Market Rule Amendment Submission

This form is used to request an amendment to, or clarification of, the *Market Rules*. Please complete the first four parts 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 Amendment 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* will *publish* this *amendment submission* if the *Technical Panel* determines it warrants consideration and may invite public comment.

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 contact information in full.

Name: IESO Staff

(if applicable) *Market Participant* / *Metering Service Provider* No.[1]: N/A

Market Participant Class: N/A

Telephone: 416-506-2801

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E-mail Address: rule.amendments@ieso.ca

PART 2 – MARKET RULE AMENDMENT SUBMISSION INFORMATION

Subject: Congestion Management Settlement Credits (CMSC)

Title: Constrained off CMSC Payments for Imports and Exports

Nature of Request (please indicate with x)

☒ Alteration ☐ Deletion ☐ Addition ☐ Clarification

Chapter: To be determined Appendix: ________ Sections: ________

Sub-sections proposed for amending/clarifying: ________

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

PART 3 – DESCRIPTION OF THE ISSUE

Provide a brief description of the issue and reason for the proposed amendment. If possible, provide a qualitative and quantitative assessment of the impacts of the issue on you and the *IESO-administered markets.* Include the Chapter and Section number of the relevant *market rules*.

The IESO's Market Assessment Unit (MAU) has identified a situation where market participants can structure their import offers or exports bids to receive constrained off CMSC payment amounts that are inconsistent with market design principles and the intent of these payments. Some market participants have determined with reasonable certainty that there will be internal congestion in Ontario, and are consistently offering imports at prices that lie between the shadow price near the intertie and the zonal clearing price in Ontario. As a result, the transaction is scheduled in the market schedule but is constrained off in the constrained schedule and the market participant receives a constrained off CMSC payment. These payments may continue over a number of hours or days and yet the market participant does not materially change its offer strategy so that the transaction can actually take place (i.e. change the offer price so that the transaction is accepted in the constrained schedule.

The MAU questions the appropriateness of making constrained off CMSC payments to a market participant calculated in the usual manner for a transaction that is consistently constrained off by the IESO with almost no risk of delivery. These CMSC payments are not consistent with the market design principle of efficiency which states that: "The market should promote allocative, productive and dynamic efficiency in the provision of electricity by minimizing the total resource costs of providing power to all customers". The Market Surveillance Panel (MSP) has asked the MAU to seek a market rule amendment to deal with this issue.

The MAU has sought the cooperation of certain market participants to temporarily exercise restraint in their offer strategies so that an appropriate solution can be developed through stakeholdering. A stakeholder engagement plan was developed to involve stakeholders in assisting the IESO to address this issue.[1] The IESO published a discussion paper to describe the issue and to present one possible solution (see attached). The IESO's initial proposal, as outlined in the discussion paper, was to address the situation through a settlements formula change.

A stakeholder working session was held on November 16, 2005 to provide stakeholders with the opportunity to:

- Comment on the issue and the initial solution suggested by the IESO, and
- Suggest alternative solutions that would address the identified issue.

As result of stakeholder input, the IESO is considering alternative solutions. Participants at the stakeholder working session asserted that it is not appropriate for all intertie transactions to be affected by a proposal intended to address the behaviour of a few market participants. Rather than an automatic settlement-based solution, it was suggested that instances where the identified behaviour is suspected should be investigated on a case-by-case basis.

[1] Details of the Stakeholder Engagement Plan and associated materials are available at http://www.ieso.ca/imoweb/consult/consult_se10.asp.

PART 4 – PROPOSAL (BY SUBMITTER)

Provide your proposed amendment. If possible, provide suggested wording of proposed amendment.

Amend the Market Rules to include provision(s) that enable the IESO to adjust constrained off CMSC payments for imports and exports to mitigate the identified behaviour.

As outlined in the attached discussion paper, one proposal would be to amend the settlements formula used to calculate constrained off CMSC payments for all import and export transactions such that importers and exporters would receive constrained off CMSC payments based on the zonal price minus the greater of:

- the participant's offer/bid price, or
- the hub price in the applicable neighbouring control area.

An alternative solution would be to assess each constrained off import and export transaction on a case-by-case basis. This would require market rule amendments to:

- establish criteria to test for the identified behaviour,
- permit the IESO to adjust constrained off CMSC payments for imports and exports where the identified behaviour is established based on those screens, and
- define the parameters for the calculation of the CMSC payment adjustments.

Recognizing that all interties do not have the same characteristics, a "one-size-fits-all" solution may not be appropriate. Therefore, a third alternative could be a hybrid combination of the above proposals.

PART 5 – FOR IESO USE ONLY

Technical Panel Decision on Rule *Amendment Submission:* ______________________

MR Number: MR-00306

Date Submitted to *Technical Panel*: November 24, 2005

Accepted by *Technical Panel* as: (please indicate with x) Date:

☒ General ☐ Urgent ☐ Minor November 29, 2005

Criteria for Acceptance:

It identifies means to better enable the market to satisfy the market design principle of efficiency. This principle states: "The market should promote allocative, productive and dynamic efficiency in the provision of electricity by minimizing the total resource costs of providing power to all customers". As stated in the 2nd Interim Report of the Market Design Committee, constrained off payments are side payments for opportunity costs from foregone energy sales. The constrained off CMSC payments in question are judged to be inappropriate because they do not reflect opportunity costs from foregone energy sales.

Priority: High

PART 5 – FOR IESO USE ONLY

Criteria for Assigning Priority:

1. Pervasiveness of the problem: The CMSC payments in question are a result of bidding strategies that result in higher costs to the market through increased uplift charges.
2. Practical consequences: The MAU has sought the cooperation of certain market participants to temporarily exercise restraint in their offer strategies while stakeholder discussions are underway. There is a need to address the issue in a timely manner to remove the potential for other participants to employ this offer strategy now that it has been exposed.

Not Accepted (please indicate with x): ☐

Clarification/Interpretation Required (please indicate with x): ☐

Technical Panel Minutes Reference: IESOTP 174-1

Technical Panel Comments: ______

Discussion Paper on Proposed Changes to Constrained off CMSC Payments to Importers and Exporters

November 4, 2005

Background

The IESO's Market Assessment Unit (MAU) identified to the Market Surveillance Panel how market participants can structure their import offers or exports bids to receive constrained off CMSC payment amounts inconsistent with market design principles and the intent of these payments. The Panel asked the MAU to bring this issue to the attention of the IESO's market rules group with a view to introducing market rule amendments to restrict CMSC payments in the identified circumstances. In the interim, so that the market rule amendment process can benefit from a comprehensive stakeholdering rather than resort to an urgent rule amendment, the MAU has sought the cooperation of certain market participants to temporarily exercise restraint in their offer strategies.

This discussion paper presents a description of the issue and one proposal to address it. Recognizing the need to address the issue in a timely manner, the IESO believes that the proposal outlined in this paper can be implemented expeditiously. However, this proposal does not preclude other suggestions for short-term and/or longer-term solutions. As such, the IESO encourages stakeholders to propose alternative solutions. Should the development of an enduring solution require additional time and/or stakeholdering sessions, the Stakeholder Engagement Plan will be adjusted accordingly.

Description of the Issue

Where a market participant knows with reasonable certainty that there will be internal congestion in Ontario, some market participants are consistently offering imports at prices that lie between the shadow price near the intertie and the zonal clearing price in Ontario. As a result, the transaction is scheduled in the market schedule but is constrained off in the constrained schedule and the market participant receives a constrained off CMSC payment. These payments may continue over a number of hours or days and yet the market participant does not materially change its offer strategy so the transaction can actually take place.

The MAU questions the appropriateness of making the usually calculated constrained off CMSC payments to a market participant for a transaction that the participant seemingly never intended to flow. These CMSC payments are not consistent with the market design principle of efficiency which states that: "The market should promote allocative, productive and dynamic efficiency in the provision of electricity by minimizing the total resource costs of providing power to all customers". The CMSC payments in question are the result of bidding strategies that result in higher costs to the market through increased uplift charges[1].

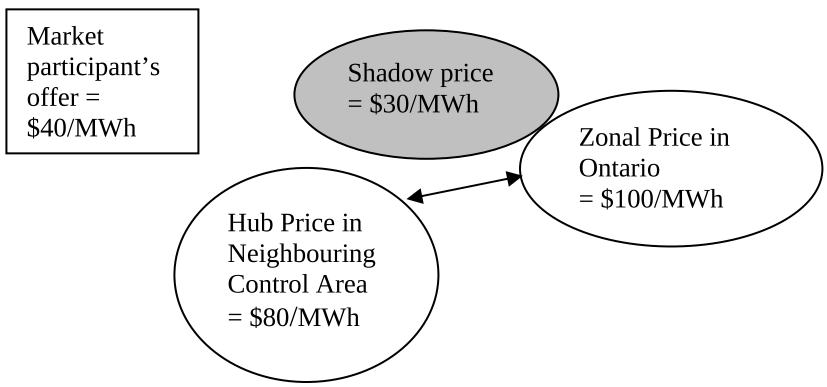
[1] For the six month period from April to September 2005, constrained off positive CMSC payments to importers totalled approximately $20 million. Using the approach outlined in the next section of this discussion paper to restrict constrained off CMSC payments to importers and exporters in the identified circumstances, total constrained off positive CMSC payments to importers alone during those six months would have been reduced by approximately $7 million.

Under the current market rules, an importer or exporter receives constrained off payments equal to the difference between the uniform price and their offer/bid price. The offers (and bids) were chosen in the original market design as a practical proxy for opportunity costs (and values)[2].
With the development of other markets surrounding Ontario, opportunity costs for importers and exporters are more transparent and easier to quantify. It's been observed that some offers and bids are not in line with the participant's opportunity costs as reflected by the hub prices in neighbouring control areas.

The following example illustrates the observed inconsistency between:

- import offer prices and opportunity costs, and
- the profit implications of the market schedule versus the constrained schedule.

<u>Example</u>



Scenario 1: Transaction flows in Ontario		**Scenario 2: Transaction constrained off in Ontario**	
MP's Production costs	($40/MWh)	MP's Production costs	($40/MWh)
Amount received by selling into neighbouring control area	$80/MWh	Amount received by selling into neighbouring control area	$80/MWh
Cost of buying out of neighbouring control area to sell into Ontario	($80/MWh)	No costs incurred for buying out of neighbouring control area since the transaction is constrained off	$0/MWh
Amount received by selling into Ontario	$100/MWh	Amount of constrained off CMSC payment	$60/MWh
Net Benefit	$60/MWh	Net Benefit	$100/MWh

CMSC payments were designed to ensure that the market participant was no worse off for following dispatch instructions, i.e. had the same profit as in the market schedule. The above example illustrates a situation where a market participant is not financially indifferent to the dispatch

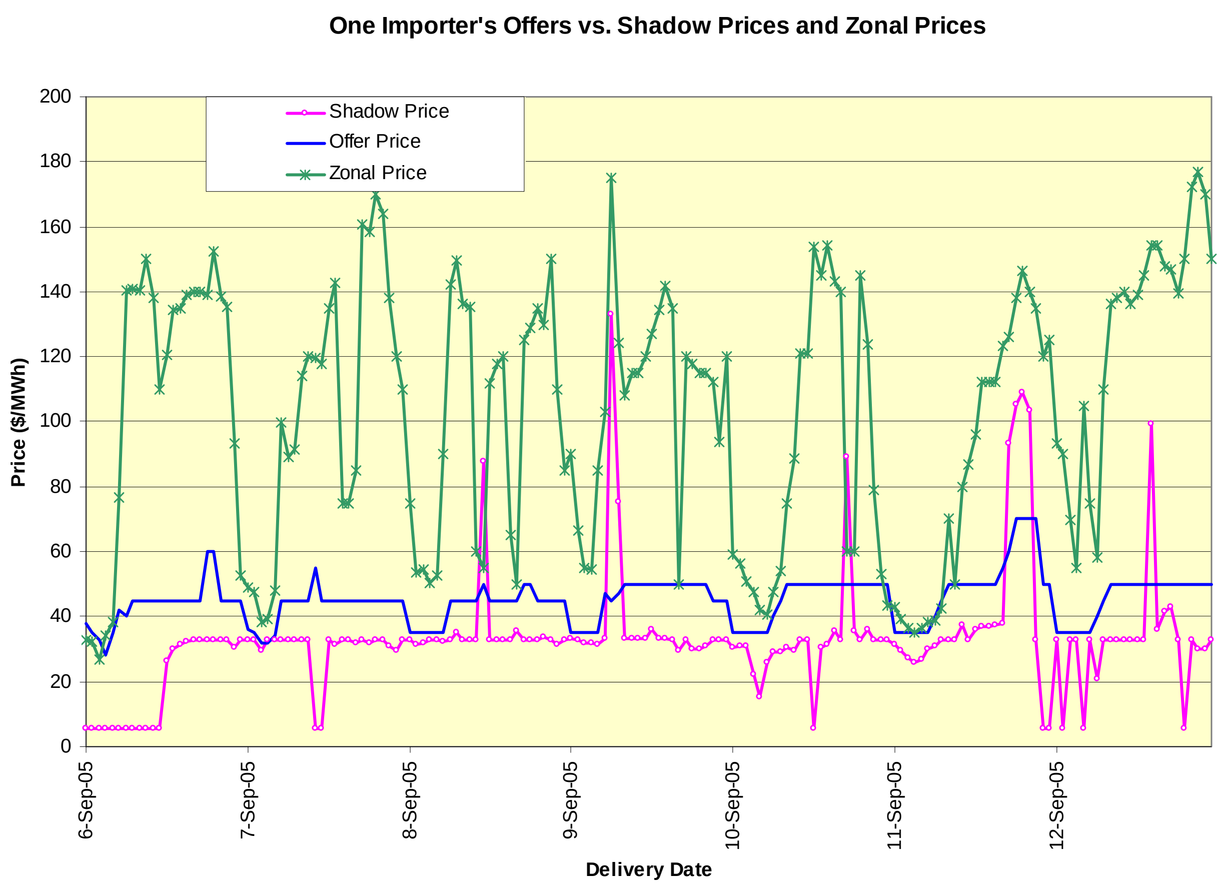
[2] The local market power mitigation framework of Appendix 7.6 accepts that current offers (and bids) should reasonably reflect opportunity costs (and values) to the extent that these offers (and bids) were similar to past offers (and bids) accepted in the market schedule. This practice was based on the assumption that the (unconstrained) market schedule was sufficiently competitive to ensure some reasonable level of consistency between offers and the costs that were expected to be incurred for the supply.

instruction; the participant earns a higher profit when the transaction is constrained off. The constrained off CMSC payments enables the participant to earn payments that are inconsistent with the intent of CMSC payments.

Figure 1 illustrates how one market participant has benefited from the identified circumstances by structuring import offers such that the offers consistently fall between the shadow price near the intertie and the zonal clearing price in Ontario.

The market rules provide for procedures by which transmission-related congestion management settlement credit (CMSC) payments may be mitigated by the IESO in circumstances where market participants are judged to have local market power. However, based on the local market power screens in section 1.3. of Appendix 7.6, the identified circumstances would not necessarily be considered a local market power situation.[3] Therefore, the IESO believes that a market rule amendment is required to restrict constrained off CMSC payments to importers and exporters in the identified circumstances.

Figure 1



[3] The review under Appendix 7.6 ends if there are at least three other market participants with resources, that in total, are able to meet the constrained off requirement.

IESO Proposed Solution

The intent of the CMSC regime is to compensate market participants who incur costs due to IESO instructions. As stated in the 2nd Interim Report of the Market Design Committee, constrained-off payments are side payments for opportunity costs from foregone energy sales, equal to the difference between the uniform price and the energy bid.[4] The report also indicates that, "additional rules would probably be needed to ensure that market participants did not use unfair bidding strategies to increase their side payments."[5]

The IESO is proposing to address the situation through a settlements formula change. The proposed change is intended to better align the constrained off payments for importers and exporters with their opportunity costs from foregone energy sales.

In order to better align constrained off CMSC payments with the intent of such payments, the IESO is proposing that importers and exporters would receive constrained off CMSC payments based on the zonal price minus the greater of:

- the participant's offer/bid price, or
- the hub price in the applicable neighbouring control area.

With the exception of Quebec, wholesale markets prices are available for each of the neighbouring control areas to which Ontario is interconnected. A suggested proxy for the Quebec interconnections is the maximum of New York or New England prices for the relevant period.

Applying this proposal to the example above, the market participant would have received a constrained off CMSC payment of $20 (instead of $60). This constrained off payment would make the participant financially indifferent about whether the transactions flows or not.

Although the identified offer strategies are more prevalent on certain interties due to the frequency of Ontario transmission constraints, the proposed change would apply to all interies to ensure consistent treatment of all intertie transactions. The proposed change would not apply to constrained off payments to generators; generators would continue to receive constrained off CMSC payments based on the difference between the market clearing price and their offer price. The rationale for excluding generators from the proposed change is due to the fact that an external price is not accessible to generators. Importers and exporters, on the other hand, have other markets in which they can transact.

[4] Market Design Committee, 2nd Interim Report (June 30, 1998), Chapter 3: Wholesale Market Design, p.14.

[5] Ibid, p.14.