

THE IESO's COMPENSATION PROGRAMS

1.0 Compensation Programs

The structure of the IESO's compensation program is designed to align with and support its business objectives. For the current planning period these objectives are set out in the 2007- 2009 Business Plan.

The objectives of the IESO's compensation program are:

- Focusing employees' efforts on meeting the IESO's business priorities
- Attracting and retaining qualified and motivated employees
- Motivating staff to achieve goals important to IESO and adapting/enhancing their capabilities to a changing workplace
- Signalling direction changes important to the IESO

The IESO's aim is to manage its compensation programs in a financially responsible manner taking into account the costs of the programs, external market relativities and, internal relativities of compensation consistent with meeting the above objectives.

The IESO's compensation programs are categorized into three groups: (i) Management Compensation Programs; (ii) Society of Energy Professionals Compensation Programs; and (iii) Power Workers Union Compensation Programs. The compensation programs are regularly reviewed with senior management and the IESO Board of Directors (the Board) to ensure they accord with the foregoing objectives. These programs are further scrutinized when a new collective agreement is required i.e. when changes to the PWU and Society compensation programs are negotiated and implemented through the collective bargaining process. As 2006 is a bargaining year for both the PWU and the Society, extensive reviews were undertaken.

This year the Board conducted an extensive review of the IESO's Management Group compensation program. This included a review of the components of the program, market comparators, market relativities for fixed compensation, total cash compensation (fixed compensation plus variable compensation) and total remuneration (total cash compensation plus benefits & pension) as well as internal relativities, and the IESO's approach to target setting.

The results of these reviews reaffirmed the IESO's compensation program objectives as appropriate for meeting the IESO's business needs. Also, as a result of these reviews, adjustments were made to the Management Compensation

Programs and to the PWU Compensation Programs to better align these programs with a dynamic external environment. The specific changes are outlined in the subsequent sections entitled PWU Compensation Program and Management Group Compensation Program.

PWU Compensation Program

This program covers fifty-nine employees (as of mid September, 2006) of whom fifty-six are regular employees and three are temporary. The positions in this group include PWU represented administrative support, technical and trade staff as well as co-op students.

Currently PWU represented employees are in the first year of a three year collective agreement which began on April 1, 2006 and expires on March 31, 2009. Under this agreement base salaries increased by 3% in 2006 and will increase by 3% in 2007, and in 2008 with no provisions for COLA adjustments over the duration of the agreement. These salary adjustments are consistent with industry trends.

In addition, the PWU staff are covered by an incentive plan linking payments with the achievement of corporate performance measures established through the IESO's business planning process and group or individual performance measures established between the group/individual and their Manager.

Within the scope of the latest settlement a variety of benefit adjustments were negotiated including some additions and some reductions/limitations, for example limitations on eligibility for post retirement benefits and on dental benefits. In addition an increase in employee pension contributions was negotiated for PWU represented employees. As well provisions for discussions between the IESO and PWU relating to a defined contribution program were included.

The Society Compensation Program

The current Society collective agreement expires on December 31, 2006. It covers two hundred and ninety-eight employees (as of mid September, 2006) of whom two hundred and seventy-five are regular employees and twenty-three are temporary. The positions in this group include professional and supervisory staff in engineering, information technology, finance and other disciplines.

The Honourable George Adams, as a result of an arbitration process, imposed the current contract on the IESO and the Society. The arbitration award provided for increases of 3.0% to base salary schedules in 2004, 2005 and 2006 respectively. The

IESO, through this award, was successful in receiving cost containment enhancements relating to benefit provisions and enhanced flexibility associated with hiring temporary staff while the Society received limited increases relating to benefits, pensions and shift considerations. Cost containment relating to benefit provisions is important as health care costs in the industry generally, including the IESO, have been increasing at rates significantly above inflation. The salary adjustments outlined above were consistent with industry trends for professional staff over that period.

In addition to negotiated or arbitrated increases to salary schedules, Society represented staff may also have their base salary adjusted as a result of a Performance Pay Plan. Under this Plan, employee performance is assessed annually resulting in recommended adjustments of individual performance pay standings (between 80% to 115% of the journey person rate). The aggregate of individual compensation recommendations under this plan is a minimum of 1% of payroll for Society represented staff in each year.

The Management Group Compensation Program

The IESO has an integrated compensation program, which applies to all management (non-represented) staff of which there are eighty-one (as of mid September, 2006) with seventy-nine regular and two temporary employees. The type of positions in this group include thirty-nine senior management (President, Vice Presidents, Directors and Managers), and forty-two non-represented supervisory, professional and administration support staff.

The Management Group Program includes a fixed compensation plan providing a framework for compensating staff based on internal relativity, external competitiveness and the competency level that each staff member demonstrates in their ongoing work. The Management Group program also includes a variable pay plan predicated on the achievement of both corporate and individual performance results. Target award levels are differentiated by job level commensurate with industry levels.

As indicated above, the Management Group Compensation Program recently underwent a thorough review by the IESO Board. This review included a survey of compensation levels for 2006 conducted by Towers Perrin. The results of the survey (as outlined in section 3 below, "Industry Comparisons") indicated that the IESO's compensation levels are still considered to be within the competitive range for this group, i.e. between the median and 75th percentile of the market. The IESO Board, as a result of their deliberations, approved the continuation of the program design but with some adjustments. In continuing its prudent approach to

compensation for 2007 the Board approved below market average fixed compensation adjustments of 2.5% for staff (while only increasing fixed band ranges by 2%), a reduction in some health and dental coverage, and a significant increase in employee pension contributions. The IESO also introduced reduced pension benefits for future hires who take a position in the Management Group. The latter change was introduced in order to help address rising cost pressures associated with future pension obligations while maintaining a competitive plan to attract future talent.

2.0 Compensation Undertakings from 2007 Fee Submission Review

Review of Target Setting

As outlined within Appendix D to the OEB Board Order of February 14, 2006 relating to the IESO's rate submission.

“The parties have agreed that the IESO, as part of its 2007 Fees Case Filing, will provide its views on whether or not it is appropriate to set targets for the IESO's compensation levels on a quartile or some other basis”.

The IESO will continue to gather market data and utilize median compensation levels as a guide in making compensation decisions. This information will be used in conjunction with other relevant factors and conditions such as the demands for skills in the marketplace, internal relativities, the various collective bargaining needs, arbitrators' decisions, pressures emanating from other ISO's and industry employers. This approach is consistent with industry practice in which percentile compensation levels are used as a guide in assessing appropriate compensation levels for specific organizations.

Pension Study

In the Decision and Order issued by the OEB concerning the IESO's rates for 2006 there were statements relating to some intervenors concerns regarding the IESO's pension costs. As a result there was an undertaking by the IESO to make these concerns known to the IESO's Board as well as the desire of some intervenors to carry out a study relating to both defined benefit and defined contribution pension programs. The rise in pension expense over the recent years provided the impetus for this concern. Pension valuations and funding under current accounting rules are sensitive to short-term fluctuations in interest rates, other economic factors and demographic variables. As result of unfavourable conditions in these factors, especially low long-term interest rates, most defined benefit pension plans have experienced a significant swing towards increased liabilities over the last few years, including the IESO.

On June 7, 2006, these concerns were reported to the Human HRGC. The IESO Board and management pay close attention to such trends. They also pay close attention to the different approaches used in industry to accommodate employee pension requirements. They take a long term perspective of pension needs, their implications for IESO costs and cost volatility, and for implications on future resourcing needs. Possible changes in pension approaches imply long-term commitments for sponsors. There are a complex set of financial, legal, accounting, and administrative considerations when looking at such changes. Management and the Board utilize their assessments of current and expected economic climate, legal changes and potential demographic changes in deciding if alternative approaches to pension provisions are in the best interests of the IESO and its customers.

A significant consideration is that, under current legislation, the IESO is restricted in the application of changing pension provisions for existing members. Changes to pension strategies generally apply to future service only and in the case of unionized employees at the IESO any changes must be collectively bargained. Accordingly the benefits, if any, that may be associated with altering a pension approach will not become significant until years in the future whereas any costs, both administrative and additional short term pension costs of implementing such changes, will largely need to be absorbed immediately or over the next few years.

In making decisions concerning future pension approaches both Management and the Board must balance competing risks and business needs. They must balance the role of the plan in contributing to the IESO's total rewards strategy, with potential short and long term costs and benefits of the changes, and the financial risks associated with any pension provisions.

A well-defined governance framework has been put into place to guide the Board and management in its decision-making on pension issues. This governance framework is designed to ensure the security, stability and professional management of the IESO's pension requirements. Through this governance structure, programs have been put in place to ensure that pension objectives are carried out and that legislative requirements covering the IESO's pension plan are met. Management and the Board continually look into the future and evaluate whether pension-related objectives require refinements. This is a dynamic process. The objectives and supporting framework 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 continually reviewed through this process.

Given the rise in pension costs however management and the IESO Board have recognized the need to address this issue. Within the new collective agreement

with the PWU, there are provisions for increased pension contributions by employees. There are also provisions in the memorandum of agreement to have discussions with the PWU during the term of the agreement to jointly review a defined contribution pension plan option with a view to possible implementation at the IESO. As noted earlier, for Management Group staff, the IESO Board has approved increased contribution levels for existing members beginning in 2007 and the introduction of new, market related provisions for future Management Group staff (with lowered pension eligibility, indexation and other provisions).

Based on these considerations, at its June 7th meeting, the Committee noted that it is familiar with the characteristics of defined benefit and defined contribution plans, as well as their advantages and disadvantages and the labour relations context in which the IESO operates. As a result of these factors and the robust governance process in existence at the IESO the Committee felt that there was not a need to conduct such a study.

The Committee noted that Management is continually focused on the Corporation's costs generally and compensation programs in particular. On June 8, 2006, the HRGC reported the concerns of intervenors to the full Board of Directors of the IESO which did not authorize such a study.

3.0 Industry Comparisons

The IESO regularly commissions an external compensation consultant to conduct a competitive compensation review. For 2006 the IESO used the services of Towers Perrin to carry out this analysis.

Within Towers Perrin's analysis, three sets of comparator groups were used. While there is a considerable overlap of organizations within each of these sets, some differentiation exists. Each of these comparator groups was selected to better align with the characteristics of various staff groupings, i.e. to better align with the types of organizations with which the IESO would compete for attraction/retention of talent. Thus one comparator group was established as representative of IESO's senior management positions. A second comparator group was selected as representative of IESO's professional and supervisory positions, i.e.; IESO's Society-represented and Management Group professional/supervisory staff. A third comparator group of organizations was selected as representative of IESO's technical, administrator and trade positions, i.e.; PWU-represented and Management Group administrative positions. These organizations range in size, but have the type of talent which is comparable to the IESO's needs, and are regarded as having well-established and comprehensive compensation programs. A listing of the organizations is provided in Attachment A.

The IESO's compensation data for various levels was matched with comparable data from each of the comparator groups. Representative positions for each IESO level (salary band/grade) were selected and job matching to other firms was carried out through the use of Towers Perrin's methodology for aligning jobs of similar size and accountability. Through the use of position descriptions, jobs were matched to those at appropriate levels in the various organizations so that size and accountability were comparable without relying just on job titles. The compensation data for the IESO and the comparator community reflected values in place as of mid 2006. Data was gathered and compared for fixed compensation levels, total cash (fixed compensation plus variable compensation at target levels) and total compensation (including total cash as above, plus employer paid pension benefits and other benefits including savings plans). The above were compared using both actual data for fixed compensation as well as structure/policy (i.e.; midpoint or full journey person) data. The latter allows for a comparison of IESO to the market based on a salary structure perspective without the impact of the IESO's actual compensation paid.

Market Relativity Results

Based upon the analysis outlined above, as conducted by Towers Perrin, the following table summarizes the results when comparing IESO's salary structure position (or policy line – mid points or full journey person rates for each grade/band) to the market for various employee groupings.

Market Relativity Results for IESO Policy Line to Market

| | Fixed Compensation | | Total Cash ¹ | | Total Compensation ² | |
|--|--------------------------------|--------------------------------|--------------------------------|--------------------------------|---------------------------------|--------------------------------|
| | 50 th Percentile | 75 th Percentile | 50 th Percentile | 75 th Percentile | 50 th Percentile | 75 th Percentile |
| IESO Relativity for Mgmt. Grp. ³ | +1% | -7% | +8% | -6% | +9% | -6% |
| IESO Average Relativity for Society-Represented Positions ³ | +21% | +13% | +13% | +3% | +16% | +3% |
| IESO Average Relativity for PWU-Represented Positions ³ | +19% | +10% | +14% | +4% | +19% | +6% |
| IESO Average Relativity for Senior Mgmt. Positions (CEO, Vice President's, Directors) ^{3,4} | +1% | -7% | +6% | -8% | +6% | -8% |

¹ Total cash includes fixed compensation plus variable compensation at target.

² Total compensation includes cash compensation plus employer-paid pension and other benefits (including savings plans)...

³ This row identifies the average percent for each component of compensation above/below the 50th and 75th percentile of the market.

⁴ The average relativity for senior management is a subset of the data contained within the data for the Management Group above.

The table below provides a similar breakdown of the data when the actual compensation levels (for fixed compensation) are utilized rather than salary structure (or policy line) comparisons.

Market Relativity for IESO Actuals to Market

| | Fixed Compensation | | Total Cash ² | | Total Compensation ³ | |
|--|--------------------------------|--------------------------------|--------------------------------|--------------------------------|---------------------------------|--------------------------------|
| | 50 th Percentile | 75 th Percentile | 50 th Percentile | 75 th Percentile | 50 th Percentile | 75 th Percentile |
| IESO Relativity for Mgmt. Grp. ⁴ | +6% | -2% | +13% | -1% | +14% | -1% |
| IESO Average Relativity for Society-Represented Positions ⁴ | +22% | +13% | +13% | +3% | +17% | +4% |
| IESO Average Relativity for PWU-Represented Positions ⁴ | +18% | +9% | +13% | +3% | +19% | +6% |
| IESO Average Relativity for Senior Mgmt. Positions (CEO, Vice President's, Directors) ^{4,5} | +4% | -5% | +9% | -6% | +9% | -5% |

- ¹ Actual values for fixed compensation (with the exception of the CEO where mid point of the band was applied).
- ² Total cash includes actual fixed compensation plus variable compensation at target.
- ³ Total compensation includes cash compensation plus employer paid pension and other benefits (including savings plans).
- ⁴ This row identifies the average percentage for each component above or below the 50th and 75th percentile of the market.
- ⁵ The average relativity of senior management is a subset of the data contained within the data for the Management Group above.

Attachment A**Comparator Groups**

| Senior Management Comparators | Professional/Supervisory Comparators (Society & Mgmt. Group) | Technician, Trade, Administrative Comparators (PWU & Mgmt. Group) |
|--|--|---|
| Alberta Electric System Operator Alliance Pipeline ATCO Atomic Energy of Canada B.C. Hydro and Power Authority Bruce Power Duke Energy Can. (Gas Transm.) Emera Enbridge Inc. Enmax EPCOR Fortis Alberta Hydro One. Kinder Morgan (formerly Teresen) New Brunswick Power Ontario Energy Board Ontario Power Generation Inc. Powerex TransAlta Corp. TransCanada Pipelines | ABB Canada Alberta Electric System Operator Alliance Pipeline Atomic Energy of Canada B.C. Hydro and Power Authority Duke Energy Can (Gas Transm.) Emera Enbridge Gas Distribution. Enbridge Inc. Enmax. EPCOR Fortis Alberta Hydro One. Hydro-Quebec Kinder Morgan (formerly Teresen) Newfoundland & Labrador Hydro Ontario Power Generation Inc. Saskatchewan Power Siemens Canada SNC Lavalin. Syncrude Canada Ltd. Teresen Pipelines TransAlta Corp. TransCanada Pipelines TSX Group | Alberta Electric System Operator Alliance Pipeline Atomic Energy of Canada Bell Canada B.C. Hydro and Power Authority Duke Energy Can (Gas Transm.) Enbridge Gas Distribution Enbridge Inc. Enmax EPCOR Fortis Alberta Hydro One. Hydro-Quebec Kinder Morgan (formerly Teresen) Manitoba Hydro Newfoundland & Labrador Hydro Ontario Power Generation Inc. Ontario Securities Commission Praxair Canada Saskatchewan Power Teresen Pipelines TransAlta Corp. |