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BY EMAIL & REGULAR MAIL

February 19, 2009
File No.: 101926.1052

Kirsten Walli
Board Secretary
Ontario Energy Board
PO Box 2319
2300 Yonge Street
Toronto, ON M4P 1E4

Dear Ms. Walli:


**Re: Independent Electricity System Operator – Fiscal 2009
Fees Submission for Review: EB-2008-0340**

I enclose for filing the Settlement Proposal agreed to between the IESO and all intervenors who participated in the Settlement Conference on February 17, 2009 (the "Intervenors").

As stated in the Settlement Proposal, the IESO and Intervenors agreed to a settlement on all issues contained in the Issues List and the Intervenors agreed to the IESO's proposed revenue requirement, capital expenditures and fees.

The IESO respectfully requests that the Board accept the Settlement Proposal and approve the IESO's proposed revenue requirement, capital expenditures and fees as set out in its Fiscal Year 2009 Fees Submission for Review.

Yours truly,


for: Glenn Zacher

/sc
Encl.
cc: Board Staff
Registered Intervenors and observers

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INDEPENDENT ELECTRICITY SYSTEM OPERATOR (IESO)
FISCAL YEAR 2009 FEES SUBMISSION FOR REVIEW
SETTLEMENT PROPOSAL
EB-2008-0340

This Settlement Proposal is filed with the Ontario Energy Board (“the OEB” or “Board”) for consideration in the determination of the Independent Electricity System Operator (“the IESO”) Fiscal Year 2009 Fees Submission for Review, EB-2008-0340 (the “IESO’s 2009 Fees Submission”). A Settlement Conference was conducted on February 17, 2009 pursuant to Rule 31 of the OEB’s *Rules of Practice and Procedure* (the “Rules”) and the OEB’s *Settlement Conference Guidelines*. This Settlement Proposal arises from the Settlement Conference and was prepared in accordance with Rule 32 of the Rules.

The following parties (the “Parties”) participated in the Settlement Conference:

- The IESO;
- Association of Major Power Consumers in Ontario (“AMPCO”);
- Energy Probe Research Foundation (“Energy Probe”);
- Ontario Power Generation (“OPG”);
- Society of Energy Professionals (“SEP”); and
- Vulnerable Energy Consumers Coalition (“VECC”).

Hydro One Networks Inc. (“HONI”) and the Electricity Distributors Association (“EDA”) participated with the Parties in the Technical Conference held on January 30, 2009, but did not participate in the Settlement Conference.

This Settlement Proposal addresses all issues on the Board-approved issues list (the “Issues List”), namely:

1. Operating Cost
2. Asset Backed Commercial Paper (“ABCP”) Investments
3. Capital Spending
4. Stakeholdering Process
5. Smart Metering Initiative
6. Reliability

The Parties are satisfied with the evidence on all of the issues and have agreed to a settlement on all of the issues.

The OEB Staff is not party to this Settlement Proposal and takes no position on any issue.

By way of background, a Technical Conference was held on January 30, 2009 and Board Staff and intervenors examined panels of IESO witnesses on the matters contained in the Issues List; the Technical Conference was transcribed. The IESO answered undertakings arising from the Technical Conference and circulated and filed these answers with the Board on February 5, 2009.

On the basis of the IESO’s 2009 Fees Submission, pre-filed evidence, evidence provided at the Technical Conference and the response to undertakings from the

Technical Conference, the Parties agree to the approvals sought in the IESO's 2009 Fees Submission, including, the IESO's proposed 2009 revenue requirement, capital expenditure requirement, usage fee and application fee.

In accordance with Rule 31 of the Rules and the *Board's Settlement Conference Guidelines*, this Settlement Proposal outlines the Parties' agreement and provides a direct and transparent link between each issue and the evidence in the record. The Parties further agree that the evidence is sufficient to support the Settlement Proposal and that the quality and detail of this supporting evidence will allow the Board to make findings on the issues.

IESO 2009 Proposed Revenue Requirement, Expenditures and Fees

The Parties agree to the IESO's 2009 proposed revenue requirement of \$130.3 million and proposed 2009 capital expenditures of \$22.9 million.

The Parties agree to the continuation of the \$1,000 application fee and proposed IESO usage fee of \$0.822/MWh commencing January 1, 2009 (to be charged in the manner provided in the IESO's 2009 Fees Submission). The Parties also agree to a rebate in 2009 of any accumulated surplus in the manner proposed in the IESO's 2009 Fees Submission.

The following general evidence, in addition to the specific evidence cited under the issues below, supports this agreement:

- Exhibit A, Tab 1, Schedule 1, IESO's 2009 Fees Submission.
- Exhibit B, Tab 1, Schedule 1, 2009-2011 Business Plan, pages 1, 8-9, 22-47.
- Exhibit B, Tab 2, Schedule 1, Letter to Minister of Energy and Infrastructure dated September 30, 2008 and Letter from Minister of Energy and Infrastructure dated October 22, 2008.
- Exhibit B, Tab 3, Schedule 1.
- Exhibit B, Tab 4, Schedule 1, Summary of Enhanced Day-Ahead Commitment Process.
- Exhibit B, Tab 7, Schedule 1, 2006-2008 Actual Capital Expenditures.
- Exhibit B, Tab 8, Schedule 1, IESO Financial Update.
- Final Transcript for January 30, 2009 Technical Conference.

1.0 Operating Cost

1.1 Are the IESO's projected OM&A Costs reasonable?

The Parties are satisfied with the evidence set out below:

- Exhibit B, Tab 1, Schedule 1, 2009-2011 Business Plan, pages 22-32, 42.
- Exhibit B, Tab 8, Schedule 1, IESO Financial Update.
- Final Transcript for January 30, 2009 Technical Conference, pages 7-39.

1.2 Are the IESO's projected staff costs and strategy for setting compensation levels appropriate and reasonable?

The Parties are satisfied with the evidence set out below:

- Exhibit B, Tab 1, Schedule 1, 2009-2011 Business Plan, pages 27-28.
- Exhibit B, Tab 5 Schedule 1, Appendix B, 2007 Annual Report pages 24-28.
- Final Transcript for January 30, 2009 Technical Conference, pages 10-23, 26-36, 39-41.
- IESO Answers to Undertaking, filed February 5, 2009, JT1.1.

2.0 Asset-Backed Commercial Paper (ABCP) Investments

2.1 What are the financial consequences of the IESO's investments in ABCP on the IESO operating costs and its 2009 revenue requirements and have they been appropriately incorporated in the fees submission?

2.2. Is the IESO's policy for treatment of ABCP investments going forward appropriate and reasonable?

With regards to Issues 2.1 and 2.2, the Parties are satisfied with the evidence set out below:

- Exhibit B, Tab 1, Schedule 1, 2009-2011 Business Plan, pages 12, 14-15, 25.
- Exhibit B, Tab 5, Schedule 1, Summary of IESO Treatment of ABCP Investments.
- Exhibit B, Tab 5, Appendices A and B.

- Exhibit B, Tab 5, Schedule 2, ABCP Update.
- Final Transcript for January 30, 2009 Technical Conference, pages 41-61.

In the Board's Decision and Order on the IESO's 2008 Fees Submission, the Board stated that it expected that IESO's 2009 Fees Submission would clearly address the ABCP issue and the financial consequences for the IESO. The foregoing evidence addresses this point, specifically: B-5-1, Summary of IESO Treatment of ABCP Investments; B-5-2, ABCP Update; and, pages 41-61 from the Technical Conference transcript.

3.0 Capital Spending

3.1 Has the IESO demonstrated the need for a day-ahead commitment mechanism?

3.2 Has the IESO considered appropriate alternatives for the proposed Enhanced Day-Ahead Commitment ("EDAC") mechanism?

3.3 Has the proposed mechanism for EDAC received appropriate stakeholder support and agreement?

3.4 Does the IESO Board approval of the EDAC mechanism constitute full and final approval for implementation of the mechanism?

3.5 Is the IESO's proposed schedule for implementation of the proposed EDAC mechanism practical and reasonable?

3.6 Are the projected expenditures including \$15.9 million in 2009 and \$10.6 million in 2010 on EDAC appropriate and reasonable?

With regards to Issues 3.1 to 3.6, the Parties are satisfied with the evidence set out below:

- Exhibit B, Tab 1, Schedule 1, 2009-2011 Business Plan, pages 7, 33-34, 45.
- Exhibit B, Tab 4, Schedule 1, Summary of Enhanced Day-Ahead Commitment Process.
- Exhibit B, Tab 4, Appendices A, B, C and D.
- Final Transcript for January 30, 2009 Technical Conference, pages 61-97.
- Schedule A attached hereto.

3.7 Are the IESO's proposed capital expenditures, other than EDAC, appropriate and reasonable?

The Parties are satisfied with the evidence set out below:

- Exhibit B, Tab 1, Schedule 1, 2009-2011 Business Plan, pages 33-39, 45-46.
- Exhibit B, Tab 7, Schedule 1, 2006-2008 Actual Capital Expenditures.
- Exhibit B, Tab 8, Schedule 1, IESO Financial Update.
- Final Transcript for January 30, 2009 Technical Conference, pages 75-76.

4.0 Stakeholding Process

4.1 Do the IESO's stakeholder engagement processes provide appropriate opportunity for stakeholders to provide input and feedback regarding IESO initiatives and processes?

The Parties are satisfied with the evidence set out below:

- Exhibit B, Tab 1, Schedule 1, 2009-2011 Business Plan, pages 7-10.
- Exhibit B, Tab 3, Schedule 1, Summary of Stakeholding of the 2009-2011 Business Plan.
- Exhibit B, Tab 3, Schedule 1, Appendices A, B, C and D.
- Final Transcript for January 30, 2009 Technical Conference, pages 107-111.

5.0 Smart Metering Initiative

5.1 Is the IESO's process for separating of costs associated with its role as the Smart Metering Entity from costs associated with its role in operating the provincial electricity system and managing the wholesale electricity market appropriate?

The Parties are satisfied with the evidence set out below:

- Exhibit B, Tab 1, Schedule 1, 2009-2011 Business Plan, pages 48-52.
- Exhibit B, Tab 6, Schedule 1, Summary of IESO Treatment of Smart Metering Costs.

- Final Transcript for January 30, 2009 Technical Conference, pages 100-107, 111-112.

During the March 20, 2008 hearing concerning the IESO's 2008 Fees Submission, the Board asked the IESO to more clearly distinguish the assets, liabilities and expenses of the SME in the financial material filed in support of the 2009 IESO fees application. The IESO has done this. Specifically, as indicated in the foregoing evidence, the IESO included in its Business Plan a separate financial outlook relating to the SME (see pages 48-52 of B-1-1, 2009-2011 Business Plan).

5.2 Has the IESO in its role as the Smart Metering Entity, received Ontario Energy Board approval of a fee mechanism to recover Smart Metering Entity costs incurred, and has the Smart Metering Entity filed a separate fees submission to recover these costs?

The Parties are satisfied with the evidence set out below:

- Exhibit B, Tab 1, Schedule 1, 2009-2011 Business Plan, pages 48-52.
- Exhibit B, Tab 2, Schedule 1, Letter from Minister of Energy and Infrastructure dated October 22, 2008.
- Exhibit B, Tab 6, Schedule 1, Summary of IESO Treatment of Smart Metering Costs.
- Final Transcript for January 30, 2009 Technical Conference, pages 100-107.

As indicated in the foregoing evidence, the Minister requested that the IESO submit a detailed implementation plan and schedule for integration of local distribution systems into the MDM/R prior to filing the SME fees application. The IESO is developing that plan. As well, the governance structure of the SME is currently under review and is the subject of discussions between the Ministry and the EDA. The IESO does not intend to move forward with an SME fee application until there is more progress in resolving these matters.

6.0 Reliability

6.1 Are the IESO's proposed 2009 measures to address reliability appropriate and cost-effective?

The Parties are satisfied with the evidence set out below:

- Exhibit B, Tab 1, Schedule 1, 2009-2011 Business Plan, pages 1, 4-6, 35, 45-47.
- Final Transcript for January 30, 2009 Technical Conference, pages 4-7.

SCHEDULE "A" SUMMARY OF EVIDENCE ON EDAC

In its Decision and Order on the IESO's 2008 Fees Submission, the Board did not approve that part of the 2008 settlement proposal concerning proposed capital expenditures for a day-ahead market ("DAM") on the basis that there was insufficient evidence. Specifically, the Board stated that the DAM cost-benefit analysis (the "CBA") had not been completed and the IESO's Board of Directors had not yet approved the DAM initiative and the associated project budget.

As indicated in the foregoing evidence, the IESO subsequently completed the DAM cost-benefit analysis in May 2008 and, on September 5, 2008, the IESO's Board approved the proposed day-ahead initiative (since renamed EDAC) and the associated capital budget. As the foregoing evidence further indicates (and as specifically regards Issues 3.1 to 3.6):

- The IESO's May 2008 CBA (Exhibit B, Tab 4, Schedule 1, Appendix A) established that the benefits of the proposed EDAC were substantial and that the payback period was approximately two years. In particular, the CBA and follow-up studies demonstrated that the proposed EDAC design would bring the most value to the province of any of the options considered at the lowest overall cost.
- The IESO considered five different options. Two were ruled out at the end of 2007 and three options were investigated further and were evaluated as part of the May 2008 CBA.
- The proposed EDAC mechanism received extensive stakeholder input and support.¹ Stakeholders were consulted on the three options that were evaluated through the CBA and on the appropriate CBA methodology. Following the CBA, stakeholders were further consulted and all supported additional work and analysis on the "common elements" of the three options. Throughout the summer of 2008, further stakeholdering was undertaken to address specific stakeholder concerns and to try to further quantify the benefits of various designs. At the end of August 2008, a draft design was released by the IESO — i.e. the proposed EDAC option — and the large majority of stakeholders approved the proposed EDAC (some marketers/traders, while in favour of a day-ahead mechanism, preferred the Unconstrained Day-Ahead Market option).²

¹ See specifically, Exhibit B, Tab 4, Schedule 1

² See specifically, Exhibit B, Tab 4, Schedule 1 Appendix C

- The IESO Board approved the proposed EDAC initiative and the associated budget on September 5, 2008. This approval constitutes full and final IESO Board approval of EDAC and the associated budget, subject to Audit Committee authorization for the graduated release of capital funds. A first tranche of capital to carry out detailed design work (i.e., design of market rules, business requirements and system requirements) was authorized by the Audit Committee on February 11, 2009.
- The IESO's proposed schedule for implementing EDAC over the next two years remains practical and reasonable. The project is well underway and the first major milestone — market design — has been completed and no significant design issues were identified by the IESO or stakeholders. At present, the IESO estimates an approximate three month delay to the schedule for project in-service filed in evidence.
- The IESO's projected capital expenditures of \$26.5 million remain appropriate and reasonable for capital planning purposes. It should be noted that this estimate included a contingency of \$4.6 million.