

The Role of the IESO In Today's Electricity Sector

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Thank you very much for that kind introduction. I am pleased to be here to talk about the Independent Electricity System Operator in the post Bill 100 environment. The conference brochure promises that you will hear from experts – but I'll share with you that a wise person once told me there were two things to remember about "experts":

- first, that X is an unknown quantity;
- and second, that spurt is a drip under pressure.

So, all I'll say is that over the next 30 minutes or so, I want to bring you up to date on how Bill 100 has affected us. More importantly, I want to look at some of the challenges that all of us in this sector face -- both short term and long term -- and outline the role the IESO has in addressing those challenges.

I also want to touch on a few issues that some market participants have raised with us over the past few weeks – namely market evolution and the treatment of the IESO's surplus fund – and give you our perspective.

Bill 100 has redefined the makeup of the electricity sector. The sector cannot be characterized as either pure market or regulated. Instead it is becoming a blend of healthy competition and regulation.

Through it all, the market price remains transparent and will incent the kind of behaviours that we were looking for when we opened the market almost three years ago.

Name Change

This conference comes at an opportune for many of us. With the ink on the Bill 100 legislation barely dry, it is valuable to hear how other electricity sector participants and stakeholders are dealing with the changes introduced in the legislation.

For us, the biggest change is demonstrated in my first overhead ... a change in our name to the Independent Electricity System Operator. This name change reflects our "prime directive" – to ensure the security and reliability of Ontario's power system.

We've responded by revising our organization's vision statement to reflect these same priorities. Our new vision reads:

"To uphold the trust placed in us by developing innovative, efficient and effective solutions that deliver a reliable supply of electricity to Ontarians today and for the future."

The new vision statement reinforces that, more than ever, we need to be sure we are helping customers take advantage of the market – and we need to maintain our core reliability performance. And we are determined to uphold the full trust and perception of value with our customers.

Both our roles – as market and system operator - will continue under our new name and we will continue to manage the delivery of electricity throughout Ontario, when and where it's needed.

Our people are proud of the excellent reputation they've earned – both at home and abroad -- for the way that we meet our responsibilities as Ontario's reliability authority. Having the additional responsibility as Market Operator also enhances reliability for the province.

Our independence as between and from market participants will carry on under Bill 100. In fact, that independence is enhanced through some of the governance changes in the Bill. Previously, our Board of Directors comprised both independent and stakeholder representatives. Now, our Board will be made up 10 Independent Directors, in addition to our CEO.

Our challenge is to make sure that stakeholder concerns are properly represented at the Board level. To address this, we are in process of undertaking a comprehensive review of our consultation and stakeholdering efforts.

As part of this review, we will be assessing the way the IESO solicits, interprets and acts on stakeholder feedback and how that stakeholder opinion can be best considered in the Board's decision making process. I have no doubt that the mechanisms for achieving meaningful stakeholder advice will be given early attention by our new Board.

Ontario Power Authority

Of course, one of the most notable changes as a result of Bill 100 has been the creation of the Ontario Power Authority.

We're delighted that Jan Carr has been appointed the first CEO of the OPA. A leader in the electricity sector reform in Ontario and in the development of the competitive wholesale electricity market, Jan's experience and expertise will be invaluable as the OPA takes up its mandate.

Jan may be feeling like the loneliest man in the world at the moment. As the sole employee of the OPA, Jan is working on staffing the organization and getting on with delivering its accountabilities ... including the development of an integrated system plan, factoring in generation, transmission and conservation to meet future electricity needs in the province.

And while Jan cannot stay the OPA's only employee for too long, he also has to be mindful of the need for efficiency and effectiveness ... two words that have become priorities for all of us in this sector. While the IESO has eased some of the funding issues for the OPA in the short term – and I will touch on this in a moment – there will be pressures on the OPA to keep its costs down. That's where I believe we can help.

In many ways, the OPA and the IESO will be closely linked.

Going forward, as I mentioned earlier, the IESO will continue to retain virtually all of our core operations including real-time operations, operational planning, post-event analysis, connection assessments ... to name a few. And we will continue to be responsible for shorter-term forecasting. The responsibilities for longer term forecasting and long-term system adequacy will rest with the OPA.

These two responsibilities overlap and close coordination will be necessary between the two organizations. Given the need to minimize costs and the desire to limit the size of the OPA, there may be an opportunity for the IESO to provide services to the OPA in the areas where we have expertise. This can contribute to the effectiveness of the new structure, limit the need for new resources, and keep overall costs in check.

There is one other change with respect to Bill 100 that will affect us. The three-member Market Surveillance Panel now reports to the OEB rather than the IESO's Board of Directors. We are developing arrangements with the OEB to have our Market Assessment and Compliance Unit continue providing support to the MSP, while at the same time continuing their support of the IESO's daily review of market operations and their compliance role. These arrangement would serve all three entities well ... the OEB, the IESO and the MSP ... while furthering the objective of providing fair and comprehensive oversight of the wholesale market.

Market Evolution

Let me now turn to several issues that have been on the minds of some stakeholders recently starting with the status of the Day-Ahead Market project.

First a little bit of history.

Back in 2002, with our real-time spot market just opened, the IESO formed the Market Evolution Program to address the continued evolution of the market.

The market worked as it should have during that hot summer of 2002, bringing power in from other jurisdictions to offset the shortage of Ontario based generation. In addition, market signals prompted large customers to shift some of their load to off-peak lower-priced periods.

But that first summer of operation made it abundantly clear to us that the market would need to evolve further to provide a greater level of price stability and supply security.

We were confident that continued evolution could result in a number of benefits including:

- Providing greater operational and price certainty ahead of real-time operations for suppliers and consumers
- Increasing load participation and promoting greater resource adequacy in the IMO-administered markets through demand-side response
- Facilitating reliable power system operations.

And we still are confident that these benefits can be realized.

But with the introduction of Bill 100, market participants and other stakeholders began to look at the implications that legislation and question the timing of the introduction of a full-function DAM.

Stakeholders preferred to wait and see how the new hybrid market settled down before moving ahead.

Last month, our Board of Directors decided that rather than continuing to proceed to development and acquisition based on the current proposed DAM design, we should consider whether any alternative approaches were likely to provide more cost-effective solutions in the post Bill 100 world.

Consequently, we will be updating our review of alternative designs for addressing the key issues that drove the comprehensive DAM design.

This review will take into account the impact of government policy and legislative changes associated with the passage of Bill 100, from the perspectives of both the IESO and market participants.

Stakeholder input remains an essential part of continued market evolution and as I mentioned, the IESO is revisiting the process for stakeholder input to ensure that stakeholders have an effective and efficient way to participate.

The estimated costs and benefits of the various alternatives will be developed as part of this review and be included in a future report to the Board.

Need to Resolve the Issues

But while we go through this exercise, it's important to note that the issues that a DAM would address still remain, as does the need for timely solutions.

And while we strongly encourage the development of demand-side measures and the advancement of a conservation culture in Ontario, the reality is that in the short- to mid-term, reduced reliance on coal-fired generation will result in greater reliance on gas-fired generation.

An electricity industry with a real-time market only, that must also accommodate increasing volumes of gas-fired generation, will be somewhat out of synch. As you will know, it will be more difficult for gas facility operators to manage their risks if they are making gas nominations the day ahead of operation without a corresponding commitment to either physical operation or the price for their electricity production. Without mitigation avenues offered by mechanisms like a Day-Ahead Market, there are potential risks that could play out in the form of higher electricity prices through the inclusion of risk premiums in asking prices, or the use of very high cost alternatives on the day-at-hand, or possibly even supply issues.

With respect to inter-jurisdictional transactions, the Ontario Market clearly has benefited from importing power in the past – in fact we wouldn't have kept our air conditioners running through the hot summer of 2002 without imports. There have been big changes south of the border since we designed our market, and those changes are consistently in the direction of day-ahead coordination.

All of New England, New York, PJM, and now MISO are, or soon will be, operating Day-Ahead Markets. Transactions between markets will mostly be in place prior to the actual day of delivery, allowing merchants to make the necessary arrangements with transmitters and suppliers to ensure these transactions actually flow as desired. Those arrangements will also be made well in advance of real-time. We believe this trend, including day-ahead transmission reservation, will increase in the near future.

If Ontario is not also arranging imports and exports along the same timelines as our neighbours, then it is very likely to lead to higher-priced imports when needed on the day-at-hand, or potentially not having such imports available to us at all.

So we'll be continuing the discussion around these issues – looking for good solutions from everyone's perspective – while working with you to enhance real-time market operations. As we have seen in other markets around us, the spot market works very well as a

balancing market and to ensure that the most efficient and effective resources are dispatched.

Surplus Funds

As you know, the IESO is in the midst of preparing for an Ontario Energy Board hearing on our fees.

Our current tariff of less than one-tenth of one cent per kilowatt hour has been in place since market opening in 2002. We are asking for that fee to stay at the same level in 2005.

Like other organizations, the IESO was asked by the provincial government to look at possible ways to assist in the implementation of Bill 100 including the creation of the Ontario Power Authority. As we moved into the OEB process at the start of January, the IESO Board approved a Memorandum of Understanding with the Ministry of Energy under which \$15 million of the IESO's accumulated surplus will be available over the 2005-2006 period as a one-time fund to assist in the start-up of the OPA.

The majority of the surplus originated as a result of savings achieved during the delays in market opening. Disciplined cost management helped retain and add to that surplus.

With the support of market participants and the concurrence of the OEB, this surplus was retained for rate stabilization purposes during a time of considerable uncertainty in the sector. IESO management projected that with continued careful attention to program activities and costs, this surplus would remain into 2007.

This is a one-time measure but the funds will help the OPA get started on a solid footing. We realize that in this current environment, we all need to be flexible and responsive to the broader needs of the sector. We want to do our part, along with the other institutions in the sector, to limit costs and increase effectiveness.

Changing Role of the IESO

I have touched on some of the ways that the IESO is changing under Bill 100. But in many respects, we have not stood still since market opening in 2002.

Multi-interval optimization, the Hour-Ahead Dispatchable Load initiative, the Transitional Demand Response Program are among the programs and services that we have introduced since 2002 to improve the effectiveness of the market.

We have also greatly improved the transparency of the market through our generation disclosure reports.

And while I have talked about the need for more effective consultation and stakeholding from the IESO, another priority for us centres on the need for customer education.

The lack of customer education and awareness of the market has been cited as one of the failings of market opening. After decades of paying one price regardless of the time of day or season, customers were not prepared to deal with the price volatility that occurred in the summer of 2002.

While the majority of the customers ... more than four million of them ... will be under the regulated rate plan, there are still 50,000 customers who are exposed to the market price. Those 50,000 customers represent approximately 55 per cent of the load in Ontario, of which only 17 percent represents current market participants.

However, many of these customers do not understand how the market works, let alone how the market can help them better manage their electricity costs.

So the IESO is taking on an education role – partly because as the system and market operator, we can provide the information customers need to better manage their electricity costs. Its available on our web site, and is highlighted in recent IESO publications. For example, our 2005 Ontario Electricity Calendar highlights the daily, weekly and seasonal characteristics of electricity demand and prices.

Simply put, we believe that a better educated customer who knows how to make the market work for them will contribute to the stability and effectiveness of the market. We've been struck by how enthusiastic this class of customers is to take advantage of this kind of information – indeed to be recognized as having specific needs in order to manage their electricity costs.

This will be a lot of work – and, it can't be done without the close involvement of local distribution companies who have a direct relationship with these customers – as well as trade associations who advocate on their behalf. Over the last year, we have been working to strengthen our partnerships with these organizations to get the message out.

Conclusion

I have outlined some of the ways that we are changing as a result of Bill 100. Before I conclude and take your questions, let me say that it is not just about making those changes, we also need to revisit our approach.

Before market opening, we were in a forced march to implement the tools and processes necessary to operate in the competitive market.

There was another sprint after Bill 210, again with us, the LDC's and other market participants hurrying to make the changes required in the legislation.

But Bill 100 should change some of our thinking.

We continue to believe that market evolution is necessary to realize the efficiencies available to Ontario's electricity sector.

Given the government's support for the market and the commitment to the hybrid model, we no longer need to look at market evolution as a sprint.

This has become more of a long distance endeavour – with a more deliberate pace over the next few years ... recognizing that changes and enhancements have to be implemented in partnership with our market participants and all of Ontario's electricity customers.

We don't want to be like some airlines' service model – “we're not happy until you're not happy”. We do want to be known for providing services that are valued by our market participants and the wider Ontario community.

Thank you very much. I look forward to your questions.