

## 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@theIMO.com](mailto:Rule.Amendments@theIMO.com)

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 *IMO* 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 *IMO* 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 –SUBMITTERS’ INFORMATION

Please enter contact information in full

<b>Name: Electricity Distributors Association</b>	
(if applicable) <i>Market Participant / Metering Service Provider No.</i>	<b>Market Participant Class: Distributor</b>
<b>Telephone: 416-484-5313</b>	<b>Fax: 416-483-9039</b>
<b>Email Address: whawkins@eda-on.ca</b>	
<b>Name: ENWIN Power Lines Ltd.</b>	
(if applicable) <i>Market Participant / Metering Service Provider No.: 102209</i>	<b>Market Participant Class: Distributor</b>
<b>Telephone: 519-251-7300 ext 609</b>	<b>Fax: 519-251-7308</b>
<b>Email Address: ggesuale@enwinpowerlines.com</b>	
<b>Name: Hamilton Hydro Inc.</b>	
(if applicable) <i>Market Participant / Metering Service Provider No.: 102084</i>	<b>Market Participant Class: Distributor</b>
<b>Telephone: 905-522-6611</b>	<b>Fax: 905-522-6570</b>

## PART 1 –SUBMITTERS' INFORMATION

Please enter contact information in full

Email Address: <a href="mailto:chmckenzie@hamiltonhydro.com">chmckenzie@hamiltonhydro.com</a>	
Name: Kingston Electricity Distribution Limited	
(if applicable) <i>Market Participant / Metering Service Provider</i> No.: 104322	<i>Market Participant Class:</i> Distributor
Telephone: (613) 546-1181 ext. 2460	Fax: (613) 546-5921
Email Address: <a href="mailto:ntaylor@utilitieskingston.com">ntaylor@utilitieskingston.com</a>	
Name: London Hydro Inc.	
(if applicable) <i>Market Participant / Metering Service Provider</i> No.: 104282	<i>Market Participant Class:</i> Distributor
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Email Address: <a href="mailto:stephenj@londonhydro.com">stephenj@londonhydro.com</a>	
Name: Orangeville Hydro Limited.	
(if applicable) <i>Market Participant / Metering Service Provider</i> No.: 104480	<i>Market Participant Class:</i> Distributor
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Email Address: <a href="mailto:gdick@orangewillhydro.on.ca">gdick@orangewillhydro.on.ca</a>	
Name: Thunder Bay Hydro Electricity Distribution Inc.	
(if applicable) <i>Market Participant / Metering Service Provider</i> No.: 102741	<i>Market Participant Class:</i> Distributor
Telephone: 807-343-1111	Fax: 807-343-2663
Email Address: <a href="mailto:twright@tbhydro.on.ca">twright@tbhydro.on.ca</a>	
Name: Whitby Hydro Electric Corporation	
(if applicable) <i>Market Participant / Metering Service Provider</i> No.: 104276	<i>Market Participant Class:</i> Distributor
Telephone: 905-427-9481	Fax: 905-668-8791
Email Address: <a href="mailto:jlavelle@whitbyhydro.on.ca">jlavelle@whitbyhydro.on.ca</a>	

**PART 2 – MARKET RULE AMENDMENT SUBMISSION INFORMATION**

<b>Subject: Settlements and Billing</b>		
<b>Title: The inconsistency between IMO's Market Rules and OEB's codes and guidelines is having an serious adverse financial impact on LDCs with potential negative implications for the stability of the broader market</b>		
<b>Nature of request (please indicate with X):</b> <input type="checkbox"/> Alteration <input type="checkbox"/> Deletion <input checked="" type="checkbox"/> Addition <input checked="" type="checkbox"/> Clarification		
<b>Chapter: 9</b>	<b>Appendix:</b>	<b>Sections: 6.11</b>
<b>Sub-sections proposed for amending/clarifying : 6.11.1</b>		

**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 *IMO-administered markets*. Include the Chapter and Section number of the relevant market rules.

**This Urgent Rule Amendment Submission is made to address the immediate and urgent adverse financial impacts on local distribution companies ("LDCs") arising from the inconsistency between the OEB-defined role and capitalization of LDCs and the Market Rules that require LDCs to bear commodity risk.** The particular amendment discussed herein should not be taken to be the only amendment that may ultimately be required to adequately deal with the broader problem of LDC risk under the current market design. **The intent of this Submission is solely to mitigate the serious problem of LDCs underwriting all non-distribution charges, and not in any way to remove or diminish the responsibility of LDCs to effectively and diligently execute cash management and collection functions.**

**The financial risks related to commodity placed on the LDCs which, as explained below, are beginning to be realized, are dealt with more comprehensively in the report entitled "LDC Commodity Risk Analysis and Recommendations dated August 8, 2002", attached hereto. We refer the reader to the attached report for the qualitative and quantitative assessment of the impacts of the issue addressed in this Urgent Rule Amendment Submission.**

The *Energy Competition Act, 1998* requires LDCs to provide "non-discriminatory access" to their distribution systems. To effectively carry out this neutral role, LDCs were intended to have no financial interest in commodity and ancillary costs.

The OEB established as a guiding principle for its decision RP-1999-0040 (Standard Supply Service) the tenet that "a distributor should not bear any [significant] volume risk or price risks in providing standard supply service". Consistent with this view, the OEB issued guidelines to LDCs regarding how to capitalize their corporations to assure compatibility with their role as pass-through agents. Specifically, the OEB provided to each LDC a formula-based working capital allotment and provided guidelines on appropriate debt to equity ratios. In other words, the financial structures of the LDCs are designed based upon their intended role as pass-through agents and are not designed to accommodate the financial risks inherent in being liable for the cost of the commodity itself.

Notwithstanding this fact, Market Rules have been issued by the IMO that are completely incompatible with

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these structures, in that LDCs are required to fully settle the IMO invoice, and to do so prior to receiving payments from end-users. Chapter 9, subsection 6.11.1 requires LDCs to bear significant commodity risk by (a) “bridge financing” the time lag between wholesale settlement and retail collection and (b) keeping the IMO whole by fully absorbing any payment defaults by end-users. The Market Rules have effectively made LDCs the bearers of credit and default risk arising in bilateral transactions between retailers/consumers and generators, which is completely inconsistent with the OEB's ruling RP-1999-0040 and the capital structure approved by the OEB for the LDCs.

**Chapter 9, subsection 6.11.1** provides that each market participant shall pay the full net invoice amount by the market participant payment date. Accordingly, LDCs bear 100% payment obligation to the IMO to pay the full amount of their monthly invoice before they have received payment from consumers through the retail settlement process. This obligation exists equally in times of higher prices and in the event that consumers, including electricity retailers and their customers, default in their payments to the LDCs.

The fact that there is a time lag between the point when LDCs must pay the monthly IMO invoice and the earliest opportunity they can fully collect from end-users creates significant cash flow problems and financial risk for LDCs which poses a serious threat to the stability and integrity of the electricity market. In order to pay the full amount of the IMO invoice before full collection from end-users occurs, LDCs must keep 100% of their working capital and credit available to be immediately accessed on the 12<sup>th</sup> business day of each month. This need for limitless, on-immediate-demand liquidity puts at risk an LDC's ability to provide stable financing to its normal business activities. To the extent that distribution operations and projects are impacted or deferred as a result of attempts to preserve the LDCs' ability to perform this bridge financing function, the business of distributing electricity and consumers can suffer serious harm. Further, the realized impact of this risk has already caused LDCs to far exceed their OEB-allowed working capital allotments and, in many cases, their available credit lines as well, and carries the potential to financially harm an LDC, negatively impact its shareholders and destabilize the electricity market. If the LDC is unable to meet its invoice payment obligation, the LDC's credit worthiness can be destroyed, its prudentials cashed, and the integrity of the commodity market put in jeopardy.

The absolute requirement upon LDCs to fully pay the IMO monthly invoice exists whether or not the consumer or retailer defaults on its payments to the LDC. The current rule requires the LDC to absorb the immediate financial loss caused by any commodity payment default by an end-user, and to bring an application to the OEB to seek approval to retroactively recover the defaulted amounts from other customers. Unfortunately, a retroactive application to seek recovery of defaulted commodity amounts does not mitigate the fact that the requirement to absorb the initial impact of defaults is a potentially significant risk which too can cause LDCs to exceed their OEB-allowed working capital allotments, and carries the same negative potential as described above.

The financial risks placed upon the LDCs are now being realized. The amounts invoiced by the IMO to LDCs for July and August were roughly \$800 million and \$860 million, respectively. It is expected that LDCs' aggregate September bill will total approximately \$1.1 billion or more. To put this in perspective, the OEB's aggregate working capital allotment to LDCs as a group is roughly \$950 million. The commodity financing obligation, along with the IMO 10-day invoicing delay recorded at market opening, IMO prudentials and other significant costs already incurred by LDCs including market readiness expenditures, have exhausted this allotment.

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Many LDCs, in addition to exhausting their working capital allotment, are quickly exhausting their lines of credit. By way of specific examples,

- a) Enwin Powerlines Ltd. has a \$30 million line of credit, but after paying the August 2002 bill, Enwin Powerlines Ltd. was overdrawn on its line of credit in the amount of \$20 million; and
- b) Kingston Electricity Distribution Limited expects to fully utilize its line of credit upon payment of the IMO's September invoice.

Accordingly, the inconsistency between the IMO's Market Rules and the OEB-defined role and capitalization of LDCs is causing an adverse financial impact for LDCs. Further, the commodity financing obligations created by Chapter 9, Subsection 6.11.1 of the Market Rules have generated the potential for LDC default.

The recent addition of the deferred payment plan ("DPP") to the Market Rules has only slightly mitigated the financial risks borne by LDCs and the broader market. Many LDCs simply do not possess the credit capacity to finance price escalations up to the current trigger point. As well, the DPP's effectiveness in protecting the financial integrity of the market is further limited by the fact that LDCs continue to bear unlimited price financing risk once the DPP coverage limit is surpassed.

In addition to being insufficient, the current obligation of LDCs to cover the costs of the DPP is inappropriate. It is a backstop credit facility to ensure the commodity market is kept whole. LDC involvement in this endeavor, and their financing of the credit facility to accomplish it, is inconsistent with the OEB's articulation of the role of LDCs and guidelines as to their appropriate financial structure.

The financial structures of the LDCs were not intended to, nor should they, support the significant commodity risk imposed by the 100% payment obligation to the IMO. Accordingly, the proposed rule amendment articulated in Part 4 below would qualify Chapter 9, subsection 6.11.1 such that LDCs would only be obliged to remit funds which they have collected up to the invoice date.

In accordance with subsection 34(1) of the *Electricity Act, 1998*, the proposed rule amendment meets the urgent rule amendment criteria of avoiding, reducing the risk of, or mitigating the affects of an unintended adverse affect of a Market Rule. As well, this urgent rule amendment satisfies the IMO's statutory objective to establish and operate the IMO-administered market so as to promote the purposes of the Act, including protecting the interests of consumers with respect to the reliability and quality of electricity service, promoting economic efficiency in distribution of electricity and facilitating the maintenance of a financially viable electricity industry.

**PART 4 – PROPOSAL (BY SUBMITTER)**

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

The proposed amendment to 6.11.1 would provide that LDCs are only obliged to remit funds which they have collected up to the due date.

The suggested wording is as follows:

6.11.1 Subject to section 6.11.2 and section 11.5 of Chapter 2, each market participant shall pay the full net invoice amount by the market participant payment date specified in the SSPC or, where applicable, determined in accordance with any of sections 6.3.23, 6.3.27 and 6.3.29, regardless of whether or not the market participant has initiated or continues to have a dispute respecting the net amount payable. Provided, however, that where a market participant is a licensed distributor, such market participant shall be obliged to pay to the IMO only the amounts related to wholesale settlement collected by the market participant at the date of the invoice.

**Further, any credit facility which is deemed necessary to address any shortfalls in payments to IMO creditors ought to be financed by those who will benefit from such a facility, namely, licensed generators and retailers.**

PART 5 – FOR *IMO* USE ONLY

<b>Technical Panel Decision on Rule Amendment Submission</b>	
<b>MR number: MR-00212-Q00</b>	
<b>Date submitted to Technical Panel:</b> 18 Oct 2002	
<b>Accepted by Technical Panel as:</b> <input checked="" type="checkbox"/> <b>General</b> <input type="checkbox"/> <b>Urgent</b> <input type="checkbox"/> <b>Minor</b> (please indicate with X)	<b>Date:</b> 22 Oct 2002
<b>Criteria for acceptance: Identifies a potential inconsistency between the “Market Rules” and applicable laws, regulations, codes, OEB licences, etc</b>	
<b>Priority: High</b>	
<b>Criteria for assigning priority: Pervasiveness of the problem: the issue could potentially affect all LDCs</b>	
<b>Not accepted (please indicate with X):</b>	
<b>Clarification/interpretation required</b> (please indicate with X):	
<b>Technical Panel minutes reference: IMOTP 115-1</b>	
<b>Technical Panel Comments:</b>	
<p>The Technical Panel unanimously determined that the identified issue, i.e. the financial stresses on local distribution companies, warranted consideration and needed to be addressed with some urgency. The Panel, however, did not agree that the suggested rule change is the appropriate means to address the issue.</p> <p>The Technical Panel believes that the financial stresses on local distribution companies needs to be addressed in the broader context of the role and regulation of local distribution companies in the wholesale and retail markets. The Panel believes an appropriate forum for addressing these broader issues is through the OEB-IMO working group recently established specifically to address these issues. The Panel urged that local distribution companies be brought into the working group soon, and that the working group address the issues expeditiously. The IMO representative on the working group asked for Technical Panel members for their advice on the issues and potential solutions.</p> <p>The Technical Panel intends to table the amendment submission until such time that the working group has identified the appropriate actions needed to address the issue. If these involve market rule amendments, the Technical Panel will consider the amendments as a priority.</p>	