

May XX, 2018

Ms. Rosemarie T. Leclair
Chair & CEO
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Dear Ms. Leclair:

Re: Market Surveillance Panel Monitoring Report

On March 26, 2018, the IESO responded to your letter dated February 23, 2018, in which you requested the IESO, to advise you of: a) the steps that the IESO plans to take in response to the recommendations made in the Market Surveillance Panel (MSP) *Monitoring Report on the IESO Administered Electricity Markets* for the period from May 2016 to October 2016, and the timelines for completion of those steps; and b) in the IESO's view, whether any actions or market rule amendments should be taken or initiated in addition to those reflected in the MSP recommendations.

In that letter, I stated that it is important for the IESO to fully understand the Panel's recommendations and observations, and that the IESO would meet with the Panel to discuss the recommendations, prior to providing a more comprehensive response. Subsequently, the IESO had a productive and collaborative meeting with the Panel to discuss its most recent recommendations and discussed the IESO's approach to address the new and outstanding recommendations.

The purpose of this letter is to provide further information on the IESO's positions on the three recommendations in the March 2018 MSP report and the actions we intend to take.

1. "Unwarranted" CMSC Payments due to a Facility's Operational Constraints

Recommendation 3-1, MSP Monitoring Report for May 2016 – Oct 2016:

The Independent Electricity System Operator should implement rules that allow it to recover Congestion Management Settlement Credit payments made to dispatchable loads when those payments are the result of an operational constraint arising from conditions at the dispatchable load's facility. The IESO should also examine whether the scope of the current provisions that allow it to recover CMSC payments from generators in relation to SEAL-related constraints

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should be expanded to cover any other operational constraints arising from conditions at the generator's facility.

The IESO is reviewing the performance of resources, including dispatchable loads, to dispatch instructions, as well as application of the current rules governing uplift payments in certain circumstances. The IESO will incorporate the MSP's recommendation with our own observations to develop a comprehensive approach to improve performance. The IESO is currently aiming to finalize the scope and approach for this project by the end of Q3 2018 and will provide an update to the MSP on next steps. The IESO will also connect with the MSP shortly in relation to its views on the application of the rules, owing to confidentiality obligations it must follow in respect of enforcement matters.

As discussed with the Panel, the IESO intends to further discuss the Panel's recommendation to examine CMSC payments made to generators for operational constraints other than SEAL arising from conditions at a generator's facility to better understand their perspectives on this matter.

2. Constrained-On Exports – Replacement Bid Price

Recommendation 4-1, MSP Monitoring Report for May 2016 – Oct 2016:

The Independent Electricity System Operator should set the replacement bid price to \$0/MWh, or slightly negative, when it calculates constrained-on Congestion Management Settlement Credit payments for exports bid at negative prices.

The IESO agrees with the Panel's observations that utilizing a \$0/MWh replacement bid price could have reduced consumer uplift charges by over \$2.1 million based on the report's look-back period from July 2011 to September 2016 for constrained-on export CMSC payments.

However, the IESO believes that the Market Rule changes¹ put in place in 2015 in response to previous Panel recommendations have addressed the issue of constrained-on export CMSC payments in the Northwest to the point where these payments are immaterial. Since the IESO implemented the 2015 market rule change, the amount of uplift charges related to this recommendation has decreased significantly to approximately \$16,000 in 2016 and \$4,000 in 2017. The IESO also notes that the existence of constrained-on export CMSC payments does not necessarily mean that any participant was engaged in "nodal price chasing", but only shows that traders were chasing perceived arbitrage opportunities, of which some could potentially be driven by "nodal price chasing" behaviour.

¹ MR-00423-R00: Limiting Constrained-Off Congestion Management Settlement Credits at the Interties – effective September 18, 2015.

Efficient intertie trade is critical to having an overall healthy and efficient electricity market. Specifically, intertie trade plays an important role in providing operational and planning flexibility that enhance the reliability and the cost-effectiveness of the Ontario electricity system. Interties allow energy providers from outside Ontario to compete with domestic suppliers to meet electricity needs at lowest cost and also provide opportunities to better utilize Ontario facilities.

Given the importance of intertie trade, the IESO is concerned that a higher replacement bid price floor, as suggested by this recommendation, may deter traders from submitting export bids below \$0/MWh on any intertie due to the risk of being constrained-on, which would impose unnecessary losses on traders and deter trading. This could result in both a reduction in the effectiveness of a valuable system tool during surplus conditions, and possibly higher costs to ratepayers.

The IESO believes the best course of action is not to make any changes related to this recommendation.

3. Operating Reserve Activation Failures

Recommendation 4-2, MSP Monitoring Report for May 2016 – Oct 2016:

- A. The Independent Electricity System Operator's Board of Directors should revise the materiality threshold value such that operating reserve payments are clawed back when a market participant fails to fully respond to its operating reserve activation.*
- B. When a market participant fails to fully respond to an operating reserve activation, the Independent Electricity System Operator should calculate the claw back based on the ratio of the energy not provided in response to the activation relative to the energy required by the activation.*

The IESO agrees with the Panel that operating reserve suppliers should not be paid if they do not provide the expected amount of energy during an Operating Reserve activation. However, the current formula for operating reserve clawback articulated in the Market Rules does not take into account the impact of the 'compliance deadband' and, as a result, will often clawback operating reserve revenues even when the full amount of energy has been delivered following an operating reserve activation.

The IESO considers operating reserve to be a critical reliability service. As such, the IESO monitors the performance of operating reserve suppliers activated to provide energy. In general, operating reserve shortfalls have not impacted power system reliability. The IESO assesses compliance to Operating Reserve activations regularly and participants that are observed to fail to produce energy when activated are frequently disqualified from

participation in the Operating Reserve market for days or weeks. The IESO has used the method described above (disqualifying participants from offering in the Operating Reserve market) to manage performance issues. This approach has allowed the IESO to maintain compliance to North American Electric Reliability Council (NERC) standards and Northeast Power Coordinating Council (NPCC) requirements related to power system balancing requirements for Ontario. For example, the BAL-002 standard requires the IESO to recover the Area Control Error (ACE), a measure to how we balance the system, using reserve within 15 minutes of a disturbance. The IESO has not had to report non-compliance to this standard.

As discussed during our meeting with the Panel, the IESO is reviewing the effectiveness of the current operating reserve regime, including whether different mechanisms are needed to ensure that suppliers are delivering the expected reliability service and providing ratepayer value, and will provide an update to the Panel on its approach by Q4 2018.

With respect to the OEB's question on whether any actions or market rule amendments should be taken or initiated in addition to those reflected in the MSP's recommendations, the IESO has not identified any additional actions or market rule amendments that should be taken or initiated related to these recommendations. However, our effectiveness review of the current operating reserve regime, including the role of dispatchable load resources, may uncover additional actions for consideration.

Please do not hesitate to contact me should you have any additional questions on these matters.

Yours truly,

Peter Gregg
President & CEO

cc: Glenn Leslie, Chair, Market Surveillance Panel