approximately four months, the total estimated project costs continue to remain unchanged at \$2.5 million.

Facility Outage Management System

This Facility Outage Management System (FOMS) project is proposed to replace the existing outage management applications and address two high level requirements. The first is to provide services that the market participants require to enable them to directly manage their outages. The second is to improve the efficiency of the outage management process for market participants and the IESO. The Outage Management Replacement Project was identified in the 2006 - 2008 Business Plan but the project start was impacted by the IESO's allowance for discussions with various ISOs and Reliability Coordinators regarding a joint project. As a result the IESO and ISO New England have agreed to develop jointly a significant portion of the FOMS and thereby reducing vendor development costs for common components. Projected spending in 2006 is \$1.0 million.

Central Alarms Management System

The Central Alarms Management System project was initiated in 2005 to make comprehensive improvements to system alarms. The project will be completed in 2006. The project successfully implemented improvements to system alarms related to IESO's operations. Specifically, the project served to provide integrated security management and prioritization of alarms addressing: the power system; market conditions and events; and IT systems. These alarms will serve to improve the IESO's delivery of its services through the reduction and/or shortening of service failures.

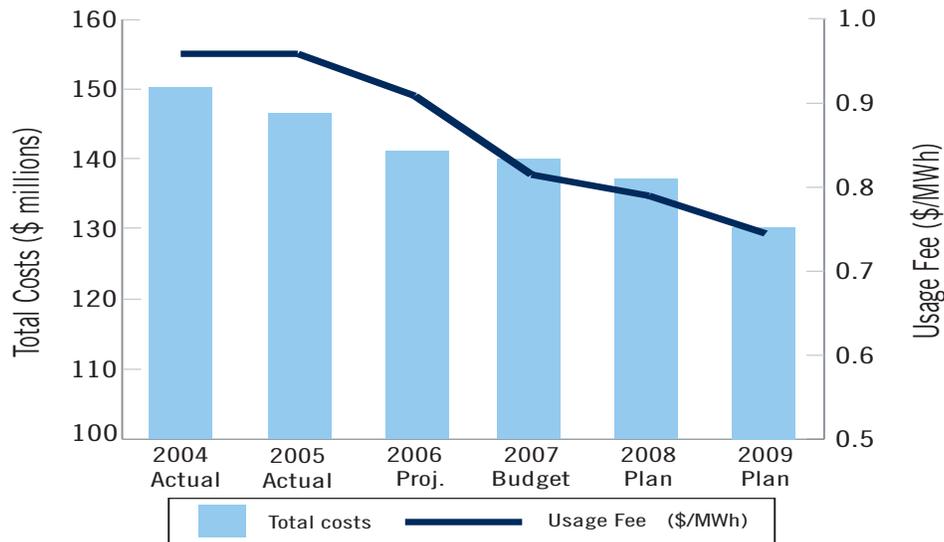
Windows Server Infrastructure Replacement

This program was initiated in 2004 and is expected to run through to 2008. The program is comprised of numerous stages/projects and its objective is to replace the IESO's aging Windows server infrastructure. This infrastructure has largely been in place since 1999. The replacement of this equipment will serve to reduce associated business risk (security, reliability) and operational costs (parts, support and maintenance). To date, stages one, two and three have been largely completed. These stages have served to: put together the overall blue-print for the IESO's new Windows architecture; replace the corporate email system; build a new core MS Windows Servers 2003 infrastructure; and facilitate the deployment of the new email system. Windows infrastructure and the migration of a number of business critical servers. Phases four and five, which are planned for completion by 2008, will migrate all remaining business applications to the more secure and reliable Windows environment.

FINANCIAL OUTLOOK 2007-2009

The financial outlook for the planning period 2007-2009 reflects strong cost management, successfully reflected in the IESO's proposed usage fee reduction of over 10 per cent, or a projected usage fee of \$0.815/MWh in 2007. This compares to a forecasted fee of \$0.909/MWh for 2007 included in the 2006-2008 Business Plan. The IESO has been able to propose the significant fee reduction through:

- Continued successful management of business costs, including OM&A, amortization and interest, resulted in these costs having an estimated total of \$126.2 million in 2007, or some \$9.9 million lower than was estimated for 2007 in last year's plan;
- A slight increase in long-term interest rates, providing a modest reprieve from the constant increases in pension expense seen over the last number of years; and
- An increase in the energy forecast volume of 3.3 TWh.



Key Assumptions over the Planning Period

Prior to reviewing the details over the period, it is important to ground these budgets and outlooks with the related assumptions. They are:

- Load forecasts used in calculating the usage fees over the plan horizon are based on the most recent 18-Month Outlook and Ontario Reliability Outlook forecasts,³
- An estimated \$11.9 million of the accumulated surplus at the end of 2006 will be rebated to market participants, as outlined earlier;
- The average annual floating interest rate paid on the long-term debt, excluding the fixed rate debt with the Ontario Electricity Financial Corporation (OEFC), will be in the range of 4.75 per cent to 5.03 per cent over the planning period;
- \$5.0 million of debt will be repaid in 2007, with a further \$10.0 million repaid in 2008 and the debt with the OEFC will be renegotiated in 2009 with terms preferable to those currently in place. (i.e. floating rate with more flexibility in the repayment options);
- Capital spending of \$20.0 million in 2007, \$20.0 million in 2008, and \$16.0 million in 2009;
- Pension expense for 2007 based on actual pension plan returns to the end of May 2006 with the 2008 and 2009 pension expense based on plan returns of 7.0 per cent. This latter rate of return is consistent with the assumed expected long-term return on plan assets;
- Pension expense over the planning period based on a discount rate of 5.6 per cent; and
- SMI costs are charged to separate rate class (by the smart metering entity).

The table below outlines the planned operating results over the planning period:

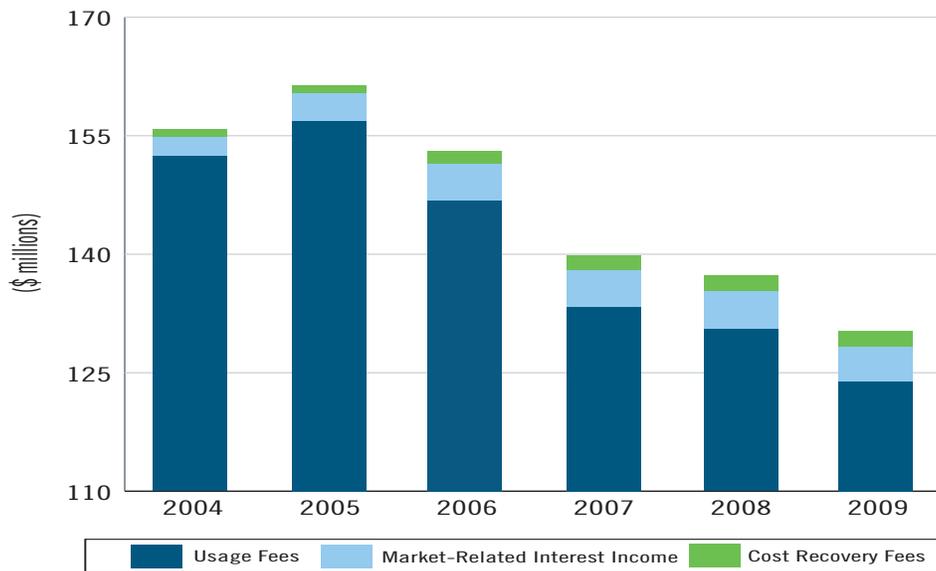
(\$ millions)	2004 Actual	2005 Actual	2006 Projected	2007 Budget	2008 Plan	2009 Plan
Usage Fees	152.4	156.9	146.8	133.4	130.4	123.9
Market-Related Interest Income	2.5	3.5	4.6	4.6	4.8	4.4
Cost Recovery for Services	0.9	0.9	1.7	2.0	2.0	2.0
Total Revenues	155.8	161.3	153.1	140.0	137.2	130.3
OM&A Program Costs	81.4	83.3	84.8	89.4	90.5	92.7
OM&A Pension Expense	7.4	8.3	17.4	13.8	11.9	10.5
Amortization	52.0	47.4	31.9	32.9	29.6	24.3
Net Interest	9.5	7.6	7.1	3.9	5.2	2.8
Total Costs	150.3	146.6	141.2	140.0	137.2	130.3
Operating Surplus/(Deficit)	5.5	14.7	11.9	-	-	-
Transfer to the OPA	-	(15.0)	-	-	-	-
Refund to Market Participants	-	(13.6)	(11.9)	-	-	-
Accumulated Operating Surplus	18.9	5.0	5.0	5.0	5.0	5.0

³ The forecasted energy demand levels that underpin the revenue forecast included in the plan are 163.6 TWh for 2007, 165.2 TWh for 2008 and 166.3 TWh for 2009.

As shown:

- The accumulated surplus is projected to remain the same at \$5.0 million in 2007 and 2008; and
- Complete financial statements covering the period 2004 through 2009 are in Appendix 1.

TOTAL REVENUES: 2007-2009



(\$ millions)	2006 Projected	2007 Budget	2008 Plan	2009 Plan
Usage Fees	146.8	133.4	130.4	123.9
Market-Related Interest Income	4.6	4.6	4.8	4.4
Cost Recovery Fees	1.7	2.0	2.0	2.0
Total	153.1	140.0	137.2	130.3

Projected total revenues are expected to decrease by approximately \$13.1 million in 2007 from levels expected in 2006, due primarily to planned reductions to the usage fee.

Usage Fee Revenue

The forecasted usage fee revenues are expected to decrease by \$13.4 million in 2007 from the current year projection, with further decreases of \$3.0 million and \$6.5 million in each of 2008 and 2009 respectively. The forecast reduction in 2007 reflects the proposed usage fee reduction from \$0.909/MWh to \$0.815/MWh. An increase of 2.1 TWh from 2006 to 2007 is also assumed due to increased domestic demand levels.

The above revenue levels reflect the following energy forecasts:

- 163.6 TWh in 2007;
- 165.2 TWh in 2008; and
- 166.3 TWh in 2009.

Terawatt Hours	2006 Projected	2007 Budget	2008 Plan	2009 Plan
Outlook Demand Forecast	155.2	158.1	160.0	161.0
Less: Transmission Line Losses ⁴	(4.7)	(4.7)	(4.8)	(4.8)
Exports ⁵	11.0	10.2	10.0	10.1
Total	161.5	163.6	165.2	166.3

Market-Related Interest Income Revenues

The market-related interest income revenues, which represent investment income earned on market funds as they flow through the settlement cycle, are expected to remain flat at \$4.6 million in 2007, incur a slight increase in 2008 before reducing to \$4.4 million in 2009. This is a result of anticipated invoice volumes in each of the years and the expected interest rate.

Cost Recovery for Services Revenues

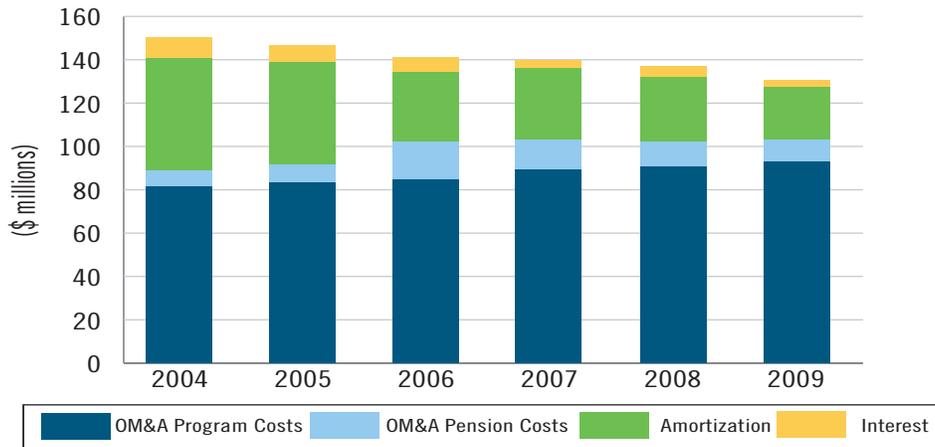
Cost recovery for services revenues (from connection assessments, assessments for the OPA and market participant training) are expected to increase in 2007 by \$0.3 million to \$2.0 million. In 2008 and 2009, these revenues are forecast to remain flat. The budgeted increase in 2007 reflects the expectation of increased connection assessment work. With respect to the assessment for the OPA, the estimated volume of work that the IESO expects to do for the OPA on a cost of service basis remains at \$0.3 million.

The work for the OPA is expected to be in the areas of assessments and reports and some related tools. Since these revenues represent services that are provided at cost, there are corresponding costs within the OM&A program for these services. Accordingly, there is no net impact on the IESO for these services, and no impact on the market participant's usage fee.

⁴Line losses are assumed to be three per cent.

⁵Export assumptions are based on a three-year rolling average.

TOTAL COSTS: 2007-2009



(\$ millions)	2004 Actual	2005 Actual	2006 Projected	2007 Budget	2008 Plan	2009 Plan
OM&A Program Costs	81.4	83.3	84.8	89.4	90.5	92.7
OM&A Pension Costs	7.4	8.3	17.4	13.8	11.9	10.5
Amortization	52.0	47.4	31.9	32.9	29.6	24.3
Net Interest	9.5	7.6	7.1	3.9	5.2	2.8
Total Costs	150.3	146.6	141.2	140.0	137.2	130.3

Over the planning period, it is expected that total costs will decrease in relation to the anticipated 2006 level.

On an annual basis, in 2007, projected total costs of the business will decrease slightly by some \$1.2 million, from \$141.2 million to \$140.0 million.

In 2008, the forecasted total costs are projected to decrease further by \$2.8 million, reflecting decreases in pension expense and amortization.

In 2009, a further reduction in total costs of \$6.9 million is projected.

The net changes over the planning period reflect:

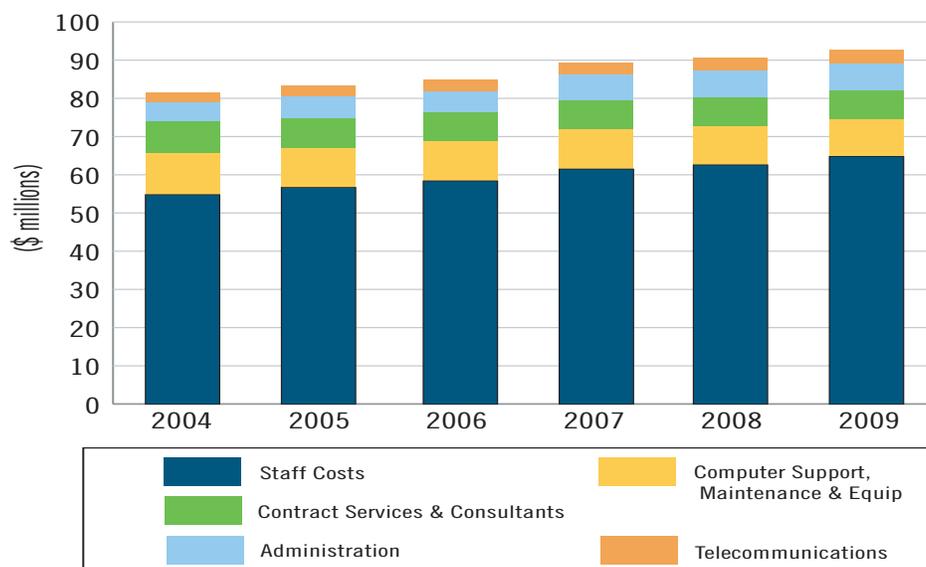
- Continued aggressive repayment of debt, thereby minimizing interest expenses; and
- Prudent capital expenditure levels that will continue to drive a longer term reduction in amortization charges;
- Decreases in pension expense, resulting largely from increasing long-term interest rates;

- Attentive management of OM&A program costs, with particular mention of the ongoing challenge to meet the growing demands of the business while holding staff levels to the reduced level of 2006.

The following sections provide the detail and rationale for the changes in each area of cost.

OM&A Program Costs

The following table outlines the OM&A program costs over the planning period.



(\$ millions)	2004 Actual	2005 Actual	2006 Projected	2007 Budget	2008 Plan	2009 Plan
Staff Costs	54.8	56.7	58.4	61.5	62.6	64.8
Computer Support, Maintenance & Equipment	10.8	10.4	10.2	10.3	10.1	9.8
Contract Services & Consultants	8.5	7.7	7.7	7.6	7.5	7.4
Administration	4.9	5.7	5.5	6.7	6.9	7.2
Telecommunications	2.4	2.8	3.0	3.3	3.4	3.5
OM&A Program Costs	81.4	83.3	84.8	89.4	90.5	92.7

In 2007, OM&A program costs are budgeted to increase by \$4.6 million, or by approximately five per cent. As shown above, the primary reason for this increase relates to increases in staff costs (\$3.1 million), administration expenses (\$1.2 million), and telecommunications (\$0.3 million).

Staff Costs

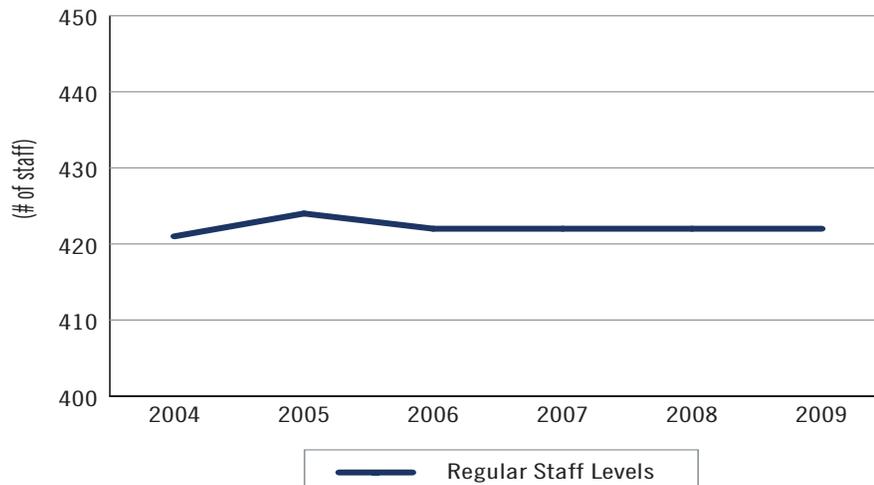
The IESO continues to be a staff-intensive business. Demands on the IESO and its staff continue to increase, reflecting the substantial changes taking place within the industry. Numerous developments within the sector continue to drive increased work in a number of areas. Examples of this include: increasing regulatory activity within Ontario and in the electricity sector across Canada and the U.S.; tremendous infrastructure changes that

drive ongoing analysis or assessments, sometimes being done numerous times for ongoing developments; the introduction of new market participants into the IESO-administered market; and overall governance demands related to the power system, the corporation and the IESO's pension plan.

In 2007, the first year of the Business Plan, staff costs are budgeted to increase by about \$3.1 million, or about five per cent. This planned cost increase reflects:

- Ongoing reprioritization of work and efficiency gains in the day-to-day activities that has allowed the increasing business demands to be met at a staffing level that remains the same as in 2006 and lower than that in 2005;
- Compensation increases, primarily the result of current collective agreements;
- A redirection of increased staff time to ongoing operating activities, reducing the portion of regular staff time allocated to capital initiatives; and
- The focus on improving the management of hiring lags. There are a number of ongoing initiatives and programs aimed to support the resourcing of staff including; on-campus recruiting, co-op programs, and internet-based resume management system.

The following table outlines the regular staff levels over the planning period:



	2004 Actual ⁶	2005 Actual	2006 Actual ⁷	2007 Budget	2008 Plan	2009 Plan
Market & System Operations ⁸		200	200	196	196	196
Information, Technology & Infrastructure		121	117	118	118	118
Corporate Relations & Market Development		39	41	43	43	43
Corporate Services		37	37	37	37	37
Market Assessment & Compliance		13	13	13	13	13
Human Resources		12	12	13	13	13
Chief Executive Officer		2	2	2	2	2
Total Regular Staff Levels	421	424	422	422	422	422

⁶ 2004 actual staff levels are not available for all business units due to the 2005 corporate realignment.

⁷ 2006 actual regular staff levels as of July 31, 2006.

⁸ Market & System Operations includes Reliability Assurance, formerly a separate business unit within the IESO. Reliability Assurance was consolidated into Market & System Operations in October 2006.

Computer Support, Maintenance and Equipment

Computer support, maintenance and equipment costs are projected to decrease slightly over the planning period. These costs include annual support and maintenance fees for the market and operating systems, annual license renewals, as well as computer leases and consumables.

Contract Services and Consultants

Contract services and consultants are budgeted to decrease slightly in each of the planning years and by approximately \$0.3 million, over the planning period. The majority of these costs are recurring annual expenses such as insurance, remuneration to the IESO Board, Panel and Committee members, audit and accounting fees, legal services, human resources services and communication products and services, as well as regulatory affairs functions.

Administration⁹

Administrative costs are budgeted to increase in 2007 by \$1.2 million, or by approximately 20 per cent over what is projected for 2006. This increase is largely due to increased membership costs in the NPCC as NERC is taking on additional costs in their new role as the ERO. Projected membership costs are expected to continue to increase slightly over the planning period. Rent costs are also expected to increase in 2007 due to the six-month overlap period during relocation to the backup operating centre. The monthly rent costs of the backup operating centre are also projected to be higher than the current location's costs and these increases have been reflected throughout the planning period. All other administration costs are expected to increase in-line with cost-of-living changes with the exception of building services which are expected to increase in both 2008 and 2009 due to non-routine planned facility maintenance in those years.

Telecommunications

Telecommunication costs are budgeted to increase by approximately \$0.3 million in 2007 – resulting from an increase in the number of leased communication lines to connect to market participant remote terminal units. Also, similar to rent, there will be a six-month overlap period for telecommunication costs during the relocation to the back-up operating centre in 2007. The increases in 2008 and 2009 reflect anticipated inflationary increases and further remote terminal unit expansion.

⁹ Administrative expenses include memberships, rent, utilities, materials and supplies, rental facilities, building services, and property taxes.

OM&A Program Costs by Business Unit

The OM&A program costs by cost type have been outlined, explaining the associated work. Business unit budgets are in Appendix 2.

OM&A Pension Expense



(\$ millions)	2004 Actual	2005 Actual	2006 Projected	2007 Budget	2008 Plan	2009 Plan
Pension Costs	7.5	8.4	17.8	14.2	12.3	10.7
Less: Capitalized Pension	(0.1)	(0.1)	(0.4)	(0.4)	(0.4)	(0.2)
Pension Expense	7.4	8.3	17.4	13.8	11.9	10.5

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 using assumptions that reflect current long-term bond yields and management's best estimates for the future. This expense reflects the proper charge for pension in the financial statements, in accordance with Canadian 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
- The 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

On pension plan investment performance, over the period 2002 through 2005, the plan earned an average annual return of 7.2 per cent. These actual returns have exceeded the benchmark (6.7 per cent) and are in-line with management's current annual long term assumed rate of return of 7.0 per cent.

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. As a result, the large positive equity investment returns of recent years have not been fully recognized in the smoother asset values. Therefore, there are currently lower plan assets assumed to be available for investment, and this results in an assumption of lower investment income, resulting in an increase in the pension expense reported.

This means that the difference between actual and assumed equity investment returns is not immediately recognized in the pension expense, and this has the effect of smoothing the impact of stronger or weaker than expected returns on equity investments. The poor returns dating back to 2002 continue to be smoothed into the smoothed-value of assets used for the 2007 pension expense. For 2007, this accounts for approximately \$0.5 million of the budgeted increase.

Critical Assumptions

The assumed long-term rate of return on plan assets remains at 7.0 per cent per annum.

Pension liability – on the opposite side of the pension plan balance sheet is the pension liability. That 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 plan provisions have not increased. In 2006 the only change in the area of pension benefits was an increase in the employee contribution rate for Power Workers' Union employees.

- Long-term obligation - since this 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 long-term interest rates on high quality corporate long bond yields 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 been dropping significantly, however in 2006 they have recovered somewhat. The effect of this change is a budgeted decrease of some \$3.3 million to the pension expense in 2007.
- 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 2005, 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 2008.

The following table summarizes the details of the change in projected pension expense in 2007 from 2006.

(\$ millions)	Current Service Costs	Interest on Benefit Obligation	Expected Return on Assets	Amortization of Experience and Plan Changes	Total
Projected 2006 Pension Expense	9.3	18.9	(18.4)	8.0	17.8
Expected Developments	0.3	1.1	(1.3)	(0.9)	(0.8)
Fund Performance	-	-	0.2	0.3	0.5
Change in Discount Rate	(1.2)	0.3	-	(2.4)	(3.3)
Budgeted 2007 Pension Expense	8.4	20.3	(19.5)	5.0	14.2

Looking at 2008 and 2009, based on no change in long-term discount rates and a plan return of 7 per cent per annum, the pension expense is expected to decrease modestly each year, as fewer prior year experience losses are recognized and the large positive equity investment returns of recent years are recognized in the smoothed asset values.

It is important to understand that pension plans represent long-term financial commitments for their sponsors. As explained above, pension valuations under current accounting rules and the rules that govern the funding of these plans are very sensitive to short-term fluctuations in interest rates as well as the economy overall. There is no question that accounting and funding of defined benefit pension plans are highly technical areas marked by confusing terminology, significant complexity as well as apparent inconsistencies.

The IESO takes a longer-term view of its pension plan. Notwithstanding recent concerns in the press about the funded status of pension plans, the cash needed to fund them and the impact on earnings, looking back only a few years ago paints quite a different picture.

The 1990s, for the most part, were very good years for such plans. Asset returns were double-digit and companies, including the IESO and its predecessor, were able to post pension income in their income statements; that is to say, a negative pension expense.

The basics of computing pension expense for accounting purposes require that companies with pension plans must report a pension expense on their income statements. For a defined benefit plan, the expense will usually bear little resemblance to what the employer actually contributes. The main components of pension expense are:

- Current service cost (i.e. the cost of pension being accrued in the current fiscal year);
- Return of Assets (i.e. the interest the fund is expected to earn in the year);
- Interest on Liabilities (i.e. the interest on accrued liabilities computed at the discount rate); and
- Amortization of various amounts (i.e. the initial deficit or surplus, plus revisions to it due to plan changes or actual experience, are amortized over a period of years).

The current service cost and the accrued liabilities are determined using a discount rate. The amortization of various amounts – such as a deficit or surplus can be either positive or negative. Accordingly, companies, like the IESO that at times had large pension surpluses, as explained above, can indeed enjoy a negative pension expense, (i.e. pension income from time to time).

Delayed recognition (or smoothing) allows companies to amortize prior service costs, gains and losses over the average remaining service period of members. It is interesting to note that delayed recognition is only becoming a problem now, even though it has been around for close to 20 years. In the 1990s, when pension funds enjoyed large gains, this smoothing of surpluses was not an issue. In fact, without this smoothing, the resultant volatility in pension expense would be unacceptable to many companies and their respective stakeholders.

Management and the Board of Directors of the IESO understand and pay close attention to the management of the pension plan irrespective of the current economic climate.

When setting the policies that govern the pension plan, both Management and the IESO Board balance a number of competing business needs. They must balance benefit policies which take into account the role of the plan in the IESO's total rewards strategy, with the cost of the benefits and the financial risks associated with providing them through the plan. They balance the need for cash to fund the obligations to the plan with the need for cash in the company. They must also establish an investment policy for the plan assets as well as an accounting policy to document the methods and assumptions to be used in accounting for the plan.

All of these policies are monitored to ensure that they are consistent with the objectives that have been set for them and the legislative framework within which the IESO operates. Management and the IESO Board look beyond the current period and evaluate whether they need to change or refine these objectives or make changes to these policies that underpin the Pension Plan. This is a dynamic process that requires ongoing and active monitoring accompanied by detailed periodic review. The objectives and supporting policies that govern the benefit security, funded status, the level and volatility of the pension expense, as well as the level and volatility of any

contributions, are reviewed under this process by Management and the IESO Board.

CAPITAL SPENDING

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

- \$20.0 million in 2007;
- \$20.0 million in 2008; and
- \$16.0 million in 2009.

This total three-year spending level of \$56.0 million includes an anticipated spending level for the DAM in the order of \$16.0 million. Excluding DAM, this budgeted or forecast spending level (\$40.0 million) is consistent with the actual and projected spending level of \$39.1 million for the three-year period ending in 2006.

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. Also, consistent with prior years, the IESO recognizes the need for robust disclosure and information about the projects for which this capital funding will be utilized.

In recognition of this inherent conflict, the IESO has employed 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, at the time, the IESO believes must be completed in the timing that is largely consistent with that in the following table. The other capital initiatives are also necessary capital projects, however, they are projects that either lend themselves to more flexibility in planning or delivery so timing is not as critical, or they are lower priority than some key initiatives so their timing is less certain. Stakeholders should expect that the IESO would undertake the key capital initiatives as scheduled and, over the life of the plan, will complete the other capital initiatives.

As well, in the later years of the Business Plan, fewer key capital initiatives are defined as lead times allow for such definition to be undertaken later. This is reflected in the increasing amounts budgeted under “other capital initiatives”.

As an example, the DAM has been assumed to be built and implemented in 2007/2008. If the project timing, deliverables or costs were different than the \$16.0 million assumption that is evenly split between 2007 and 2008, then some of the resourcing for other capital initiatives might move ahead or be deferred.

Ultimately, the IESO believes this is a prudent and realistic manner in which to budget capital.

The following table provides more information on the capital plan.

(\$ millions)	2006 Projected	2007 Budget	2008 Plan	2009 Plan
Key Capital Initiatives				
Day-Ahead Commitment Process	2.7	-	-	-
Day-Ahead Market	-	8.0	8.0	-
Energy Management System/ Market Information System Upgrade	3.4	3.2	-	-
Unix Server Infrastructure Refresh	2.2	1.5	0.5	-
Application Changes/ Vendor Change Requests	0.4	-	-	-
Windows Refresh Program Stage 2 & 3	2.0	-	-	-
Back-up Operating Centre Relocation	1.2	1.3	-	-
Facility Outage Management System	1.1	0.3	-	-
Central Alarm Management System	1.0	-	-	-
Backup Infrastructure Enhancement	1.3	-	-	-
Windows Refresh Program Stage 4 & 5	1.0	2.5	0.8	-
Customer Information System	-	-	0.3	-
Other Capital Initiatives	4.7	3.2	10.4	16.0
Total Capital	21.0	20.0	20.0	16.0

The planned capital spending level of \$20.0 million in 2007 represents a \$1.0 million decrease from the 2006 projected level of \$21.0 million.

Key Capital Initiatives

The majority of the key capital initiatives within the planning period were begun in 2006 and hence their descriptions are found earlier in this document. The exceptions are the DAM and the Customer Information System.

Day-Ahead Market

Day-Ahead Market design is expected to be approved by the IESO Board by the summer of 2007, and to be operational in 2008. The total projected capital spend is estimated at \$16.0 million and is currently allocated evenly between 2007 and 2008. The project scope is based on maximizing use of existing processes while providing day-ahead pricing options to participants. The project costs and the timing are subject to variability depending on the final design.

The DAM is expected to deliver:

- Improved operational signals to generators, which, among other things should result in improved coordination of gas and electricity markets;
- Increased commitment certainty for domestic generators;
- The availability of better price signals for both consumers and producers to plan their business;
- The ability for participants to lock in a price for their electricity and not be subject to the risks inherent in real-time operations; and
- A reduction in the failure of energy imports in real time.

Customer Information System

The Customer Information System will facilitate high quality customer support by tracking customer contacts, characteristics, issues and activities and making that information available in a timely fashion throughout the IESO to provide better service to its customers. The Customer Information System is expected to be implemented in 2008 at a cost of \$0.3 million.

Other Capital Initiatives

Please refer to Appendix 3 for a complete listing of all other capital initiatives and their expected costs during the planning period.

Throughout the planning period, based on shifting priorities, opportunities, and challenges, the actual capital initiatives may differ from that outlined in this plan. Within the IESO, all capital projects require Business Unit Leader, President & CEO, or IESO Board approval as appropriate.¹⁰

Asset Service Lives

As part of the business planning process, the service lives used in the capital asset amortizations 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 support in order to extend asset lives.

In the 2003 and 2004 reviews, the service lives were revised. In 2003, some service lives on IT infrastructure assets were shortened, resulting in service lives of IT infrastructure assets that range from three years (small servers) to five years (communications network). In 2004, service lives were changed on some of the major market systems, resulting in service lives that range from about four years (market participant interface) to seven and an half years (Energy Management System).

¹⁰ Business Unit Leaders can approve capital projects up to \$500 thousand, President & CEO can approve capital projects up to \$4.0 million, and the IESO Board's approval is required on all capital projects in excess of \$4.0 million.

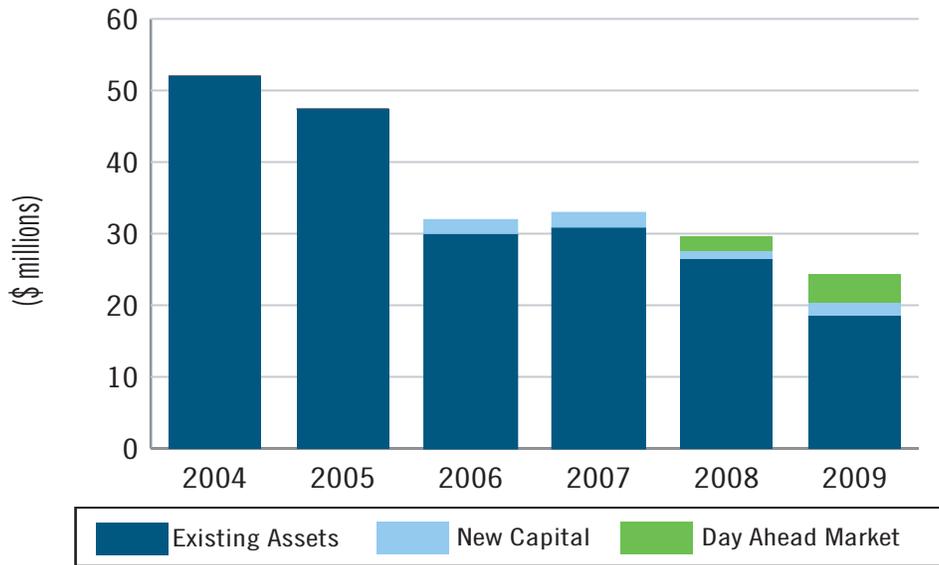
The approval of the EMS/MIS Upgrade project business case in 2006 led to an extension of the service life of these assets. The assets had previously been assumed to be completely amortized by 2008; however the upgrade project is expected to extend their service lives out to 2011.

Amortization Expense Over the Planning Period

Over the planning period, the expected annual amortization expense will decrease from the projected 2006 level. This reduction reflects the IESO's success in using some information system infrastructure longer than originally planned, and lower costs for replacement infrastructure.

As well, for those applications that are being upgraded or replaced over the planning period, this work is expected to cost less than the original implementation due to the increased knowledge of the IESO staff and the additional costs in the initial development because the market rules were developed in parallel to developing the systems.

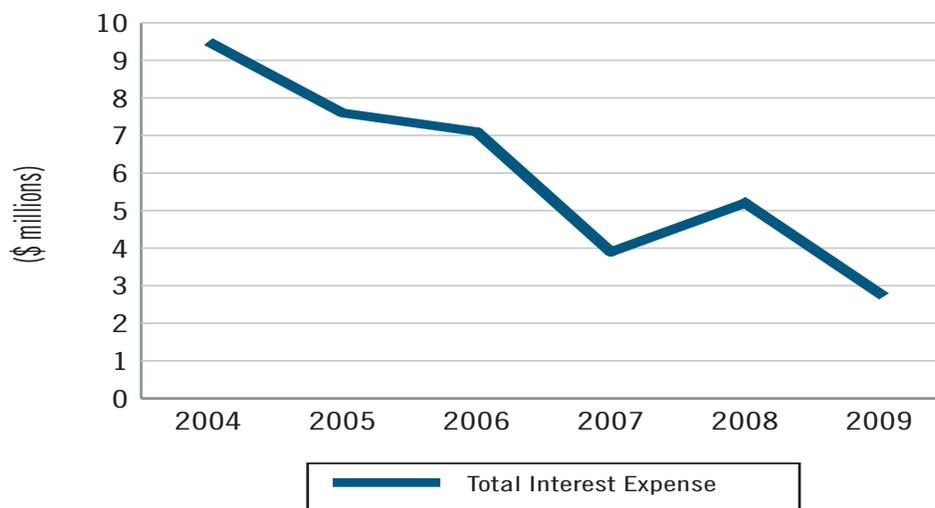
The following table outlines the amortization expense over the planning period:



(\$ millions)	2006 Projected	2007 Budget	2008 Plan	2009 Plan
Existing Assets In-Service	29.8	30.7	26.5	18.6
New Capital	2.1	2.2	1.1	1.7
Day-Ahead Market	-	-	2.0	4.0
Total Amortization	31.9	32.9	29.6	24.3

Net Interest Expense

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



(\$ millions)	2004 Actual	2005 Actual	2006 Projected	2007 Budget	2008 Plan	2009 Plan
Net Interest Expense	9.5	7.6	7.1	3.9	5.2	2.8

Financing Strategy

At the beginning of 2006, the unsecured long-term debt was comprised of the following notes payable:

- \$50.0 million held by the Province of Ontario, repayable on March 31, 2007, bearing a floating rate of interest of Bankers Acceptance rate plus 50 basis points, reset quarterly; and
- \$78.2 million held by the OEFC, repayable on May 1, 2009, bearing a fixed interest rate of 7.9 per cent.

As the debt with OEFC includes a 'hold harmless' clause within its legal structure, it is likely to remain in effect for the duration of the planning period and will result in \$6.2 million of interest annually.

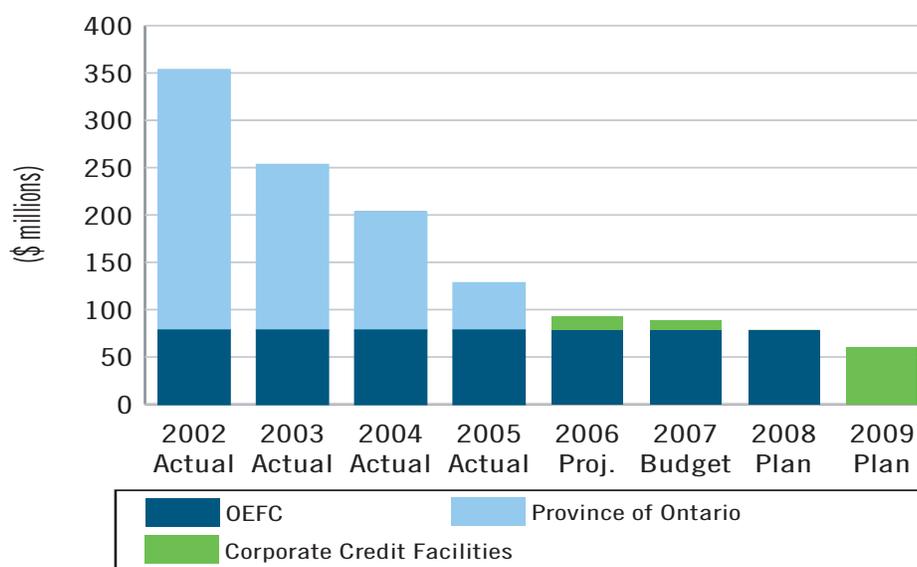
In 2005, the IESO repaid \$75.0 million of the Province of Ontario debt, \$5.0 million greater than was anticipated in the 2006-2008 Business Plan.

In 2006, the IESO refinanced the Province of Ontario debt due March 31, 2007 with a \$60.0 million corporate credit facility provided by a Canadian chartered bank. The cost to borrow under the credit facility is lower and the agreement gives the IESO flexibility to adjust borrowings to cash flow and changes in interest rates. Specifically, the IESO may borrow at the prime rate of the bank or under the Bankers Acceptance facility plus a stamping fee of 30 basis points; the standby fee is ten basis points. The assumed average interest rates on this debt for each year over the planning period are:

- 2007: 4.8 per cent;
- 2008: 5.0 per cent; and
- 2009: 5.0 per cent.

Based on budgeted cash flows, the IESO anticipates paying off the existing credit facility in 2008 – with \$5.0 million being repaid in 2007 and the balance of \$10.0 million in 2008. Also, the IESO expects to refinance the debt to the OEFC in 2009. Likely, this debt would be refinanced through a corporate credit facility. Based on current cash flow projections, \$18.2 million of the original OEFC debt would be retired in 2009, resulting in a total debt level of \$60.0 million at the end of 2009 – that would reflect repayment of over 83 per cent of the IESO’s debt since 2002.

The financing strategy above outlines the plan to continue to reduce the debt over the planning period. The result-

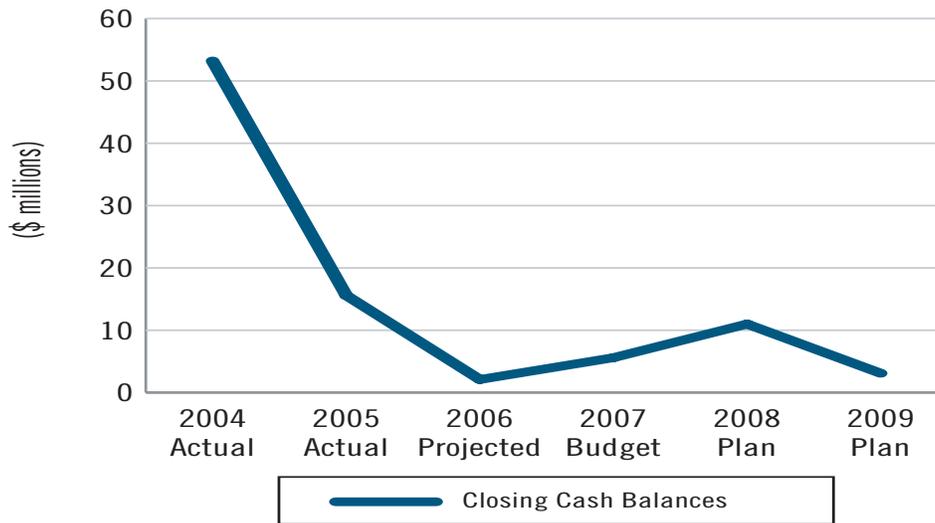


ing interest costs, which reduce over the planning period, are estimated as follows:

- \$6.9 million in 2007;
- \$6.6 million in 2008; and
- \$4.1 million in 2009.

Over the planning period, the IESO intends to maintain adequate cash balances, while still repaying debt as outlined above.

The following chart shows the planned closing cash balances from 2004 through 2009.



Investing this cash will result in investment income that will partially offset interest expense. The assumed average rates of return on investments are 4.5 per cent over the planning period. These rates are in comparison to a forecast rate of return on 2006 investments of 4.0 per cent.

In addition to cash and temporary investments, the IESO also holds long-term investments. These investments represent corporate assets that have been notionally put in place to discharge the liabilities associated with the Supplemental Employee Retirement Plan (SERP). The SERP represents the IESO's pension obligation that exceeds the component of individuals' benefits in excess of the limits outlined in the *Income Tax Act*. As the long-term investments relate to a long-term obligation, these assets are invested in a balanced portfolio of pooled funds. Consistent with Canadian GAAP, up until 2007, capital appreciation in the investment has not been recognized. Only distributions of earnings, which have not typically been large or frequent, have been recognized. A recent change in GAAP will require the IESO to recognize all gains/losses as they occur. This will impact investment income in two ways: in 2007, the life-to-date unrealized gains will be taken into income; and the IESO will include an assumed return on these assets in each year of the planning period. The one-time gain to be recognized is 2007 is budgeted at \$1.8 million. On an ongoing basis, the Business Plan will assume a return of 7.0 per cent on these assets – a rate of return consistent with management's assumed long-term rate of return of the registered pension plan assets. The ongoing forecasted income is \$0.9 million in 2007, \$1.1 million in 2008, and \$1.3 million in 2009.

The IESO maintains two separate lines of credit: \$60.0 million of corporate credit facility (use of which is described above) 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 \$0.3 million in each of the planning years.

For large and enduring projects, interest is capitalized on funds expended before the project is placed in-service. Over the planning period, this includes the DAM.

The resulting capitalized interest is:

- \$0.3 million in 2007; and
- \$0.3 million in 2008.

(\$ millions)	2004 Actual	2005 Actual	2006 Projected	2007 Budget	2008 Plan	2009 Plan
Interest Expense on Debt	10.1	9.1	7.8	6.9	6.6	4.1
Investment Income	(0.8)	(0.6)	(0.4)	(0.2)	(0.2)	(0.2)
Returns on Long-Term Investments	(0.3)	(0.6)	(0.5)	(2.7)	(1.1)	(1.3)
Financing Charges	0.5	0.2	0.2	0.2	0.2	0.2
Capitalized Interest	-	-	-	(0.3)	(0.3)	-
Net Interest Expense	9.5	7.6	7.1	3.9	5.2	2.8

The following table outlines net interest expense over the planning period:

COMPARISON WITH OTHERS

The IESO continues to want to learn from other jurisdictions. However, as was outlined in the 2006-2008 Business Plan, useful comparative information on other ISOs/RTOs has not been publicly available. With the passing of FERC Order 668, more useful financial information will become available from all FERC-registered ISOs/RTOs. As well, the IESO committed to the OEB in its 2006 rate application that it would make available the same information for the IESO. In August 2006, the IESO posted their second quarter 2006 actual costs consistent with the uniform system of accounts included in Order 668. As well, as part of a separate filing that will be included in the 2007 rate application, the IESO will include the comparative information for that same period for other jurisdictions.

The IESO is encouraged to see progress in this important area and plans to either undertake, or participate in, a comprehensive analysis of the full-year 2006 results that will become available in the first quarter of 2007. The effort to undertake this first review will be significant so the IESO has decided that there is very little benefit in performing analysis on the results/comparison of one fiscal quarter.

YEAR 2007 REGULATORY APPROVALS

This section details the calculation of the IESO usage fees for approvals from the OEB for the year 2007 are requested. Revenue sources, detailed rationale, derivation and amounts are listed.

Revenue Sources

There are several sources of revenue for 2007:

- Cost recovery for services;
- Interest earned on market settlement funds; and
- Revenue from IESO fees.

Cost Recovery for Services

The IESO will continue in its plan to recover the cost of services that are directly attributed to a participant, such as training, assessments, and services to the OPA on a cost recovery basis. The estimated total revenues from cost recovery in 2007 are \$2.0 million.

Interest Earned on Market Settlement Funds

According to the market rules, at the end of each year, monies which have been earned from interest on market settlement funds are applied to offset the IESO administration charge in the following year. The projected market-related interest income is \$4.6 million for 2007.

Revenue from IESO Fees

The OEB approved the fee methodology in 2000. The 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 2007.

Usage Fee

This section derives the fee for the year 2007 for approval by the OEB, and provides a projection for 2008 and 2009.

The first step is to calculate the revenues required.

Revenue Requirement Calculation for IESO Usage Fee			
(\$ millions)	2007	2008	2009
Revenue Requirements	140.0	137.2	130.3
Less: Other Revenues			
Cost recovery for services	2.0	2.0	2.0
Interest earned on market funds	4.6	4.8	4.4
Revenue Requirement to be recovered by IESO Usage Fee	133.4	130.4	123.9

The second step is to estimate the charge determinant for the usage fee. The charge determinant is the total Allocated Quantity of Energy Withdrawn (AQEW) for the year, in addition to exports out of Ontario.

Year	18-Month & 10-Year Outlook Demand Forecast (TWh)	-	Transmission Line Losses (TWh)	+	Exports (TWh)	=	Market Demand (TWh)
2007	158.1	-	4.7	+	10.2	=	163.6
2008	160.0	-	4.8	+	10.0	=	165.2
2009	161.0	-	4.8	+	10.1	=	166.3

The third step is the rate calculation:

Year	Revenue Requirement To Be Recovered (\$ millions)	÷	Market Demand (TWh)	=	Usage Fee (\$/MWh)
2007	133.4	÷	163.6	=	0.815
2008	130.4	÷	165.2	=	0.790
2009	123.9	÷	166.3	=	0.745

Implementation of 2007 Usage Fee

Pending approval by the OEB for the 2007 usage fee, the 2006 usage fee will continue to be charged to market participants. Once the OEB approves the fee, rebates to market participants will be made for the difference between the old and new usage fee based on the AQEW for the period January 1, 2007 and the end of the month in which the OEB approves the fee. The rebate will be redirected to market participants in the next billing cycle following the month in which the OEB approves the fee.

Disposition of Deferral Account Balance Surplus

Based on the settlement agreement accepted by the OEB on March 18, 2005, any surplus held at the end of a year in excess of \$5.0 million is returned to the market participants in the form of a rebate in the following year. The rebate is based on the market participant AQEW during the prior year.

Overall, the 2006 projected operating results would result in an accumulated operating surplus of \$16.9 million by year-end. This is determined by adding last year's actual accumulated surplus of \$5.0 million to this year's projected surplus of \$11.9 million. The result is an estimated rebate of approximately \$11.9 million.

The final amount to be rebated will be based on the audited financial statements for the fiscal year 2006 and the refund will be rebated to market participants in the next billing cycle following the month in which the IESO Board approves the 2006 financial statements.

APPENDIX 1: FINANCIAL STATEMENTS

Actual and Pro Forma Statement of Operations and Accumulated Surplus

For the Year Ended December 31

(in Millions of Canadian Dollars)

	2004 Actual	2005 Actual	2006 Projected	2007 Budget	2008 Plan	2009 Plan
REVENUES						
Usage Fees	152.4	156.9	146.8	133.4	130.4	123.9
Market-Related Interest Income	2.5	3.5	4.6	4.6	4.8	4.4
Cost Recovery for Services	0.9	0.9	1.7	2.0	2.0	2.0
Total Revenues	155.8	161.3	153.1	140.0	137.2	130.3
EXPENSES						
OM&A Program Costs	81.4	83.3	84.8	89.4	90.5	92.7
OM&A Pension Expense	7.4	8.3	17.4	13.8	11.9	10.5
Amortization	52.0	47.4	31.9	32.9	29.6	24.3
Net interest	9.5	7.6	7.1	3.9	5.2	2.8
Total Expenses	150.3	146.6	141.2	140.0	137.2	130.3
Operating Surplus/(Deficit)	5.5	14.7	11.9	-	-	-
Transfer to Ontario Power Authority	-	(15.0)	-	-	-	-
Rebates to Market Participants	-	(13.6)	(11.9)	-	-	-
Accumulated Operating Surplus - End of Year	18.9	5.0	5.0	5.0	5.0	5.0
Market-Related Penalties & Fines	0.3	0.5	0.6	-	-	-
Customer Education Fund Expenditures	(0.1)	(0.4)	(0.2)	(1.1)	-	-
Accumulated Fines and Penalties - End of Year	2.4	2.5	2.9	1.8	1.8	1.8

Actual and Pro Forma Statements of Financial Position

As at December 31

(in Millions of Canadian Dollars)

	2004 Actual	2005 Actual	2006 Projected	2007 Budget	2008 Plan	2009 Plan
ASSETS						
Current Assets						
Cash & Cash Equivalents	7.3	9.6	2.1	5.6	11.0	3.1
Temporary Investments	45.9	6.0	-	-	-	-
Accounts Receivable	18.3	19.9	20.2	19.0	19.0	19.0
Short-Term Prepaid Expenses	1.9	2.7	2.4	2.4	2.3	3.0
	73.4	38.2	24.7	27.0	32.3	25.1
Property & Equipment						
Property & Equipment In-Service	327.3	335.3	351.0	369.9	395.0	408.3
Less: Accumulated Amortization	<u>(160.1)</u>	<u>(207.4)</u>	<u>(239.3)</u>	<u>(272.2)</u>	<u>(301.8)</u>	<u>(326.1)</u>
Net Book Value	167.2	127.9	111.7	97.7	93.2	82.2
Construction-In-Progress	2.0	4.0	9.3	10.4	5.3	8.0
	169.2	131.9	121.0	108.1	98.5	90.2
Other Assets						
Long-Term Investments	8.0	9.9	11.8	15.5	18.0	20.7
Prepaid Pension Expense	22.1	21.9	11.7	6.0	2.5	0.9
Deferred Charges - Smart Meters	-	-	0.7	-	-	-
	30.1	31.8	24.2	21.5	20.5	21.6
TOTAL ASSETS	272.7	201.9	169.9	156.6	151.3	136.9
LIABILITIES						
Current Liabilities						
Accounts Payable & Accrued Liabilities	17.9	19.9	19.0	19.0	19.0	19.0
Accrued Interest	1.7	1.0	1.0	1.0	1.0	-
Current Portion of Long-Term Debt	-	-	15.0	10.0	-	60.0
Rebates to Market Participants	-	13.6	11.9	-	-	-
	19.6	34.5	46.9	30.0	20.0	79.0
Long-Term debt	203.2	128.2	78.2	78.2	78.2	-
Accrual for Employee Future Benefits other than Pension	28.6	31.7	36.9	41.6	46.3	51.1
TOTAL LIABILITIES	251.4	194.4	162.0	149.8	144.5	130.1
ACCUMULATED SURPLUS						
Accumulated Fines and Penalties	2.4	2.5	2.9	1.8	1.8	1.8
TOTAL LIABILITIES & ACCUMULATED SURPLUS	272.7	201.9	169.9	156.6	151.3	136.9

Actual and Pro Forma Statement of Cash Flows

For the Year Ended December 31

(in Millions of Canadian Dollars)

	2004 Actual	2005 Actual	2006 Projected	2007 Budget	2008 Plan	2009 Plan
OPERATING ACTIVITIES						
Operating Surplus/(Deficit) for the Period	5.5	1.0	-	-	-	-
Market Participant Rebate	-	13.6	(1.7)	(11.9)	-	-
Market Penalties and Fines	0.3	0.5	0.6	-	-	-
Customer Education Fund Expenditures	(0.1)	(0.4)	(0.2)	(1.1)	-	-
Amortization	52.0	47.4	31.9	32.9	29.6	24.3
Decrease in Prepaid Pension Expense	7.5	8.4	17.8	14.2	12.3	10.7
Increase in Accrual for Employee Future Benefits	4.0	4.5	6.4	6.0	6.1	6.3
Pension Plan Contributions	(5.0)	(8.2)	(7.6)	(8.5)	(8.8)	(9.1)
Payment of Employee Future Benefits	(1.1)	(1.3)	(1.2)	(1.3)	(1.4)	(1.5)
Changes in Non-cash Items Related to Operations	0.9	(2.1)	(0.9)	1.2	0.1	(1.7)
Cash Provided from Operations	64.0	63.4	45.1	31.5	37.9	29.0
INVESTING ACTIVITIES						
Net Sale (Purchase) of Temporary Investments	(33.4)	39.9	6.0	-	-	-
Purchase of Long-Term Investments	(1.5)	(1.9)	(1.9)	(3.7)	(2.5)	(2.7)
Investment in Property & Equipment	(8.7)	(9.1)	(21.0)	(20.0)	(20.0)	(16.0)
Investment in Deferred Charges - Smart Meters	-	-	(0.7)	0.7	-	-
Cash Used in Investing Activities	(43.6)	28.9	(17.6)	(23.0)	(22.5)	(18.7)
FINANCING ACTIVITIES						
Retirement of Debt	(50.0)	(75.0)	(35.0)	(5.0)	(10.0)	(18.2)
Draw on Contribution to the OPA	-	(15.0)	-	-	-	-
Cash Provided from Financing Activities	(50.0)	(90.0)	(35.0)	(5.0)	(10.0)	(18.2)
Net Change in Cash Flow	(29.6)	2.3	(7.5)	3.5	5.4	(7.9)
Cash and Cash Equivalents - Beginning of Year	36.9	7.3	9.6	2.1	5.6	11.0
Cash and Cash Equivalents - End of Year	7.3	9.6	2.1	5.6	11.0	3.1

APPENDIX 2: OM&A - BUSINESS UNIT DETAILS

(\$ millions)	2005 Actual ¹¹	2006 Projected	2007 Budget	2008 Plan	2009 Plan
Information Technology & Infrastructure	32.0	32.1	34.6	34.8	35.7
Market & System Operations ¹²	26.8	30.1	31.6	31.9	32.9
Corporate Relations & Market Development	6.8	8.1	9.3	9.4	9.5
Corporate Services	7.5	8.4	8.5	8.6	8.8
Chief Executive Officer	2.8	3.2	3.6	3.7	3.9
Human Resources	2.5	2.8	2.8	2.8	2.9
Market Assessment & Compliance	2.2	2.4	2.4	2.4	2.5
Board of Directors	0.6	1.1	0.9	0.9	0.9
Market Evolution Program	2.7	-	-	-	-
Corporate Items	7.7	14.0	9.5	7.9	6.1
Total OM&A	91.6	102.2	103.2	102.4	103.2
Less: Pension Expense	8.3	17.4	13.8	11.9	10.5
OM&A Program Costs	83.3	84.8	89.4	90.5	92.7

Due to the corporate realignment in 2005, reliable comparative figures are unavailable for 2004.

¹¹ The pension burdens charged to business units as a component of labour costs only include current service costs - this burden rate increased from 12.5 per cent in 2005 to 20.0 per cent in 2006.

¹² Market & System Operations includes Reliability Assurance, formerly a separate business unit within the IESO. Reliability Assurance was consolidated into Market & System Operations in October 2006.

APPENDIX 3: CAPITAL PROJECTS

Key Corporate Capital Projects (in \$ millions)

Project Name	Project Description	2006 Projected	2007 Budget	2008 Plan	2009 Plan	2007-2009 Total
Day-Ahead Market	As described in the Business Plan.		8.0	8.0		16.0
Windows Refresh Program (Stages 4 & 5)	Stage 4: Migrate those Business Applications deemed critical from a reliability, capacity or performance perspective to the new MS Windows Server 2003 infrastructure. Stage 5: Complete the replacement of aging IESO Windows server infrastructure (Hardware & Software), by migrating remaining Business Applications to the new core MS Windows Server 2003 infrastructure.	1.0	2.5	0.8		3.3
Energy Management System/Market Information System Upgrade	Upgrade the EMS/MIS which monitors and facilitates the reliability of the IESO controlled grid, and supports market operations. The upgrade will extend the life of the current systems from 2008 to 2011, maintain system performance, improve functionality of tools, better integrate EMS/MIS user interfaces with other IESO interfaces, and reduce costs related to IESO user workstation and server maintenance and support, that would otherwise increase beyond economic levels.	3.4	3.2			3.2
UNIX Server Infrastructure Refresh	Replace aging UNIX server infrastructure on an on-going basis, which no longer has vendor support, in order to reduce support and maintenance costs, reduce hardware purchase costs, and provide better availability. Examples of benefits include: reduced support calls due to hardware failures; increased reliability with newer more stable systems; reducing licensing costs; server consolidation and reducing the server count.	2.2	1.5	0.5		2.0
Back-Up Operating Centre Relocation and Configuration	Relocate the IESO's back-up control centre to a more secure location, to address current and assessed future security environment status.	1.2	1.3			1.3
Facility Outage Management System	Provide an automated and integrated real-time tool to deliver significantly improved outage management services. Currently two separate applications: Integrated Outage Management System (IOMS) and Outage Scheduler (OS), provide outage management services for submitting, modifying and viewing outage information. A single automated and integrated application will improve data validation, on-line viewing of outage information, improve planning capability, and reduced process inefficiencies. It will also provide IESO staff with additional capability to perform performance tracking, and will reduce internal process inefficiencies. The project would result in IESO being able to determine security limits with greater accuracy, thereby positively impacting on the efficiency and security of the IESO-controlled grid.	1.1	0.3			0.3

Project Name	Project Description	2006 Projected
Customer Information System	Deliver a Customer Information System that would facilitate high quality customer support by tracking customer contacts, characteristics, issues and activities in an integrated fashion throughout the IESO. It would also provide significantly enhanced reporting capabilities.	
TOTAL - KEY CORPORATE PROJECTS		8.9
TOTAL - OTHER IESO CAPITAL PROJECTS See Other IESO Capital Projects table.		12.1
TOTAL - CAPITAL PROJECTS		21.0

2007 Budget	2008 Plan	2009 Plan	2007-2009 Total
	0.3		0.3
16.8	9.6	0.0	26.4
3.2	10.4	16.0	29.6
20.0	20.0	16.0	56.0

Other IESO Capital Projects (in \$ millions)

Note: All IESO Other Capital Projects will be prioritized with stakeholders, as appropriate, and implemented on an ongoing basis, while respecting the annual Total - Capital Projects capital funding envelopes. Project spending identified in 2006 does not reflect prior year costs that may have been incurred on some projects.

Project Name	Project Description	2006 Projected	2007- 2009 Total
APPLICATIONS			
Market Enhancement Project - Day Ahead Commitment	This project addresses reliability challenges such as import failures and supply issues, allows more accurate forecasting and managing of energy and capacity a day before real time dispatch, and minimizes out of market actions.	2.70	
Central Alarm Management	Comprehensive improvements to system alarms related to IESO's operations to provide integrated management and prioritization of alarms addressing: Electrical Systems and Grid; Market Conditions and Events, and IT Systems in order to: reduce the frequency of failed IESO services; decrease the duration of failed IESO services; and help IESO meet its corporate objectives.	1.00	
Market Participant Interface Modernization	Provide market participants with greater convenience in connecting to IESO systems, improved security management and reduced costs of maintenance to the IESO. Other objectives are to reduce IESO maintenance costs, and enforce standards in the deployment of market facing applications such as the Day Ahead Market, Facility Outage Management System, Real Time Web Interface - Phase 4, Message Exchange, Report Navigation Interfaces and new workflow applications.	0.45	
Security Software Enhancements	Enhance and reinforce the IESO's current cyber security architecture and contribute toward ensuring compliance with evolving Audit, NERC and Access Control standards and contribute to maintaining IESO's cyber security posture at a level consistent with those evolving threats and security practices elsewhere. Deliverables include: External Firewall re-configuration; Improved Anti-Virus protection; Improved Intrusion Detection Software / Intrusion Protection Software; Improved SPAM control; Additional firewall hardware and software to improve internal electronic access controls; Improved administration of the Content Management Software and; Authentication Software.	0.20	
Real Time Web Interface - Stage 4	Deliver technology upgrades necessary to deploy a single version of the real time web interface, which will improve the efficiency and reduce costs associated with currently identified technological and functional deficiencies. This project would also facilitate development of a fee-based user-friendly market tools kit for market participants.	0.20	

Project Name	Project Description	2006 Projected	2007-2009 Total
NERC Cyber Security	Satisfy the requirements of recent NERC Standards CIP-002 through CIP-009 by improving Authentication software and associated hardware to integrate logical and physical access controls; Hardware/software for centralized logging; Hardware/software to capture network traffic; Hardware/software for forensic analysis and detection; Software used to monitor compliance with security related policies and procedures; Security awareness training software and an associated delivery vehicle.	0.12	
Server Management Software	Acquire software to facilitate increased monitoring of server activity within the IESO, for reliability purposes.	0.04	
Human Resources Information System Upgrade	Upgrade the IESO's corporate human resources information system (HRIS) for time and exception reporting and for payroll processing and maintenance of employee related information. The current system was commissioned in 1999 and no system upgrades have been performed since that time. The new products will provide an efficient Employee Self Service capability which will permit employees to report their time directly without the need for manual entry by a time reporting clerk.	0.02	
Application Changes / Vendor Change Requests	A funding envelope, to facilitate minor changes to IESO applications. Allocation of these funds is managed by a cross-functional IESO team, the IT User Committee, comprised of representatives of all business units.	0.40	3.0
Interconnect Metering	Upgrade or purchase metering on certain intertie connections with another ISO jurisdiction. This is required to satisfy operational obligations.		1.1
On-Line Limit Derivation	Currently much of the limit derivation in the IESO is performed manually both on and off shift. This project would acquire or develop the tools to facilitate on-line limit derivation in both the on-shift and back office environments. The new systems would be fully integrated into the existing suite of tools.		1.0
Meter Data Repository	Acquire and implement an application that will replace MVStar.		1.0
Real-Time Commercial Reconciliation System Upgrade	This project is being undertaken to upgrade the Commercial Reconciliation System and its' Graphical User Interface (GUI) from the current version used in support of the real time electricity market. It will put the settlement process on an up-to-date technology platform that is supported by the vendors and will meet the needs of the settlement process while resulting in reduced support costs and ensuring continued compatibility of this system with infrastructure, operating system, and database technology.		1.0
Configuration Management System	This project will introduce a Configuration Management system and respective processes.		1.0

Project Name	Project Description	2006 Projected	2007-2009 Total
Meter Trouble Report and Notice of Disagreement Upgrade	Place the Meter Service Provider/Market Participant facing Meter Trouble Reporting and Notice of Disagreement workflow systems on a current platform and technology with applications supported by the vendor of choice. This is a lifecycle driven upgrade, which includes functionality driven upgrades and improvements.		0.8
Security Application Testing Automation	This project will introduce a method of performing security checks on Web based applications.		0.5
Apropos System Upgrade/Replacement	This project will extend or replace the Apropos customer support solutions, as they will have been in service for 5 years and are in need of improvements.		0.5
Other Minor IT Applications Projects			4.4
TOTAL APPLICATIONS		5.1	14.3
IT - INFRASTRUCTURE			
Windows Server Infrastructure Replacement Stage 2 & 3	Replace aging Windows server infrastructure (Hardware & Software), much of which no longer has Vendor support, in order to reduce associated business risk (security, reliability) and operational costs (parts, support & maintenance). This core infrastructure project will lay the foundation for reduced operational costs, reduce the high number of Windows servers, simplify the environment, increase E-Mail reliability and address security concerns. Phase 2 will facilitate the replacement of the current E-Mail system, the selection of a new server hardware vendor and the building of a new core MS Windows Server 2003 infrastructure. This creates the foundational architecture that is essential for the subsequent migration of IESO's corporate business applications in WSIR Stages 3, 4 and 5. Phase 3 will facilitate the deployment of the new E-Mail system, core Windows infrastructure and the migration of 30 business critical servers.	2.00	
Backup Infrastructure Enhancements	Improve performance and capacity of the Corporate Tape Backup system, which is currently reaching full capacity.	1.30	
Telecom Expansion Program	Upgrade and refresh technology to ensure the continued reliability, security and scalability of the IESO's voice systems expansion and address recommendations made following the August 2003 Blackout. This project will facilitate more efficient call accounting and call reporting, a reliable secondary means of communication with critical market participants as outlined in the Market Rules, a refresh / replacement of the operations voice recording system, and expand the capacity of the operational inbound call management system, allowing the handling and prioritization of a larger volume of inbound calls specifically in emergency situations.	0.63	

Project Name	Project Description	2006 Projected	2007-2009 Total
Cisco Network Gear	Exercise option to buy out end-of-lease equipment.	0.30	
Increased Disk Storage	An annual program to address planned and needed increases in storage capacity requirements.	0.30	
Remote Access Projects	Improve the security of remote access for vendors and staff and establish the security architecture required to permit larger volumes of remote access traffic. This will reduce operational exposure that can result in outages to market or energy systems by improving the IESO's ability to manage the risks associated with contingencies that would make on-site operation difficult or impossible.	0.20	
Printer Consolidation	Replace end-of-life printing, copying, faxing and scanner equipment, and reduce the number and variety of printers, copiers, faxes and scanners leased or owned by the IESO; reducing operational and support costs associated with this equipment.	0.04	
Network DMZ Redundancy	Replace problematic lower-cost hubs with established vendor switches to improve both the future availability and reliability of the network gateway for all Internet based access to and from the IESO. In addition, resolve the emerging cross-site congestion situation due to inadequate bandwidth.	0.04	
Network Infrastructure Replacements	Replace network load balancers which are no longer supported by the vendor and are creating an increasing risk to on-going reliability of market operations. Replacement system will improve capacity, functionality and vendor support.	0.01	
Pre-Production Environment	Improvement to and consolidation of the quality assurance/pre-production environment that will enable better simulation of the IESO's production environment. This will enable improved quality and reliability assurances from implementation testing, which occurs prior to introducing systems into a full production environment.		2.0
EMC Storage Addition	Add 2 new Tier 1 Storage arrays for additional capacity and scalability		2.0
Network Equipment Replacement	Replace the existing CISCO Network Gear which has a technological life cycle end of life in 2008. This equipment serves as the technical infrastructure that facilitates the connection between corporate business applications.		1.5
Desktop Hardware Refresh	Provision for the refresh of personal computers used by IESO staff, based on lifecycle planning.		1.0

Project Name	Project Description	2006 Projected	2007-2009 Total
System Data Repository Constellation	Reconfigure the data warehouse (constellation style) database design, enabling improvements in handling the large and increasing data volumes, which are utilized in supporting market analysis and satisfying reporting obligations. Current capabilities of the System Data Repository of market activity data requires modifications and upgrades to handle increasing data volumes, and facilitate faster and more effective data retrieval and analysis in support of surveillance and compliance activities.		0.8
Frame Relay Upgrades	Replace/Upgrade the Frame Relay Access Devices (FRADS) at the control centre and backup centre, which are at end of life and at maximum capacity.		0.5
Systems Management Rationalization	This project will rationalize all the systems management tools into a common infrastructure		0.5
Other Minor IT Infrastructure Projects			3.0
TOTAL IT - INFRASTRUCTURE		4.8	11.3
IESO FACILITY IMPROVEMENTS		1.9	0.7
OTHER UNPLANNED PROJECTS AND CONTINGENCY		0.3	3.3
TOTAL - OTHER IESO CAPITAL PROJECTS		12.1	29.6

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