

August 2, 2013

Independent Electricity System Operator
Stakeholder Engagement

Re: SE 110 Transmission Rights Market Review – Phase 1 Analysis: Results and Recommendations

OPG would like to thank the IESO for the opportunity to comment on the results and recommendations presented at the July 25, 2013 stakeholder engagement meeting.

Absent the numerical value of the correlation coefficients accompanying the data, OPG directionally agrees with the IESO's assessment that strictly based on the graphical representation of the analysis none of the three areas of study: competition, energy trade, and increased participation in the TR market are ostensibly correlated to TR availability. However, OPG submits that the apparent lack of correlation could be primarily attributable to deficiency of the analysis and that there isn't conclusive evidence to support the claim that changes to TR availability have no impact on trader behaviour. In specific, energy traders' primary motivation is to realize gains from trade between areas with price spreads that exceed the costs of moving power and the risk of congestion. Ownership of TRs can "hedge" the congestion risk; however, absent the forecast of a favourable price spread, traders have no incentive to engage in physical transactions and to purchase Transmission Rights regardless the quantity of TRs available. As OPG stated in its previous submission in the stakeholder forum, in order to yield high conclusive credibility, the analysis should be *normalized* against other key variables, such as the presence of favourable trading conditions. For example, an increase in TR availability during periods when there is no market incentive to trade would not result in increased completion, trade, and TR participation. Conversely, when market conditions incentivize trade, increased TR availability would offer more opportunity for "hedging" congestion and would attract more trade-related activity. In summary, OPG believes that a logical relationship between TR availability and energy trade is obscured by market conditions, undermining the strength on the conclusions that could be drawn by the performed analysis.

OPG believes there are other market factors that may skew the analysis, especially when focusing on TR Participation and Ownership, and Market Share. In Appendix G, the IESO observes that "the number of participants bidding in ST auctions increased until 2009, then levelled", meanwhile "confidence levels changes have not resulted in a significant or continued increase in TR participation". OPG submits that, given the nature of the electricity market and the small number of entities that generally participate in this type of economic activity, reaching a plateau in TR participation is to be expected. Although, past a certain point increasing availability of TRs is not sufficient incentive to attract new participants in the TR market, the converse cannot be assumed to be true; reducing the TR volume would likely increase the expected TR price, which in turn can dissuade exiting participants to both register and participate in future TR auctions. TR market participation can also be affected by other factors independent of TR availability. For example, entities can decide to either engage or forgo TR auction activity strictly based on strategic decisions related to business direction and financial well-being, introducing further inaccuracy into a strict correlation analysis.

Ultimately, OPG contends that the performed analysis suggests that there isn't a strong correlation between TR availability and trading activity, where the volume of TR available for purchase is able to overcome market conditions and other external factors and drive participation in TR auctions and overall trading behaviour. However, supported by the actions and behaviour of its own trading outfit, OPG asserts that when market conditions support trade, TR availability is an important factor influencing the level of activity in the TR Auction as well as the actual inter-jurisdictional trading activity. Reducing TR availability reduces the likelihood that an entity would participate in a TR auction on account of a higher expected price, and also decreases the likelihood of it putting on a physical trade due to higher risk of unmitigated congestion losses. OPG contends that intended benefits set out in 2004 were achieved to some degree by the increase in TR availability, although the extent to which is unclear and is obscured by the presence of other factors in the IESO analysis.

In summary, OPG believes that any changes to TR availability must be made cautiously and gradually via a closely monitored iterative process. As discussed above, given certain market conditions, a reduction in TR availability will reduce trader activity, which in turn may adversely impact the IESO in periods of SBG as well as during periods of supply shortages. OPG encourages the IESO to share the limitations of its analysis with the IESO board to inform their understanding of the risks involved in changing, and in specific reducing the number of available transmission rights.

OPG understands IESO's goal for Phase 1 to be a change to the existing confidence level for Long Term TRs (i.e., change the derivation of the base quantity) and a modification to the stabilization algorithm used in the calculation of the Short Term TR quantity. OPG would like to express concern regarding a possible duplications leading to over-reductions of TRs on paths affected by both processes and again cautions the IESO to take a conservative approach in converging towards its intended outcome of matching transmission congestion rents to TR holder payouts.

Regards,

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