

**INDEPENDENT ELECTRICITY MARKET OPERATOR (IMO)
YEAR 2002 FEES SUBMISSION**

SETTLEMENT AGREEMENT

RP-2001- 0046

This Settlement Proposal is filed with the Ontario Energy Board (“the OEB”) for consideration in connection with the Submission of the Independent Electricity Market Operator (the IMO), for an order or orders approving its proposed expenditures, revenue requirement and fees for Fiscal 2002 (“the Test Year”), in accordance with Rule 39 of the Board’s *Rule of Practice and Procedure* and the Board’s *Settlement Conference Guidelines*.

The Settlement Proposal arises from a series of ongoing discussions with stakeholders whereby the IMO addressed all issues raised by stakeholders. In fulfillment of last year’s settlement agreement undertakings, outlined in Appendix 8.4 of the 2002 – 2004 Business Plan, the IMO held regular meetings throughout the year with intervenors in past IMO fees proceedings, and presented and discussed benchmarking material, which is also included in the pre-filed evidence.

The following parties participated in the settlement discussions:

- The IMO;
- Aegent Energy Advisors Inc.;
- Association of Major Power Consumers in Ontario (AMPCO);
- Electricity Distributors Association;
- Energy Cost Management Inc.,
- Guelph Hydro-Electric Systems Inc.,
- Hydro One Networks Inc.,
- Hydro-Quebec;
- Natural Resource Gas Ltd.;
- Ontario Association of School Business Officials;
- Ontario Federation of Agriculture (OFA),
- Ontario Power Generation (OPG);
- Power Workers Union (PWU);
- The Society of Energy Professionals;
- Toronto Hydro-Electric System Ltd.,
- TransCanada Energy Ltd.,
- Vulnerable Energy Consumers Coalition (VECC); and
- OEB staff who were present as observers at both meetings.

The Settlement Proposal deals with all issues raised during the discussions.

We are pleased to inform the Board that the parties reached a comprehensive Agreement on all issues. No issue is left unsettled.

Board Staff takes no position on any issues and as a result is not a party to this proposal.

This Settlement Proposal was prepared in accordance with Rule 39 and the Settlement Guidelines. The Settlement Proposal accordingly describes the agreements reached on the settled issues, including the rationale, and provides a direct and transparent link between each settlement and the supporting evidence in the record to date. In this regard, the parties agree that the evidence provided with the IMO's Submission for Review is sufficient to support the Settlement Proposal in relation to the settled issues. Moreover, the quality and the detail of the supporting evidence together with the corresponding rationale will allow the Board to make findings on the settled issues.

This Settlement Proposal will have no impact on the total proposed Test Year expenditures, fees, and revenue requirements.

Introduction

In support of its submission the IMO filed its 2002 – 2004 Business Plan (the Business Plan) along with the final cost study report prepared by Rumla, Inc. dated July 20, 2001 entitled "Review and Analysis of Administration Charge Practices of Independent System Operator" (the ISO Cost Comparison Report). The IMO is seeking OEB approval for:

- a revenue requirement of \$153.9 million in 2002;
- capital expenditures of \$66.3 million in 2002;
- authorization to use the forecast deferral account surplus of \$8.8 million to reduce its total revenue requirements for 2002;
- monthly revenue of \$12.03 million under the Transition Revenue Allocation Agreement for each month prior to market opening; and
- a usage fee of \$0.959/MWh to be charged to wholesale customers and market participants on energy withdrawals upon market opening.

The Executive Summary from the Business Plan that sets out the IMO's proposals is attached to this Settlement Proposal.

The intervenors have reviewed the 2002 Fees submission and have accepted the IMO's proposals outlined in its submission, except for the issues set out below.

Parties to the Settlement have agreed to accept the proposals set out below as a Settlement of the outstanding issues.

Benchmarking

(Section 4.3 and Appendix 8.4 of the Business Plan and the ISO Cost Comparison Report)

The IMO reaffirmed its commitment to continuing to learn from comparable organizations and to benchmark the IMO's performance. The IMO will continue to collect and analyze such information and continue to work with Stakeholders, during fiscal year 2002.

AMPCO agrees to sign off on the Settlement Proposal and respectfully requests the Board to give due consideration to the recommendation and comments concerning the IMO's incorporation of benchmarking into its fee submission attached in Appendix B.

Performance Management

(Section 4.1 of the Business Plan)

During the course of the stakeholder meetings, several participants asked how and when the IMO would set the measures to assess the performance of two targets under "Operational Effectiveness", (i) Electrical reliability maintained within the province, and (ii) Market Systems and Processes Operate Effectively". *(Reference, Table on p.16 of the Business Plan)*. The IMO explained that specific measures would be brought to the IMO Board of Directors in December, 2001 or January 2002 for approval. In the case of item (ii), these measures would apply to the first four months of operations following market opening. Thereafter, the IMO notes that electrical system reliability is a shared responsibility between the transmission owners and the IMO.

This issue was settled on the basis of the following undertakings given by the IMO:

(i) The Vice-President, Corporate and Legal Affairs, will communicate to the IMO Board of Directors that stakeholders consider that the weighting to be attributed to those two targets should be viewed as part of the IMO's overall performance in meeting participants' and stakeholder needs;

(ii) The IMO will canvass market participants and stakeholders four months after market opening about which market systems operating measures are the best indicators of performance and, after such consultation, establish the measures for the balance of 2002; and,

(iii) The IMO will use its best efforts following market opening to report to market participants and stakeholders meaningful information on the congestion costs, incurred in operating the IMO markets.

(iv) The IMO confirms that elements of its management compensation process has been and will continue to be linked to the Corporate performance targets. These targets are approved by the Board of Directors and are directly linked to the incentive part of the management compensation process.

Capital Expenditures

(Section 5.2 of the Business Plan)

On p. 34, line 1043 of the Business Plan reference is made to "the remaining \$8.7M" of capital expenditures will be approved on a "case-by-case basis". The IMO undertook in the settlement discussions to provide additional detail as to potential capital projects for 2002. Attached, as Schedule "A" to this Settlement Agreement is a list and description of the capital expenditures projects currently under consideration. This listing, updated from time to time, sets out those capital items which will be considered for implementation and which would make up the remaining \$8.7M in 2002 capital expenditures.

- (i) IMO management will review these projects during the year and select the projects on a priority basis.
- (ii) The IMO will specifically report on the projects in the list and actual expenditures as part of the 2002 year capital expenditures when preparing the capital expenditure budget for the 2003 Fees Submission.

Appendix A – Proposed Projects for 2002 Capital Expenditures of \$8.7 M

IMO has included within its proposed 2002 capital expenditures \$8.7M relating to currently uncommitted capital projects. Currently there are many proposed capital projects, which, in total exceed the uncommitted \$8.7M limit. IMO is actively addressing the effective prioritization and processing of capital initiatives identified, as well as those not yet identified but which may arise over the course of the fiscal year 2002.

At this time, a detailed list of projects that will be undertaken in 2002 has not been developed. The intent is to monitor market needs and prioritize projects accordingly.

An illustrative list of Projects which may go forward in 2002 include, but are not limited to the following:

Work Program Name	Estimated Fiscal 2002 Capital Requirement	Work Program Description
Market Surveillance Enhancement – Compliance Tracker	\$0.5M	Automate analysis of potential non-compliance events and provide capability to extract operational data for after-the-fact analysis.
RTU Expansion – Initial Registration	\$1.5M	Increase remote communication links to generators and dispatchable loads to acquire new real time data in conformance with technical requirements of the market rules.
SCADA Front End Expansion	\$0.7M	Expand Supervisory Control and Data Acquisition (SCADA) facility at Clarkson and Skymark to accommodate additional Remote Terminal Unit connections.
Consistent Information Set II / Network Models Management	\$0.5M	Provide a consistent and auditable way of handing facility registration data from submission to operational use by consolidating and centralizing power system equipment data.
Transmission Rights Enhancements	\$0.9M	Provide capability for a holder of the transmission rights to assign ownership to a third party or to resell into the market, and significantly expand system capability to allow participants to short sell transmission rights.
Exchange Coordinator Training Simulator	\$0.3M	Provide training environment for IMO operations staff with the capability to exercise operational scenarios using simulated market activities and simulated power system grid events.
Market Participant Access to	\$0.1M	Publish Operating Security Limit data to

Operating Security Limits		all market participants in usable form
Consistent Information Set Operating Security Limits Study Process Enhancement	\$0.5M	Improve work processes between control room and back office function through use of common network model and contingency definition data. Facility will be provided to extract data from Energy Management System /Market Information System to Power Technology Inc. environment
Unanticipated Rule Changes	\$1.5M	Modify IMO tools and processes in support of required changes to market rules.
Customer Relationship Management System	\$0.5M	Improve tools and process for IMO help center for better contact management, more efficient handling of participant queries and after-the-fact analysis of customer profile for continuous improvement
Additional Software Licenses	\$0.3M	Minor acquisition of additional software licenses
Consolidation of Information Delivery Infrastructure	\$0.5M	Reduce license cost and maintenance effort by consolidating multiple report infrastructures into one
Secure Voice Circuits Upgrade	\$1.3M	Reduce operating costs by replacing the legacy System Voice Circuit with modern technology
Clarkson/Skymark Link Upgrade	\$0.3M	Increase communication bandwidth between Clarkson and Skymark to meet the demands for increasing data traffic between the sites.
Quality Assurance Test Network Environment	\$0.4M	Provide a test bed for network configuration updates.
EMC Expansion/Enhancements	\$0.4M	Add new capacity to meet the increasing demands for data storage
Server Hardware Enhancements	\$0.4M	Add new servers to meet the increasing demands for computing.
TSD Migration to Peregrine	\$0.5M	Migrate Tivoli Service Desk to Peregrine necessitated by vendor buyout and resulting new Peregrine business model.
Total Currently Listed Potential 2002 Capital Expenditures	\$11.1M	

Appendix B – AMPCO’S Comments on Benchmarking

Please note that these are AMPCO’s comments only and do not constitute a workplan for this settlement agreement.

RP-2001-0046

ONTARIO ENERGY BOARD

IN THE MATTER OF Sections 18 and 19 of the *Electricity Act, 1998*
AND IN THE MATTER OF a Submission by the Independent Electricity Market Operator to the Ontario Energy Board for Review of its proposed expenditure and revenue requirements and the fees which it proposes to charge for the year 2002

AMPCO COMMENTARY ON THE IMO PROPOSED SETTLEMENT AGREEMENT

RECOMMENDATION

AMPCO recommends that the Board direct the IMO to use benchmarking substantively as an objective means to become the most efficient ISO among neighbouring jurisdictions.

INTRODUCTION

AMPCO has been a strong advocate of benchmarking as a means to ensure that the performance of regulated entities is equal to or better than similarly situated organisations. Before the restructuring of Ontario Hydro, AMPCO requested that Ontario Hydro include benchmarking in its rate applications. The Board recognised the value of benchmarking (Board Decision HR-22, August 31, 1994) and recommended that Ontario Hydro include benchmarking in subsequent rate applications. The Settlement Agreement flowing from the RP-2000-0134 application contained a direction from the Ontario Energy Board (the “Board”) to the Independent Electricity Market Operator (the “IMO”) to initiate a benchmarking process to compare its costs for specific services and functions with other ISO’s, to establish targets and to measure its annual performance against the targets in connection with its application for its fees in 2002. The Settlement Agreement also stated at page 3 that:

The IMO further undertakes to the OEB to make benchmarking an integral part of all future IMO fee review processes and that such benchmarking results will be used as a guide by IMO management.

While the IMO has undertaken some initiatives to improve its information base with respect to benchmarking, AMPCO believes that the IMO could further integrate benchmarking into its budget decision process.

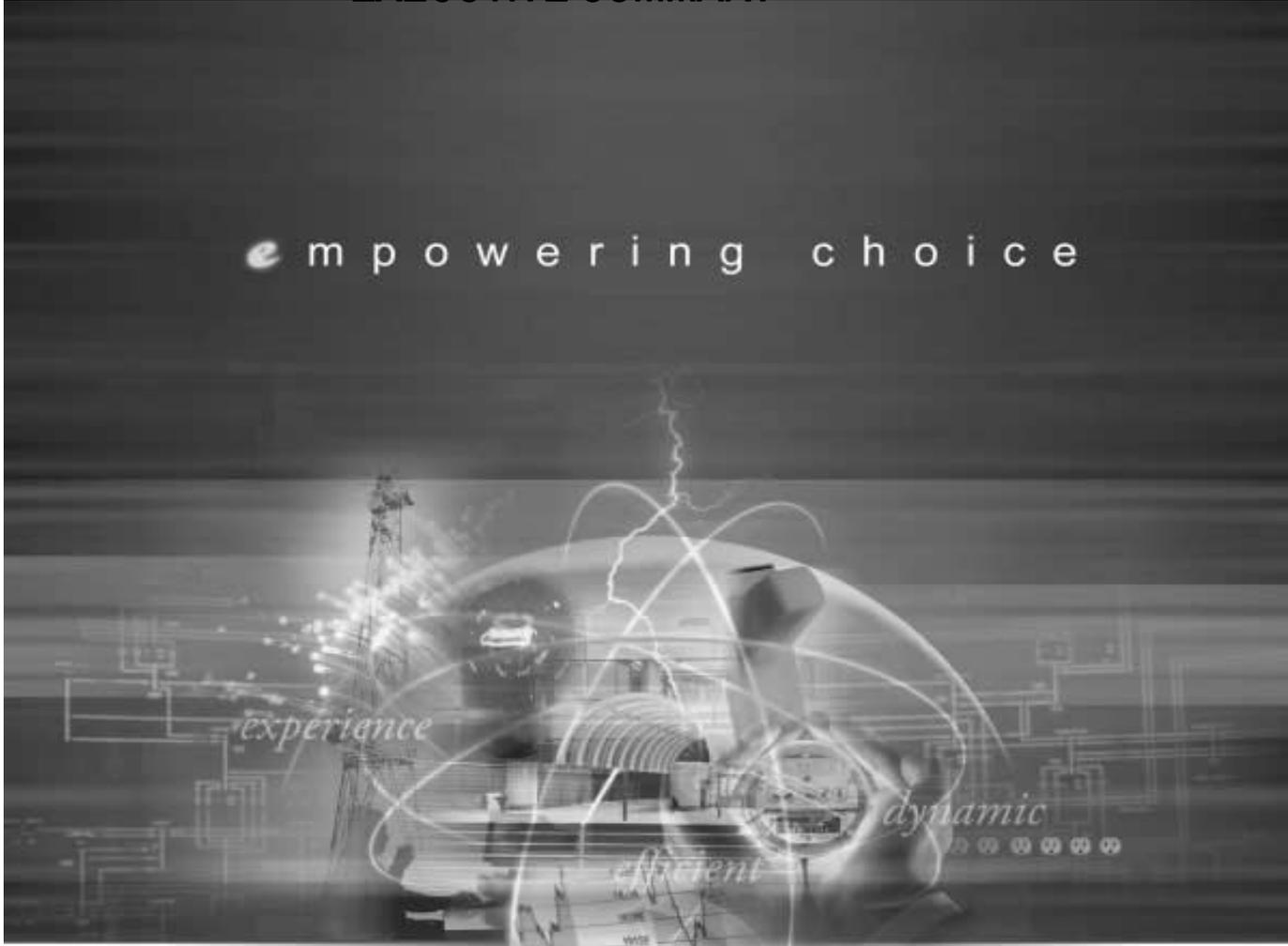
COMMENTARY

The IMO Business Plan for 2002 to 2004 (the “Plan”) contains two pages, out of 49, describing benchmarking. The Plan contains one graph comparing the 2001 budgets for three nearby ISOs, including PJM, New York and New England. The graph shows that the IMO has the highest budgeted costs of the four ISOs for 2001, even though PJM is approximately 75 per cent higher in energy throughput. The Plan provides little analysis of the Rumla, Inc study commissioned by the IMO and does not indicate that benchmarking provided any guidance in developing the budget in the Plan.

AMPCO believes that the IMO should use benchmarking as a means to establish objectives in its budgeting process, e.g. being the most efficient in some measurable way among the ISOs. AMPCO recognises the fact that comparative benchmarking is a time-consuming exercise, however it is a valuable one for all market participants and the IMO in terms of cost control.

AMPCO, along with several other stakeholders, support the initial steps taken by the IMO in the direction of estimating costs for specific services rather than a simple “lump sum” for each cost category. The Plan provides estimates of operating costs for the dispatch function, settlement services as well as operating the spot market and other markets. AMPCO believes this is an important initiative for the IMO because such delivery costs on a per megawatt basis will allow stakeholders to compare delivery costs in other ISOs and such services that may be available in the private sector. As a result, AMPCO strongly encourages the IMO in this initiative.

EXECUTIVE SUMMARY



**2002-2004
BUSINESS PLAN
October 2001**



EXECUTIVE SUMMARY

Electricity restructuring worldwide continued as a dynamic process in 2001 and provides context for Ontario as it proposes to launch its markets in 2002. The drivers to this business plan are market launch early in 2002 and a shift in focus to market operation and customer service.

The following table summarizes the resources required to meet the IMO's objective of managing a robust and viable electricity marketplace in Ontario.

Resource Estimates 2001 - 2004

	2001 OEB Approved Budget	2001 Projection	2002	2003	2004
Revenue Requirements¹					
OM&A					
Program Costs	\$90.7M	\$86.0M	\$85.0M	\$86.0M	\$80.7M
Pension Income	(\$4.2M)	(\$2.9M)	-	-	-
Amortization & Interest	<u>\$49.4M</u>	<u>\$37.6M</u>	<u>\$68.9M</u>	<u>\$64.4M</u>	<u>\$62.6M</u>
Total Revenue Requirements	\$135.9M	\$120.7M	\$153.9M	\$150.4M	\$143.3M
Capital Expenditures					
Integration Management Program	\$34.5M	\$53.3M	\$43.8M	-	-
Other	<u>\$26.7M</u>	<u>\$12.6M</u>	<u>\$22.5M</u>	<u>\$15.0M</u>	<u>\$15.0M</u>
Total Capital Expenditures	\$61.2M	\$65.9M	\$66.3M	\$15.0M	\$15.0M
Staff Levels at Dec. 31²	417	424	414	409	398
IMO Usage Fee (\$/MWh)	N/A	N/A	0.959	0.959	0.900

OM&A program costs have been managed down through 2001, and are projected to remain at this reduced level over the period of market opening in 2002.

Revenue requirements increase in 2002 due to increased amortization and interest associated with Integration Management Program assets being placed into service¹.

Capital expenditures, in total, are \$0.4M higher in 2002 compared to projected 2001.

² 2001 Projected staff levels is based on actual staffing at the end of August 2001.

¹ Revenue requirements have been restated from the 2001-2003 Business Plan to be consistent with this plan's treatment of the prior period surplus/(deficit) and cost recovery revenue. Section 5.1 provides further details.

Integration Management Program (IMP) costs have increased over the 2001 estimate, reflecting the impact of delay in market opening, associated adjustments in project work, and later in-service dates for some elements of project capital.

Staff levels are reduced in 2002.

Usage Fee is at \$0.959/ MWh in 2002.

The 2002 – 2004 Fee Calculations are based on the following assumptions:

- Market opening March 1, 2002;
- Energy withdrawals including exports (in terrawatt hours): 2002 – 152.6 TWh (125.5 TWh for the period March 1 – Dec. 31, 2002); 2003 – 155.8 TWh; 2004 – 158.0 TWh.
- Interest Rates: 3.0% on short-term investments, long-term debt refinanced over the planning period at 5.0%.
- The forecast variance account balance of \$8.8 million contributes to meeting the revenue requirements for 2002.
- Cost recovery for services of \$0.7 million for 2002, and \$1M for 2003 and 2004.
- The Fees for 2003 and 2004 reflect the currently identified programs. As these change, so will revenue requirements and fees.

The IMO is seeking the following approvals from the OEB:

- approval of its proposed revenue requirement of \$153.9 million in 2002;
- approval of its proposed capital expenditure of \$ 66.3 million in 2002;
- approval of monthly revenue of \$ 12.03 million under the Transitional Revenue Allocation Agreement for each month prior to market opening; and
- approval of a usage fee of \$0.959/MWh to be paid after market opening by all wholesale customers or market participants on all energy withdrawn for use or sale in Ontario and on all export schedules out of Ontario.

Comparisons to similar organizations have been conducted. They show that the IMO's total costs are comparable to other market operators in the Northeastern U.S.

This Business Plan is organized as follows:

- A review of industry developments in North America, Canada and Ontario. It is in this context that guidelines for this plan were developed (Chapter 2).
- A description of the IMO business from the perspective of the services provided to market participants. This presentation, new to this Business Plan, will be further developed for future plans. (Chapter 3)
- Performance management is addressed in Chapter 4, and is a priority for the Board of Directors, our customers and in the regulatory process associated with the review of our fees and our expenditure and revenue requirements.
- Resource requirements are detailed starting in Chapter 5, with Chapter 6 addressing Revenue Sources and Associated Approvals, and Chapter 7 setting out Financial Policies and Pro Forma Statements.

Review of this Plan by the IMO Board

The IMO Board of Directors has reviewed and approved the 2002 – 2004 Business Plan as setting the overall direction for the business, and within that context, the budget for 2002. The proposed expenditures and revenue requirements for 2002 along with the fees the IMO proposes to charge during 2002 have also been approved by the IMO Board for submission to the Ontario Energy Board (“OEB”) for review under Section 19 of the *Electricity Act, 1998*.