Market Rule Amendment Written Submission

This form is used to provide comment on a *market rule* amendment under consideration by the *IESO*. Please complete all four sections of this form and submit the completed form by email or fax to the following:

Email Address: Rule.Amendments@ieso.ca
Fax No.: (416) 506-2847 **Attention: Market Rules Group**
Subject: Market Rule Written Submission

All information submitted in this process will be used by the *IESO* solely in support of its obligations under the *Electricity Act, 1998,* the *Ontario Energy Board Act, 1998*, the *Market Rules* and associated policies, standards and procedures and its licence. All submitted information will be assigned the *confidentiality classification* of "Public" upon receipt. You should be aware that the *IESO* intends to *publish* this written submission.

Terms and acronyms used in this Form that are italicized have the meanings ascribed thereto in Chapter 11 of the *Market Rules*.

PART 1 – SUBMITTER'S INFORMATION

Please enter your organization and contact information in full.

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PART 2 – MARKET RULE AMENDMENT REFERENCE

Type of Rule Amendment Being Commented on (please indicate with x):

☐ Amendment Submission ☒ Proposed Rule Amendment ☐ Recommended Rule Amendment

MR Number: MR00370

This *Market Rule* number is located on the "Current Market Rule Amendment" web page.

Date Relevant *Amendment Submission*, Proposed or Recommended Rule Amendment Posted for Comment: July 7, 2010

[1] This number is a maximum of 12 characters and does not include any spaces or underscore.

PART 3 – COMMENTS ON RULE AMENDMENT

Provide your comments.

Pursuant to the IESO's request for feedback on market rule proposal MR-00370 (Limiting CMSC Payments for Exporters and Dispatchable Loads), below please find comments from Ontario Power Generation Inc (OPG). OPG appreciates the opportunity to provide comments on this subject.

Background

The IESO has proposed a market rule amendment which, for the purpose of calculating constrained on CMSC payments for an exporter or a dispatchable load, would replace all bid prices less than $-50 with the lesser of $-50 or the zonal market clearing price. This change would effectively act as a bid price floor mechanism for CMSC calculations, capping the revenue any market participant may earn pursuant to the market rules in respect of constraint payments.

Intended Outcome

In its proposed rule amendment, the IESO cites concerns raised by the Market Surveillance Panel (MSP) in its January 2010 Monitoring Report specifically in reference to constrained payments in the Northwest. In its report, the MSP suggests using replacement bid prices for all export and dispatchable loads to alleviate what it considered to be excessive CMSC payments. It is stated that this would achieve consistency with generators and importers, who have been subjected to a similar restriction since 2003.

General Comments on Proposal

There are a number of issues with the proposed market rule, both at the principled level and the practical level.

Ontario's existing two-pass dispatch system takes transmission constraints into consideration in determining which assets will operate and which will not. CMSC payments are an integral part of the market design as they ensure that a participant will receive the operating profit received under the market (unconstrained) schedule, thereby preventing penalization based on physical location. The proposed rule amendment is one sided in that it limits revenues earned by exporters in successful transactions that improve market efficiency by moving energy from a lower priced market to a higher priced market, but provides no compensatory downside risk coverage when transactions are unsuccessful and the trader suffers a loss. The proposed amendment limits gains but allows for unlimited losses.

The IESO needs to ensure that the proposed change does not create market outcomes where a market participant is forced to suffer a financial loss on a transaction despite an economic bid to the market that would have mitigated such loss. Failing to address the possibility of undue, rule-induced financial losses would violate a fundamental principle of Market Design – efficiency. The presence of unwarranted financial risk will discourage exporters from participating in otherwise economic transactions, which in turn will reduce competition and create inefficient market outcomes.

Market efficiency considerations come into sharper focus within the context of the Surplus Baseload Generation (SBG) situation in which Ontario currently finds itself. Practically speaking, this proposed rule change, if approved, would reduce the capability of market

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participants to move energy out of Ontario during periods of Surplus Baseload Generation (SBG), an activity that has served market operations well in the last 18 months. While the IESO has attempted to address such situations in its proposal, the analysis contains a number of elements that render its output somewhat suspect. OPG will address these elements below.

Specific Comments on Proposal

In a published market rule amendment revision, the IESO calculates an average of $26.60 and standard deviation of $21.75 for 2009 ONTW prices. The average minus two standard deviations was calculated to be -$16.90. The IESO also estimated transactional costs incurred by exports by summing relevant outbound charges paid in Ontario as well as import fees in MISO. The average, standard deviation, and 'average minus two standard deviations' were calculated to be respectively $7.44, $4.44 and $16.32. Further, an assertion that "95% of all prices fall within two standard deviations from the average price" was made and used as a basis for including a portion of the worse case scenarios highlighted above. -$50 was proposed as a replacement bid price.

OPG believes that the analysis does not appropriately capture an exporter's exposure to MISO negative zonal prices, transaction charges and fixed costs. Firstly, OPG's own analysis of the identical data set (reflected in matching average and standard deviation numbers) does not concur with the IESO's assertion regarding the percentage of price falling within two standard deviations from the average. As the data did not conform to a normal distribution, 95% (5thpercentile equivalent of lowest prices) of all prices do not fall within two standard deviations from the average price. Similarly, export transaction costs did not exhibit normal distribution properties either.

OPG also disagrees with the IESO's inclusion of all hours in 2009 as the sample space for the 5th percentile analysis. The presence of primarily positive MISO-ONTW prices yields a 5th percentile price of $2.69, which is not reflective of the worse case scenarios and the risks that exist for exporters. OPG believes that the analysis should focus on instances when market conditions present the opportunity for efficient exports into a negative MISO market.

Furthermore, the 95% consideration allows traders in 5% of the worst case scenarios to continue to be arbitrarily penalized for executing an efficient trade with a bid price that hedges their risk in the sink market. Given that ONTW prices do not follow normal distribution and do not comply with the 2 standard deviations or 5th percentile equivalent principle, OPG could support the use of the 1st percentile, which provides a more meaningful basis and ensures that the Ontario market has rules in place to adequately prevent penalization of efficient trade.

Furthermore, the summation of values derived from the average of two data sets likely misaligns the time of occurrence of the worse case scenarios. In other words, an event where a low ONTW price and a high export charge occurred simultaneously will be ignored by yearly averages. A more appropriate analysis would look at the hourly cost summation of ONTW prices and transaction charges prior to the application of statistical analysis.

Alternate Proposal

While OPG firmly holds to the principled arguments that arbitrary bid limits are unnecessary, if

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the IESO feels compelled to impose such a limit, OPG could support a limit which provides adequate incentive for traders to continue to participate in economic export transactions. Furthermore, opportunity costs and a portion of fixed costs should also be considered to better capture the fundamentals of trading activity, where a market revenue neutral transaction would not recover other associated costs and support the existence of a trading entity.

The proposed analysis (described above), which incorporates the considerations and methodology brought forth by the IESO, requires that the alternative price be no greater than -\$150/MWh. A cap of less than -\$150/MWh should allow the majority of efficient trades to occur. This price limit represents a 93% reduction relative to the current limit of -\$2,000 and consists of a -\$125/MWh base price (rounded value of -\$124.23) and \$-25 allowing for cost recovery and encouraging trading activity. The -\$124.23 reflects the 1st percentile of all 2009 instances when the reference Ontario price was more negative than respective ONTW price. The following table provides a summary of OPG's analysis (described above).

		Number of hours	5th percentile (95% equivalent)		1st percentile (99% equivalent)		0.01th percentile (99.99% equivalent)	
			No Charges	With Charges	No Charges	With Charges	No Charges	With Charges
2009	All 2009 hours	8,760	\$2.69	-3.10	-\$32.82	-39.00	-\$155.30	-166.10
	ONTW< 0	360	-\$82.78	-91.45	-\$138.92	-144.76	-\$174.18	-179.72
	Pine < ONTW < 0	145	-\$74.18	-79.69	-\$120.02	**-124.23**	-\$152.31	-163.77

Table 1- ONTW and Export Charge analysis

As is the nature of fixed price solutions in a changing market, the validity of a fixed price may lessen if market conditions where to change. In order to ensure that the market rule amendment does not force a market participant to perpetually lose money in the future, it is important that this price be periodically reviewed; moreover, to allow for expedited change if necessary, it is recommended that the bid replacement price be set by the IESO Board and not hardcoded into the Market Rules. Participants should also be informed in advance of any change to the bid replacement price.

PART 4 – EXTERNAL CONSULTATION MEETING

If you believe that a special meeting of stakeholders would be necessary/desirable to discuss the issues raised by the rule amendment, please complete the following information:

External Stakeholdering meeting necessary/desirable (please indicate with x): ☐

Reason(s) why you believe a meeting is necessary/desirable:

PART 4 – EXTERNAL CONSULTATION MEETING