ANNUAL REPORT

COMPLIANCE ENFORCEMENT 2008

A Report to the President & CEO of IESO
on Compliance Enforcement Activities
for the Year Ending December 31, 2008

June 2009

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1. Introduction

This report summarizes enforcement of the market rules in the Ontario electricity market for the calendar year 2008, in addition to other compliance-related activities.

The responsibility to investigate and enforce compliance in individual cases rests with the Compliance section of the Market Assessment and Compliance Division ("MACD" for the purpose of this report), to be carried out on a neutral and arm's length basis from the rest of the Independent Electricity System Operator of Ontario ("the IESO").

The IESO and the broader community of stakeholders need to be satisfied that the function is being performed in a fair and effective way, consistent with the IESO's mission and strategic priorities. Towards that objective, this report is a proactive effort by MACD to provide a measure of transparency and accountability. It also aims to provide a signal as to the strategic direction of enforcement going forward, as well as a reinforcement of investigative processes in use by MACD.

The report is organized as follows:

- Section 2 provides an overview of important contextual information related to the investigative process
- Section 3 reports on key enforcement activity levels
- Section 4 outlines other areas of emphasis in 2008, which were related to the overall compliance program of MACD
- Finally, Section 5 provides a projected outlook regarding MACD's intended focus in 2009 and beyond

2. Overview

2.1 Overview – Referrals and Case Screening

Potential non-compliance events are identified to MACD through a number of referral processes. As a matter of present practice, MACD receives the vast majority of its referrals from IESO business units. These referrals are essentially flags of incidents which might possibly involve a market rule breach. MACD also receives referrals via self-reports by the IESO and market participants and, less frequently, via compliance monitoring projects undertaken by MACD itself or by third parties referring matters related to another market participant.

MACD reviews every referral to assess whether the matter requires further investigation or analysis to determine whether a rule has been breached. In addition, before MACD decides to "open a case", or "commence an investigation", it assesses each referral with the help of screening criteria.

Due to the sheer volume of matters referred to MACD, when considered in relation to the size of its enforcement staff, such criteria are needed to assist the triage of potential investigations and to assist the focus of staff to those matters which are of the greatest relevance and impact. Examples of factors considered at this stage include the degree of market or reliability impact, whether the matter involves repeat conduct and whether the conduct was deliberate, or exhibited a lack of due diligence.

A critical element of the triage process is the requirement of MACD to adhere to performance measures concerning the timeliness of any enforcement work it commences. In addition, the extent of enforcement work initiated by MACD must be balanced against the need to supplement investigative activities with broader compliance activities, such as education, proactive communication of rule interpretations and process improvements.

These other activities can also materially impact on the overall objective of fostering greater compliance with the market rules. As will be described in the Outlook section, MACD has determined that both its timeliness performance measures and its complementary activities need to be reviewed in light of its performance in these areas. Accordingly, the screening criteria will be adjusted to provide flexibility and generate more effective balance to the overall compliance work.

2.2 Overview – Formal vs Informal Tracks

Once the screening criteria determine which matters to pursue in more detail, a choice is made as to whether an event or series of events should be investigated following a formal or an informal track.

The informal process typically includes voluntary requests for information from market participants to assist MACD's analysis. It also often leads to a resolution of the matter outside the strict bounds of the enforcement provisions of the market rules. Examples of such resolutions, which have been termed "alternative case resolutions", or "ACRs", include the issuance of market rule reminder letters or the communication of a decision by MACD to conditionally "close" a matter, upon recognition of some corrective action already taken or a proposed mitigation plan which MACD believes is an acceptable remediation.

The informal process was developed by MACD for a number of reasons, including:

- its fostering of the most effective and timely means of coming to the desired outcome in any matter, namely the achievement of compliance with the market rules, especially as
- it allows for market conduct to be addressed by renewed expectations of conduct or other remedial outcomes when staff levels cannot support extensive and resource-intensive formal investigations;
- it also recognizes the elements of learning and evolution inherent in the process of those market participants coming to grips with a daunting set of market rules and manuals upon entry into the market; and
- it reflects MACD's intent of leveraging the idea of a pre-existing culture of compliance present in the electricity industry into an enforcement philosophy marked more by prevention, cooperation and education, rather than punitive deterrence.

As will be shown in the description of the distribution of enforcement work in the next section, the majority of staff activity has been in the "informal process" category. This is a continuation of the pattern from previous years' work, and it is MACD's assessment that this manner of dealing with referrals has been both appropriate in the circumstances to date, as well as effective in achieving the objectives outlined above.

A substantial number of matters were also pursued via the formal process, and the most relevant determining factors which directed those decisions are laid out above in the description of the screening criteria. In short, the formal process involves the issuance of a Notice of Alleged Breach, and can end in a formal finding of breach, which is communicated by a Notice of Non-Compliance, as detailed in Sections 6.2 and 6.6 of Chapter 3 of the market rules.

A finding of breach usually results when: 1) the non-compliance has had an impact on reliability, 2) a material impact on the market, 3) undertakings to remedy a breach have not been kept, or 4) the circumstances supported specific and/or general deterrence via the publication of a finding. In addition, a financial sanction may be imposed.

3. Activity Levels[1]

3.1 Activity Levels - Investigations

In 2008 MACD received and reviewed approximately 2003 referrals. This is an increase of almost 25% over the 1611 referrals received in 2007 (Table 1). Table 1 also shows that despite the increase in referrals, the number of informal and formal cases opened in 2008 is down from 2007. This is due to a number of factors, as detailed below.

TABLE 1: Comparison of Overall Activity Levels in 2007 and 2008

	2007	2008
Referrals Received and Reviewed	1611	2003
Informal Investigations Opened	212	162
Formal Investigations Opened	37	14
2008 Formal and Informal Cases Closed	n/a	151
Cases From Previous Years Closed	n/a	15
Outstanding Cases at Year End	44	54

First, the number of referrals related to the Spare Generation Online ("SGOL") program increased from 133 in 2007 to 230 in 2008 due to an increased use of the program by market participants. Few compliance cases have been opened relating to SGOL but MACD uses the referrals to confirm eligibility for SGOL payments and to monitor for unintended congestion management (CMSC) payments.

Second, commissioning and newly dispatchable generators typically lead to a number of potential non-compliance referrals as they learn to offer and operate their facilities in the IESO-administered market. In keeping with MACD's philosophy of promoting compliance with the market rules, MACD exercises the discretion allowed under the market rules and applies resources to work with commissioning and newly dispatchable generators to facilitate their entry into the market. Therefore, no compliance cases were opened based on these referrals in 2008.

Thirdly, as market participants have become more informed about the compliance process during the years post-market opening, MACD is receiving more self reports of potential non-compliance from market participants. At the same time, these reports increasingly contain details of corrective action that is planned or has been implemented and may not result in a formal or informal compliance case being opened, as a result.

[1] Throughout this report the statistics reflect the year in which the identified enforcement action took place, which does not always coincide with the year the event or breach occurred.

Finally, while statistics in 2007 reflected work done with a full complement of assistant analysts, in the second half of 2008, several assistant analysts left MACD to advancement elsewhere within the IESO. With loss of capacity, as well as time spent by senior staff recruiting and then training new staff, there has been an impact into 2009 on the number of cases pursued and completed.

Table 2 further breaks down 2008 activities by the ultimate disposition of cases which were closed in the year.

TABLE 2: Summary of Concluded Cases in 2007 and 2008

	2007	2008
Total Cases Closed	230	166
Informal Cases Closed	192	137
Formal Cases Closed	37	29
Number of Letter Sanctions	11	3
Number of Financial Penalties	10	7
Total Amount of Financial Penalties	$31,000	$63,000

The importance MACD places on its prevention role is reflected again in the relative volume of cases (82.5%) that concluded as alternative case resolutions within the informal process. Our standard practice for client contact matters, except those involving a potential breach of a reliability standard and metering installation upgrade, is to first make an 'informal' Request for Information (RFI). This has proven to be a quick means to determine whether there is a genuine issue to pursue. For example, the matter may involve a situation where the market participant was unaware of our expectations regarding an obligation. These cases are typically concluded with corrective actions taken and/or MACD setting an expectation for the party's future performance.

This information is recorded in MACTRAX, our compliance database, so that we can easily access the information as required in the future. This allows MACD to evaluate a market participant's overall compliance efforts, including the outcomes of informal processes. That information could be a consideration in determining whether to pursue the formal track in subsequent matters.

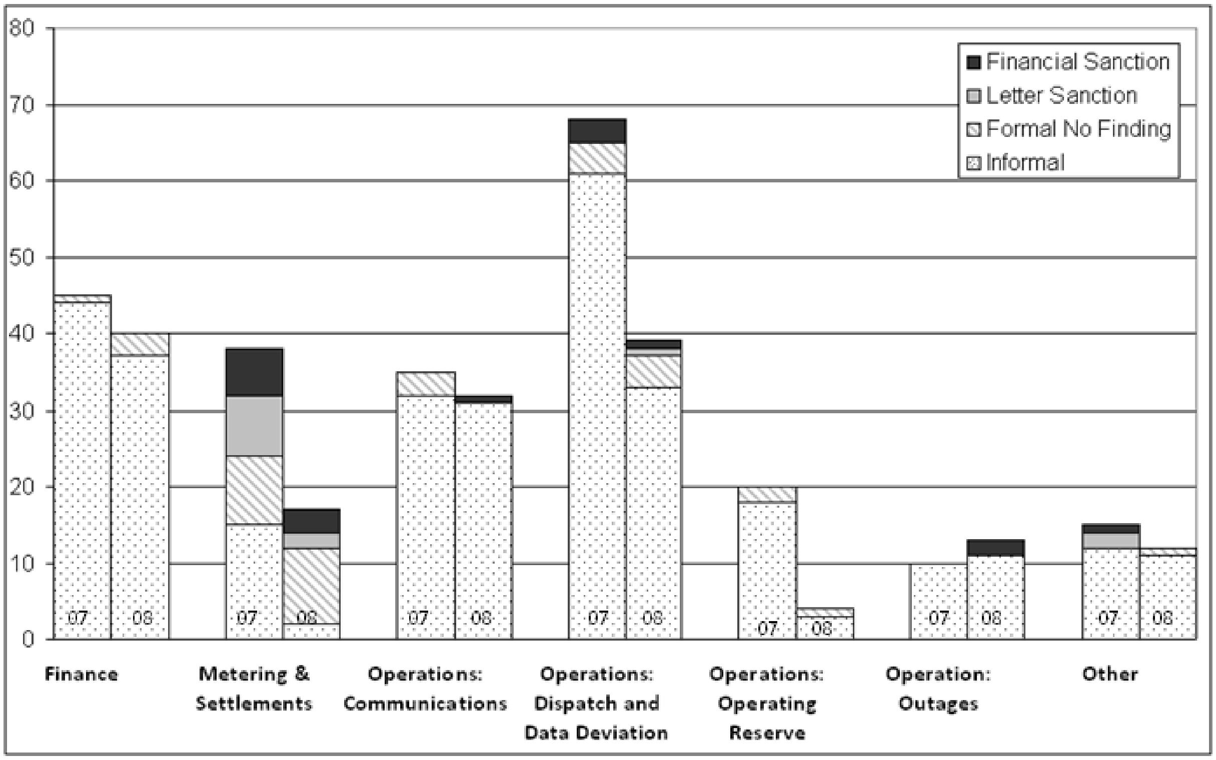
In 2008, MACD concluded 29 formal investigations. Of these, 10 resulted in a finding of breach and seven financial penalties (totalling $63,000) were imposed.

Brief details of confirmed breaches are published monthly (forming part of a running list) on the IESO web site at:

http://www.ieso.ca/imoweb/marketComp/sanctions.asp.

3.2 Activity Levels – Category of Breach

Figure 1: COMPARISION OF MARKET PARTICIPANT CASES CLOSED IN 2007 AND 2008; BY AREA OF THE MARKET RULES



More precise details and historical comparison data is provided in Table A-1 in the appendix.

The distribution of cases is largely reflective of the source areas from which MACD obtains its referrals, in combination with set priorities as determined in annual business unit planning exercises.

<u>Dispatch Data and Dispatch Deviation</u>

The most notable change in 2008 was a relative decrease in informal cases pursued pertaining to submission of dispatch data and generator deviation from dispatch. In 2008, 33 cases were pursued compared to 61 in 2007.

Of the 39 cases concluded in 2008, the vast majority of these were due to the participant's failure to update dispatch data (Chapter 7, section 3.3.8). Particular focus was given to dispatch data revisions that failed to be made prior to the start of the mandatory window, as these failures have a greater likelihood of causing market and/or reliability impacts.

Of the six formal cases which were concluded, four did not result in sanctions; one letter sanction was issued for failure to submit revised dispatch data, and one was sanctioned with a $1,000 penalty for failure to revise dispatch data to be consistent with an outage plan.

Communications

Prompt communication between market participant facilities and the IESO Control Room is important for reliability and safe operation of the electricity system. This category generally captures real-time communications involving failures to notify of equipment synchronization and/or de-synchronization or failure to promptly report changes in facility status.

The number of investigations in this category was similar in 2007 and 2008. In 2008, of the 32 cases concluded, 31 were handled informally. Most cases concluded with undertakings by the participants to conduct training and refine procedures. The one formal case was concluded with a finding of breach and a $4,000 financial penalty for failure to inform the IESO of an anticipated change in the status of a generation facility.

Operating Reserve Activation

In 2008, MACD concluded four cases where operating reserve failures took place. Three were resolved through the ACR process and the formal case was concluded with no finding of a breach. As mentioned in the annual reports for 2006 and 2007, MACD focused its efforts in those years on facilities with the worst compliance rates. The results of that focus has been a greater awareness of the requirements for operating reserve and how MACD assesses compliance in these circumstances.

Clarification of the requirements were published in the Market Rule Interpretation Bulletin for Compliance with Dispatch Instructions Issued to Dispatchable Facilities.

Metering and Settlements

In 2007, MACD initiated the 2006 metering upgrade program (for those metering installations that should have been upgraded by December 31, 2006) by issuing communications, posting case assessment principles and a submission guide to parties subject to formal actions. These documents set out clear expectations and a streamlined review process.

Of the 17 cases concluded in 2008, two were informal, and 15 were formal. A total of four letter sanctions were issued and two financial penalties totalling $32,000 were levied. The remaining formal case closed in 2008 resulted from the failure of a market participant to comply with an order to upgrade a metering installation. The participant was issued a letter sanction and a $20,000 financial penalty.

MACD found that its metering enforcement process improvements implemented were quite effective and resulted in more timely investigation and closure of the cases. However, as noted earlier, it lost its analyst midway through the year, which negatively impacted case resolution for the year as a whole. In addition, other environmental considerations impacted the program. This is further discussed in the "Areas of Emphasis" section.

Outages

In 2008, MACD concluded 13 cases relating to outage management and notification. Eleven were resolved through the ACR process. Two formal cases were sanctioned with penalties of $3,000 each for misuse of forced outages.

Finance

It should be noted that 'events of default' are not considered to be breaches or potential breaches of the rule, *per se*. What is recorded as 37 cases in this category were simple notifications of late payment and immediately remedied. As well, MACD initiated suspension and disconnection proceedings for three market participants in financial difficulties. These cases concluded when the issues were resolved or the market participant withdrew from the IESO-administered markets.

Other

MACD concluded an additional 13 cases, 12 informally and one formally, with no finding of breach. The formal case was initiated based on a referral related to intertie transactions. It was noted that as the volume of linked wheels expanded considerably in late 2007 and into 2008, the volume and rate of failed intertie transactions also increased.

In March 2008, MACD launched investigations under sections 6.6.10(A) of Chapter 3 of the rules. Upon being advised of MACD's activity and with a proposal to extend the intertie failure charge under active discussion in stakeholder forums, one of the market participants active in scheduling linked wheels proactively altered its transaction scheduling and significantly curbed its transaction failures.

After further review of the applicable market rules, MACD concluded that we had an insufficient basis to pursue the failed transactions as a breach of the market rules or seek a financial remedy if a breach had been found. However, we elected to open good faith discussions with the participant seeking a voluntary repayment of settlement amounts received or avoided due to its prior transactions. The participant neither accepted the analysis nor made any admission of wrongdoing, but elected to repay $100,000 as illustrative, in a material and tangible way, of the sense of responsibility and fairness with which it approaches participation in all electricity markets in which it is active, including the Ontario market.

In addition, MACD concluded nine informal investigations involving the IESO. The cases were resolved as ACRs as they were determined to have had little or no impact and were not recurrent. Details are provided in Table A-2.

3.3 Performance Measures

TABLE 3: ELAPSED TIME FOR CASES RESOLUTION, 2008

Case Type	Concluded Cases	Percentage Within Performance Measure	Performance Measure	Number of days of performance measure
Formal	**29**	**76%**	**70%**	**6 months**
Informal	**137**	**83%**	**70%**	**37 days**

Performance targets for 2008 were as follows:

i) For informal compliance cases: the elapsed time for resolution for 70 percent of these will be 37 days or less.

ii) For formal compliance cases: the elapsed time for resolution for 70 percent of these will be 6 months or less.

As shown in Table 3, performance targets for 2008 were met as they measure the timeliness of cases resolved during the year.

However, it should be pointed out that due to staff turnover some cases carried over from previous years planned for completion in 2008 were not concluded and will be a priority for 2009. In addition, MACD will be reviewing the sufficiency of this performance measure in terms of its objective of promoting timeliness of response.

4. Areas of Emphasis

The statistics presented in the previous section give only a partial description of compliance enforcement initiatives in 2008. Large blocks of time were devoted to:

4.1 ERO Development

In 2008 MACD continued discussions with NPCC to mesh the NERC and Ontario enforcement processes. MACD has shared the processes and experience gained in tracking and enforcement of compliance issues since the opening of the market in Ontario in 2002 with NPCC. One of the ways this was accomplished in 2008 was the hosting of an NPCC review (with NERC as an observer) of IESO's reliability compliance enforcement program, including the MACD component of that program.

MACD has also undertaken consultations with other provincial enforcement units to share experiences, policies and procedures. These consultations included an exchange of staff visits with the Alberta Market Surveillance Authority.

4.2 Market Entry Activities

In keeping with its prevention philosophy, MACD devotes significant resources to facilitating entry of new participants and facilities into the IESO-administered markets. MACD conducts a review of all activities for the first two to three months after market entry of new participants to provide learning and set expectations for their performance. During 2008, we conducted this process with three market participants. In 2009, we anticipate conducting market entry activities with at least four new significant entrants.

Through this work, MACD has noted common issues with many of the new facilities entering the market. Most new facilities are developed and commissioned by organizations that will not be involved in the ongoing routine operation of the facility and offering into the market. Developers need to be aware of the enduring obligations under the market rules. Lessons learned during commissioning need to be passed on to the enduring operators and marketers. MACD will continue to evaluate the efforts made by market participants in this regard when considering how to exercise its discretion in enforcement decisions.

As well, combined cycle generators need to give consideration to offer strategies prior to commencing commercial operation to ensure that they construct offers such that they reflect the generator's physical capability. Enduring staff should avail themselves of all of the training opportunities provided by the IESO.

Wind generators need to understand how their facilities affect the electricity grid and plan to provide the communication and dispatch data updates that are required to ensure reliability and accurate price signals. Wind generation has now reached a level of maturity and MACD has made clear its expectations with respect to revising dispatch data. In 2009 enforcement of failure to revise dispatch data is expected to be less lenient.

4.3 Revenue Metering Upgrade Program

Through the assessments completed in 2008 for the 2006 Revenue Metering Upgrade Program, MACD has been informed that certain resources required by market participants to complete meter installation upgrades are unavailable in the labour market in sufficient numbers to meet timelines specified in the Metering Upgrade Compliance program. Implications of this infrastructure issue were assessed in 2008 and will be addressed prior to commencing the 2007 Meter Upgrade Program.

In 2009, MACD will be initiating another metering upgrade compliance program for upgrade years 2007 and 2008, as well as initiating actions against any metered market participant that failed to meet outstanding compliance orders.

4.4 Voluntary Repayment of Benefit Obtained from a Breach of a Market Rule

In 2008 MACD undertook to amend the market rules to include Sanctioning Guidelines for Extraordinary Financial Penalties, clarification of non-compliance level descriptions and additional factors to consider when determining penalties. Pursuant to the latter, MACD developed a procedure for voluntary repayment of benefits obtained from a breach of the market rules. In 2008, approximately $865,000 of unwarranted CMSC was repaid in this fashion. Assessment and refinement of the process will continue in 2009.

5. Outlook

In terms of emphasis of the compliance program going forward, there are a number of key strategic priorities which MACD has decided to address.

First, MACD will focus its efforts on making changes aimed at improving the timeliness of its response to enforcement matters brought before it. Key enabling activities in this regard will include enhancing staffing stability, as well as reviewing internal coordination functions and processes between MACD and business units within the IESO to ensure they are as efficient and effective as possible. This is especially important in the area of reliability compliance, as enforcement developments in this area continue to accelerate with the EROs and their regional delegated entities. In this regard, MACD will continue to work with NPCC, in particular, to advance coordination of enforcement regimes.

Collateral to this focus will be a review of the screening criteria to ensure, given the above considerations, that the filter is most appropriately calibrated to the objective of timely response to referrals as well as to gauge whether the balance between informal and formal tracks is appropriate at this stage of evolution of the market's adherence to and understanding of the rules.

In addition, a consequent examination of the mix between enforcement and communication initiatives, such as the issuance of more Interpretation Bulletins or Guidelines, will be conducted. An example of renewed efforts in the latter areas is the development of a statement respecting MACD's expectations regarding market participants' compliance programs and self-reporting policies. This statement is expected to be completed in 2009.

Finally, substantial effort will be expended on ensuring an orderly and effective transition into the Ontario market by new generation using unconventional technologies. Combined cycle generation is coming on line in significant quantity in 2009, and this technology brings with it some unique challenges in respect of many aspects of market conduct. MACD will work with these facilities to maximize avoidance of breaches, using its three month period-of-review process. Similarly, consultations with wind generators will continue in order to assist a more effective adherence to dispatch data requirements.

TABLE A-1: MARKET PARTICIPANT CONCLUDED CASES; BY AREA OF THE MARKET RULES, 2007

Categories	Total Concluded		ACR*		Formal Cases		Letter Sanctions only		Financial Penalties: Number		Financial Penalties: Amount	
	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008
Dispatch Data and Deviations	68	39	61	33	7	6	0	1	3	1	$5,000	$1,000
Finance	45	40	44	37	1	3	0	0	0	0	0	0
Metering & Settlements	40	17	15	2	25	15	8	2	6	3	$25,000	$52.000
Operational Communications	32	32	32	31	0	1	0	0	0	1	0	$4,000
Operating Reserve	20	4	18	3	2	1	0	0	0	0	0	0
Outages	10	13	10	11	0	2	0	0	0	2	0	$6,000
Miscellaneous	4	3	4	3	0	0	0	0	0	0	0	0
Failed Intertie Transactions	4	4	4	3	0	1	0	0	0	0	0	0
Operations: Other	3	5	3	5	0	0	0	0	0	0	0	0
Reliability Standards	3	0	0	0	3	0	2	0	0	0	$1,000	0
Information Confidentiality	1	1	1	1	0	0	0	0	0	0	0	0
Total	230	157	192	128	38	29	10	3	10	7	$31,000	$63,000

*Alternative Case Resolution

TABLE A-2: IESO CONCLUDED CASES BY AREA OF THE MARKET RULES, 2007 AND 2008

Categories	Concluded		ACR*		Formal Cases		Letter Sanctions Only		Financial Penalties: Number		Financial Penalties: Amount	
	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008
Metering & Settlements	8	0	6	0	2	0	1	0	0	0	0	0
Miscellaneous	6	1	4	1	1	0	0	0	0	0	0	0
Failed Intertie Transactions	3	1	2	1	1	0	0	0	0	0	0	0
Information Confidentiality	6	1	6	1	0	0	0	0	0	0	0	0
Operational Communication	1	1	1	1	0	0	0	0	0	0	0	0
Dispatch data	1	1	1	1	0	0	0	0	0	0	0	0
Operating Reserve	1	1	1	1	0	0	0	0	0	0	0	0
Operations: Other	1	3	1	3	0	0	0	0	0	0	0	0
Total	26	9	22	9	4	0	1	0	0	0	0	0

*Alternative Case Resolution