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Susan Frank

Vice President and Chief Regulatory Officer
Regulatory Affairs

BY FAX AND COURIER

December 11, 2006

Ms. Kirsten Walli
Secretary
Ontario Energy Board
Suite 2700, 2300 Yonge Street
P.O. Box 2319
Toronto, ON.
M4P 1E4

Dear Ms. Walli:

Hydro One Networks Application to the Ontario Energy Board for review of Market Rule Amendment MR-00284-R00-R02

Hydro One Networks Inc (“Hydro One”) is applying to the Board under Section 33, subsection (4) of the *Electricity Act, 1998* (“the Act”), for review of IESO’s market rule amendment MR-00284-R00-R02: *Include Reliability Impact as Criterion for Determining Financial Penalties*.

Section 33 of the Act deals with *Amendment of market rules*. Sub-section (4) (*Application for review*) states that “Any person may apply to the Board for review of an amendment to the market rules by filing an application with the Board within 21 days after the amendment is published under subsection (1).”

MR-00284 was approved by the IESO Board on November 17, 2006 and published on the IESO website (http://www.ieso.ca/imoweb/pubs/mr2006/mr_00284-R00-R02-BA.pdf) on November 20, 2006.

Summary of amendments under MR-00284

- MR-00284-R00: includes the actual or potential impact of a market rule breach on system reliability among the criteria for fixing the amount of a financial penalty.
- MR-00284-R01: includes the impact of a market rule breach on system reliability among the criteria allowing fines in excess of \$10,000 and up to \$1,000,000.
- MR-00284-R02: requires market participants to operate in a manner consistent with the Ontario Power System Restoration Plan (OPSRP).

Request to the Board to revoke and refer the amendments back to the IESO

Hydro One requests that the Board revoke the proposed amendments and refer them back to the IESO for further consideration. As currently formulated, the amendments are likely to unjustly discriminate against or in favour of Ontario market participants. These amendments should not be approved for implementation until it can be demonstrated that the IESO's compliance framework can be applied in an objective, transparent and consistent manner. As currently approved by the IESO Board, the amendments have a number of shortcomings that prevent such application.

These amendments deserve to be properly considered before they are approved. It cannot be argued that they are urgently required to implement reliability standards and criteria, or for any other reason as compliance with reliability standards has been already successfully in place for many years.

Rationale

Hydro One requests that the Board review the MR-00284 amendments for the following reasons:

1. Absence of a defined framework for the application of financial penalties

The approval and implementation of the amendments is premature in the absence of an appropriate implementation framework. Any penalty structure, in the electricity industry or elsewhere, must have the following attributes:

- A defined structure that links the severity of the breach to the magnitude of the corresponding penalty;
- Clearly articulated, documented guidelines and criteria for applying the penalties;
- Communication of the above to both the enforcers and the subjects of such penalty structures;
- Transparency; and
- Consistency of application within the market rules

In the absence of such a framework, market participants have no assurance that the penalty regime can operate without unjustly discriminating against, or in favour of market participants. Such discrimination need not be intentional. The mere absence of any guidelines virtually guarantees that the application of penalties will vary from case to case and from individual to individual. This is comparable to the passing of traffic laws that permit undefined traffic fines for drivers: How could drivers be assured a fair application of fines for 'running a red light', for example, if the fines were nowhere documented, and only the maximum fine for *any* traffic violation were posted? Would there be any assurance that fines would be consistent from one driver to another, from one police officer to another, and from one courtroom to another?

The absence of a framework for monetary sanctions is also inconsistent with industry “best practice” in North America. For example, the North American Reliability Council (NERC) has developed a well-defined and specific matrix that structures the application of penalties. The matrix determines penalty amounts commensurate with the level of non-compliance and its severity i.e. the reliability risk associated with a violation. The IESO should be directed to examine such practices in developing the penalty criteria for Ontario.

Section 6.6 of Chapter 3 of the existing market rules contains a process for determining financial penalties for breaches of market rules. To date the IESO has used the procedures outlined in that section to enforce compliance with market rules and market participants understand the process for establishing the penalties. The proposed amendments to introduce penalties for reliability related breaches should be reflected in appropriate changes to Section 6.6 of the market rules so that market participants have a clear understanding of process that will be used by the IESO.

2. Unsupported use of financial penalties for Reliability Breaches in Ontario

The recently executed Memorandum of Understanding between the North American Reliability Council (NERC) and the Ontario Energy Board states that NERC has no intention of applying monetary sanctions to the IESO for violations to the NERC reliability standards. However, this market rule amendment gives the IESO the authority to apply monetary sanctions to other Ontario entities for the same concept.

In Hydro One’s view, there is no advantage to create a disparity between reliability standards across the region. Imposition of these criteria in Ontario, are insufficiently developed or supported, will set Ontario apart from neighbouring jurisdictions. There are no distinct aspects of the Ontario power system that justify special treatment of Ontario entities, and the IESO has offered no rationale for a “made in Ontario” penalty ‘structure’.

3. Undefined imposition of Financial Penalties for *Potential* (vs. Actual) Breaches

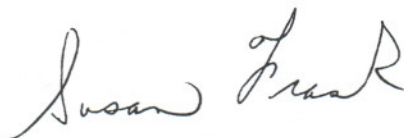
The IESO’s Market Assessment and Compliance Division (MACD) has been granted the authority to levy penalties based on consequences that did not happen (*potential* impacts on system reliability). The authority to levy fines for potential breaches did not include a definition of *potential* breach, nor did it explain how *potential* breaches can be assessed in a fair, consistent and transparent manner. This authority creates an unfair precedent for Ontario’s market participants and exposes participants to unknown risk due to arbitrary penalties for unknown or undefined breaches. Again, this facet of the proposed amendment can unjustly, and perhaps randomly, discriminate against, or in favour of market participants.

Requested changes to Market Rule amendment MR-00284

Hydro One requests that the following changes be made to the amendments:

- (i) Remove monetary sanctions for reliability breaches, or create a transparent and consistent framework, complete with a method of quantifying the impact of reliability breaches and determining appropriate fines.
- (ii) Remove “potential impact” as a criterion for levying penalties.
- (iii) Align penalties with North American practices.

Sincerely,

A handwritten signature in cursive script that reads "Susan Frank". The signature is written in dark ink and is positioned below the word "Sincerely,".

Susan Frank