



REPORT

Intertie Transactions Failures Guidelines

Market Assessment and Compliance Division
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1. INTRODUCTION

In March 2005 the IESO's Market Assessment and Compliance Division (MACD) established a working group to advise on the effectiveness of its existing guidelines in reducing intertie transaction failures and to provide advice on revised guidelines and the associated market manual. The group's terms of reference are attached as Appendix A.

MACD took this action in light of the continuing problem of significant volumes of inter-jurisdictional energy transactions failing in real-time in the IESO-administered market. As will be apparent later in the report, this is not a problem uniquely associated with traders; however MACD took the view that its enforcement of the market rule provisions dealing with the component of transaction failures perceived as within the control of market participants was not effective and needed review.

The market rules address transaction failures in two provisions. Section 7.5.8A of Chapter 7 of the rules places an obligation on market participants to schedule energy across the intertie in accordance with the relevant interchange schedule. The rules provide for a formula-based penalty if it is determined that there were no 'bona fide and legitimate reasons' for the failure of any such transaction. Section 7.5.8B states that bona fide and legitimate reasons "...include failures caused by actions and circumstances beyond the control of the market participant..." or due to errors or actions by the IESO or external system operator. A separate provision, section 1.3.5 of Market Manual 4.2 identifies errors in the NERC tagging process as a potential breach of the market rules by market participants.¹ NERC tag errors may cause interchange transactions to fail.

MACD's guidelines with respect to intertie failures on the NYISO and MISO interfaces explain the tests it applies to decide whether to investigate for a possible breach of the rules those transaction failures that appear to be under the control of market participants. They identify 'safe harbours' or conditions under which an investigation will normally be discontinued. The guidelines were established to ensure an efficient use of MACD and market participant resources and not unnecessarily restrict electricity trading. There were published to clearly communicate to market participants MACD's enforcement intentions.

The working group was chaired by MACD and composed of representatives of Brascan Energy Marketing Inc., Coral Energy Canada Inc., DTE Energy Trading Inc., HQ Energy Marketing Inc., MACD, Ontario Power Generation Inc., and Powerex Corp. A series of meetings were held to discuss the nature and significance of transaction failures and discuss possible remedies to reduce them. Extensive non-confidential data were made available to provide details on transaction failures across the different interties from several different perspectives.

This report summarizes MACD's key findings. While the report benefits from the insights and observations of the working group, ultimately it is the responsibility of the business unit delegated by the IESO to enforce compliance with the market rules, MACD, to reach decisions on its enforcement approach. In drafting the report, an effort was made to develop and reflect the consensus view of the working group, to the greatest extent possible. The impact of these views is clearly reflected in the policy conclusions described in section 4 of the report. The conclusions also take into consideration the initiatives recently announced by the IESO designed to improve reliability in preparation for summer, 2006

¹ Section 7.7.2 of Chapter 1 of the market rules binds the IESO and market participants to comply with the provisions of market manuals.

The report is organized as follows: the next section provides an overview of the impact of intertie transaction failures on Ontario system reliability and market performance. While both are important, reliability is identified as the primary goal driving enforcement. Section 3 presents summary data on transaction failures over the past two years. It documents that NYISO accounts for more than two-thirds of IESO's transaction failures. The data also reveal that MACD's screening guidelines for New York transaction failures tolerate relatively high failure rates for several market participants.

Section 4 provides a brief summary and conclusions. It considers the salient points of the data and provides the rationale for the resulting policy conclusions. These relate to clarifications of MACD's screening guidelines for both the NYISO and MISO markets, more stringent conditions on supply tight days and identification of a means to make the treatment of market participant intertie failures market-based without the stigma of rule breaches. Finally, in addition to the main body of the report, there are a number of appendices providing more detailed information.

2. SYSTEM AND MARKET IMPACTS OF TRANSACTION FAILURES

Market Efficiency

As noted in successive reports of the Market Surveillance Panel, failed intertie transactions are a contributing factor to distorted market signals exemplified by the persistent price discrepancy between pre-dispatch and real-time prices.² As an input to the Working Group deliberations MACD conducted a study to give a sense of the contribution of failed transactions to change in real time price. The study simulates the impact on the real-time market clearing price had transactions failures not occurred in subsets of randomly selected days over the period August 2003 to April 2005. It provides an illustration of the impact of failures due to NERC tag errors or uneconomic bids. The methodology and findings are summarized in Appendices B to D.

Though the working group members agreed that transaction failures contribute to price discrepancy between pre-dispatch and real time price, they felt the analysis did not accurately capture the proportion of this contribution relative to other contributions. They recommended further work before attempting to draw policy conclusions. MACD undertook to continue to refine its analysis, subject to conflicting priorities in its work program. Because of the primordial importance accorded system reliability, as described below, MACD was reluctant to delay the release of this report pending the completion of this work.

System Reliability

The IESO plans generation and dispatchable load commitment to ensure system adequacy and reliability. These plans take into consideration the scheduled intertie trades. With little advance notice of import failures the IESO is often limited in its options to recover from failures and has limited time to assess the reliability impacts of the failures and the impacts of the actions required to replace the failed transactions. Due to the timing of intertie failures the market is unable to solve for deficiencies that have been created as a result of the import failures. In general the reliability impacts of transaction failures fall into 3 categories:

² The MSP's latest report released June 2005 describes this on pages 34-35.

Energy and Capacity

Generators are not committed in anticipation of failures and some of these generators have start up lead times that exceed the time provided after failed transactions. Depending on the depth and makeup of the spare offers in the stack this can result in operating reserve and energy deficiencies. Repeated reserve deficiencies are not looked at favourably by Ontario's interconnected neighbours. There is also the added effect of increasing the frequency and duration of scheduling Control Action Operating Reserve (CAOR). Depending on the duration and extent of the reserve deficiencies emergency purchases (if available) will be required to recover and maintain operating reserve.

When additional quick start resources are activated to make up for import failures it can create a situation where energy limited resources that were needed later in the day are scheduled earlier than expected. This can create energy deficiencies in the hours where the energy was originally expected to operate. This occurs most often in the preshet period, when forebays have been drawn to minimum in anticipation of freshet and there is limited flexibility in hydroelectric resources, and also during the summer months when the hydroelectric inflows are normally low. These impacts create the requirement to rely more on emergency control actions such as purchasing Emergency Energy and implementing voltage reductions to manage energy deficiencies.

On the other hand, export failures during periods of excess generation may also create excess base-load generation (EBG) problems and could result in area control error (ACE) management issues. Reliability issues may also develop as exports are failed and units have to be decommitted to manage the over generation. With many units having minimum turn around times this can create situations where for example units are shut down in the overnight period and are therefore unavailable to be back on line in time to provide ramp capability during the morning pick up period.

Operating Security Limits (OSL)

The dispatch solution is based on the expectation that scheduled transactions will flow. The dispatch tool compensates for counter flow effects when calculating OSL impacts. Transaction failures can create OSL violations when the transactions that were scheduled fail and interface and or other OSL's were depending on those transactions to operate within the limit. This can result in the need to curtail other transactions to manage the impact (i.e. if an import failed, an export on the same interface may need to be curtailed). These failures can also have the effect of causing the net intertie schedule limit to be exceeded as this limit is based on the net of transactions.

Closing Comments on System Reliability

Intertie failures result in three types of reliability disturbances, namely, energy deficiencies, capacity deficiencies, and operating security limit violations. This creates a greater reliance on emergency control actions such as emergency energy purchases and implementation of voltage reductions to cope with these disturbances. Chronic transaction failures near real-time leave insufficient time to respond reliably.

In September 2005 the IESO's Chief Operating Officer, Paul Murphy, announced several measures that would be introduced to improve reliability.³ He observed: "[t]he Ontario power system cannot consistently be in an emergency operating state as it was in the summer 2005". Mr. Murphy identified a number of contributing factors, including the failure of import transactions to Ontario. He noted that

³ See http://www.ieso.ca/imoweb/pubs/consult/dayAhead/da_20050920_operation_reliability.pdf

“Import failures:

- are equivalent to suddenly losing a large generator;
- happen at the last minute;
- occurred almost every day this summer;
- aggravated energy shortage; and
- consistently contributed to the need to enter an emergency operating state”

Among the initiatives announced by Mr. Murphy was an implementation of a day ahead mechanism to allow imports to be guaranteed their offer price in an attempt to ensure real time delivery similar to financial commitments made in neighbouring markets. The policy proposals introduced in section 4 is meant to be consistent with this initiative.

Enforcement Drivers

The Working Group asked MACD to state its primary goal in developing its enforcement policy regarding intertie transaction failures. As system operator, the IESO’s primary responsibility is to maintain system reliability. This view shapes the policy recommendations contained in the final section of the report and supports a more effective application of the rules vis-à-vis intertie transaction failures within the control of market participants. However, the effect that transaction failures have on market efficiency issues (pre-dispatch to real time price difference) need to be considered when selecting a solution in spite of the lack of specific quantification of those caused by reasons under the control of market participants. The sheer volume of transaction failures due to market participant actions on all interfaces is 31% (Appendix F), hence, MACD feels addressing transaction failure under participant control is of value in addressing efficiency issues created by transaction failures.

3. DATA ON TRANSACTION FAILURES

The data provided to the working group initially covered the period August 1, 2003 to February 28, 2005. As work progressed the data series was updated to July 31, 2005 so the information now covers two years of operations. It identifies, by month, the difference in MWh and number of transactions between the one hour ahead pre-dispatch constrained schedule and what actually flowed in real-time. A list of the initial data series reviewed by the working group is found in Appendix E.

The various causes for transaction failures have been classified for the purposes of this report into two major categories: scheduling errors that are attributable to trader actions and those that are system operator initiated actions. Those in the first category are economic and NERC tag errors. Those in the second category are external security, internal TLRs, external TLRs, and other.⁴

The purpose of developing the comprehensive data set was for all parties to understand the magnitude, frequency and source of transaction failures. The working group’s focus related to the usefulness of MACD’s guidelines for enforcing the market rule provisions related to transaction failure; however, it

⁴ “Other” refers to failures caused by reasons not attributable to market participant actions such as export cuts due to adequacy or IESO scheduling errors.

was recognized that the enforcement policy needed to take into consideration the relative importance of the various causes of transaction failures and parallel work by the IESO to address them.

The key facts about the inertia failures experienced in Ontario are as follows:

New York Independent System Operator

- The NYISO interface accounts for the largest share of total system transaction failures, both in terms of failures for all reasons, and in terms of only those failures due to uneconomic bids and tag errors. Between August 1, 2003 and July 31, 2005, 71% of the total MWh of transaction failures over all interfaces were with NYISO (Appendix F - Table F). 31% of total system failures were due to uneconomic bids and tag errors, 84% of which occurred over the NYISO interface.
- Over the period under review the volume of exports from Ontario to NYISO was almost seven times that of imports; however, the failure rate⁵ for imports was slightly higher compared to exports – 12% versus 11% (Appendix F - Table A). These represent failures for all reasons.
- In terms of failures due solely to uneconomic trades or NERC tag errors, the import failure rate at 7.46% was double that of exports (3.68%) (Appendix F - Table A). In other words, even though significantly more trade flowed as an export, market participants were less successful in navigating the NYISO market when importing.⁶ In fact these ‘economic’ and tag error failures constituted the dominant segment of import failures with NYISO in almost every month, accounting for about 60% of MWh failures over the period (Appendix F - Table B).
- Causes other than uneconomic bids or NERC tag errors account for a significant proportion of total NYISO transaction failures, especially with respect to exports.⁷ On average 66% of monthly export transaction failures are attributable to these other causes, the largest share being external security (53%). External security was the cause of almost a quarter of total MWh import failures over the period, with smaller fractions attributable to the other causes (Appendix F - Table B).
- The application of MACD’s guidelines for the NYISO market eliminated from further investigation a relatively large share of the total MWh that failed because of uneconomic bids. While a high number of transaction failures and market participants were screened in after the first test, by the time the third test was applied very few, if any, MWh of failures were left. This allowed several participants to maintain relatively high failure rates over the period.
 - As a result of the first test, on average 75% of MWh associated with economic failures were screened in for review.⁸ After applying the second criteria, the volatility test, the percentage of MWh in each month subject to further review dropped. On average 48% of

⁵ The failure rate is the MWh of failures expressed as a percentage of the total MWh scheduled in the one hour ahead pre-dispatch.

⁶ These failure rates increased during the 6-month period of the working group deliberation.

⁷ External security, external TLR, internal TLR and ‘other’.

⁸ This percentage is the MWh of failed transactions with NYISO that failed the first test divided by the total MWh of transactions with NYISO that failed due to uneconomic bids or NERC tag errors.

MWh of these transactions failures were left for further review. When all three safe harbours were applied, on average only 2% of all the MWh that failed due to uneconomic trades were eligible to be investigated as a breach (Appendix F - Table C).

- Finally, considering economic transaction failures in NYISO on a stand-alone basis, on average 37% of these failures occurred in volatile hours over the period (Appendix F - Table E). In other words, this measure of volatility figured as an important safe harbour during the period.
- There is a wide variation in average failure rates, between zero and 38%, among market participants trading on the New York interface who failed for economic reasons.⁹
- Eleven market participants had two year average failure rates greater than 5%. Of the eleven, three had scheduled trading volumes of less than 100,000 MWh over the period (August 2003 – July 2005). The rest had substantial volumes, including two with more than 1 TWh of scheduled trading over the period. These eleven organizations account for 86% of all the New York economic failures and 61% of the traded volume on the NYISO interface for the period.
- Eight of the 22 market participants had average failures rates lower than 3% over the two-year period. Four market participants had relatively high scheduled trading volumes in excess of 500,000 MWh and one just under 2 TWh. The remaining four had trading volumes below 100,000 MWh with failure rates around 1% or below. These eight organizations account for 6% of all the New York economic failures and 20% of the traded volume on the NYISO interface for the period.
- Eight percent of all New York economic failures and 19% of New York traded volume was conducted by three market participants with failure rates between 3% and 5%. Of these three organizations, one traded over 2 TWh for the period.
- The same performance analysis was conducted using the historical failure rate in Appendix G (second bar).¹⁰ Trading organizations with historical failure rates greater than 5% contributed 57% of economic failures and 32% of trade on the interface. Market participants with historical failure rates between 3% and 5% accounted for 29% of economic failures and 29% of trade on the interface. Those with historical failure rates of less than 3% were responsible for 13% of economic failures and 39% of trade. Similarly, small trading organizations (less than 100,000 MWh) and large trading organizations (greater than 1 TWh) occupy each performance range.
- In summary, the ability to successfully navigate the New York interface does not seem to be linked to the volume of trade of an organization. Both small and large traders have been able to achieve relatively low failure rates.

⁹ See Appendix G. The period covered is from August 1, 2003 to July 31, 2005. Of the 25 market participants, numbers 4, 6, and 10 as denoted in Appendix G, are not included in the performance ranges because they were not actively trading.

¹⁰ Historical failure rate is calculated for each organization as follows: total MWh volume failed in New York market divided by the total MWh volume traded in New York market. The rate was calculated for the two year period of August 2003 to July 2005. The average failure rates reported earlier were the averages of the 30 day rolling failure rates, used in the guidelines, for the same 2-year period.

Midwest Independent System Operator & Other Interfaces

The opening of the MISO market April 1, 2005 changed some of the parameters of trade with Ontario. The summaries below are based on data before these changes.

- Michigan and NYISO are Ontario's two most important interjurisdictional trading interfaces.
- In terms of transaction failures, after NYISO, the Michigan interface is the second most important source of failures although it was a distant second with only 24% of total MWh failures over the period August 2003 – August 2005 (Appendix F – Table F).
- Over the period under review the volume of imports to Ontario from Michigan was roughly 16 times that of exports; however, the export failure rate of 9% was over double the failure rate for imports.¹¹ (Appendix F – Table A)
- The principal reason for both import and export failures in almost all months was Transmission Loading Relief in the Michigan control area. On average external TLRs represented about 70% of MWh export failures and 74% of MWh import failures (Appendix F – Table B).
- Manitoba, Minnesota and Quebec are responsible for only small fractions of transaction failures with Ontario (Appendix F - Table F).

While the working group was not shown transaction data for the MISO interface post April 2005, we note that over the period April 1 – September 30, 2005 the rate of import failures has increased to the point that it almost equals the export failure rate - 7.8% imports vs. 8.7% exports.

Supply Tight Days and Recurrent Failures

Market participants frequently fail more than one transaction because of either uneconomic trades or NERC tag errors during supply tight days, defined as when an Energy Emergency Alert (EEA) had been declared by the IESO. At times these failures occurred during volatile hours however, there are recurrent¹² and consecutive¹³ failures that also occur during stable hours when an EEA has been declared. Recurrent and consecutive failures were also observed outside of the period of EEA declaration within the same day.

Of the eighteen days examined, 13 (72%) had transactions where the same market participant failed on economic grounds for three or more consecutive hours.¹⁴ 72% of the days experienced failures during the hours the EEA was declared. Ten days (56%) had failures occurring in both volatile and stable hours. Import failures were observed twice as often as export failures.

Further analysis of market participant recurrent behaviour was also conducted outside of the days defined as supply tight. Recurrent economic failures within a day by market participants were

¹¹ Calculated the same way as explained earlier for NYISO.

¹² Recurrent failures are defined as three or more transaction failures which occur in the same day for the same reasons (tagging or economic grounds) by the same market participant.

¹³ Consecutive failures are defined as failures observed in three or more consecutive hours for the same reasons by the same market participant.

¹⁴ April 2 was removed from the supply tight day analysis because of the opening of the MISO market. This day had a high number of recurrent tagging failures.

examined.¹⁵ Of the 696 days examined, 181 days (26%) contained one trading organization that failed three or more economic trades during a day (Appendix H).¹⁶ Approximately 62% of the days examined contained at least one market participant that failed recurrently on economic grounds.

Recurrent NERC tagging failures within a day by individual trading organizations on days outside of those defined as supply tight were examined.¹⁷ Of the 696 days examined, 193 days (28%) contained one trading organization that failed two or more tagging failures during a day (Appendix I). Approximately 41% of the days examined contained at least one market participant organization which recurrently failed on tagging grounds.

4. POLICY CONCLUSIONS

Overview of Changes

We propose two changes to the existing enforcement of the market rules related to intertie transaction failures viewed as within the control of market participants. The first is to make the tests contained in MACD's screening guidelines for the NYISO and Midwest ISO markets more stringent for import failures during supply tight days.

The second, more fundamental proposal, is to no longer treat transaction failures as a compliance matter, except where there appears to be egregious behaviour. Rather, as part of the settlement process, a market participant would compensate the market for transaction failures that are deemed to be under its control. This would require a rule change to remove the formula-based penalty. Potential egregious conduct associated with transaction failures would lead to the normal compliance investigation if it is alleged that the market participant unfairly benefited from transmission rights payments, CMSC or other revenues.

The proposals are described in more detail below after explaining their rationale.

Rationale for Proposals

New York Economic Guideline Changes

In our view, if considered in isolation, the data provided to the working group and summarized in sections 3 of this report justify a tightening of the NYISO guidelines. For the last two years the largest share of transaction failures is at the NYISO interface. Many of these failures, particularly exports from Ontario to New York, are for reasons that are traditionally viewed as outside the control of market participants. At the same time a significant volume of failed transactions result from uneconomic bids or offers by market participants in the NYISO market¹⁸. A review of the record of MACD's NYISO guidelines demonstrates that, as presently structured, few MWh are selected for investigation and some market participants have relatively high failure rates. The guidelines also do not effectively screen in for

¹⁵ Recurrent failures on economic grounds are defined as three or more within the same day by the same market participant.

¹⁶ Study period was from August 1, 2003 to June 26, 2005 and excluded days when EEA alerts were declared.

¹⁷ Recurrent failures due to NERC tagging are defined as two or more within one day.

¹⁸ It may be possible to change the IESO-NYISO scheduling protocols to reduce the number of intertie transactions scheduled that will likely fail. The working group was briefed on the efforts by the system operators in this regard but, at the time of this report, there was no information as to whether such changes were feasible.

further investigation participants who fail transactions during supply tight periods or for other reliability related issues.

However, in light of the unanimous opposition expressed by the working group to our earlier proposed changes to the NYISO guidelines, the broad support for a new approach to the treatment of real-time transaction failures and the opportunity to implement these changes coincident with day-ahead proposals, we have decided not to substantially change the guidelines at this time. Rather, other than the supply tight days mechanism described below, MACD will maintain the status quo recognizing that if the settlement based solution for curbing transaction failures is not implemented more extensive guideline changes will be required.

Supply Tight Days (Energy and Capacity Shortfalls)

From a reliability perspective transaction failures occurring on supply tight days are serious. The data summarized in section 3 documents that there is a very high incidence of consecutive and recurrent transaction failure on the NYISO interface and import failures occurred twice as often as export failures. While no separate data was reported for the MISO interface with Ontario, the direct link of import failures to energy and capacity shortfalls and the fact that import failures from MISO have increased significantly since MISO's market opening in April 2005, in our view also justifies a more stringent review of MISO failures on these supply tight days. Most working group members generally accepted this logic but asked that market participants be given adequate notice before the usual screening tests are tightened for imports. We believe that our proposal addresses this concern. Clearly, this proposal is only a partial answer to reliability concerns, but we feel it is an appropriate interim addition until the settlement proposal can be adopted.

The implications for transaction failures of MISO policies and procedures with respect to the acquisition of ramp and transmission service needs further study; however, we do not wish to delay the release of this report. For now the only change of substance in the MISO guidelines would be related to supply tight days. However, the revision to the MISO guidelines will give an opportunity to clarify that the existing screen applies not just to the Michigan interface and that the guidelines are used to screen both potential breaches of NERC tagging requirements and Chapter 7, section 7.5.8A. This has always been our view but the guidelines would benefit from an edit to introduce clearer language and address new issues that have arisen since they were released two years ago.

Settlement Proposal

The attractiveness of the settlement proposal is that it would remove the stigma associated with market rule breaches and the related administrative burden on market participants and MACD in reviewing and remedying alleged breaches. Transaction failures would no longer be 'compliance' issues; rather market participants would have an incentive to ensure that they navigate the neighbouring markets successfully by virtue of a settlement charge for their failed transactions deemed within their control. The cost of this would vary depending on the market circumstances, so that one would expect the charge to rise during times when the Ontario market is supply tight.

From a conceptual point of view, we see this market-based approach as much more desirable than the current regulatory scheme where there is a natural incentive for market participants to adjust their trading strategy to conform to whatever precepts are advanced by the regulator, in this case MACD. This report documents how MACD's current enforcement approach has tolerated significant volumes of intertie energy transactions to fail and allowed individual market participant failure rates to be as high as 38%. The risk of a significantly more stringent regulatory approach is that it may lower transaction

failures but at the cost of lost trade. MACD joins with the majority of working group members who support developing a more market-oriented approach to addressing transaction failures, as along the lines of what is outlined below.

With the implementation of such an approach coincident with, and complementary to, the proposed arrangements to protect system reliability for summer 2006, we believe there still needs to be some form of compliance safety net to address potential abuses by market participants related to CMSC transmission rights payments, or other revenues. This was not a matter put forward for consideration by the working group members and it would need to be the subject of future discussions with market participants.

The Proposals

Guideline Changes

The content of the guidelines for both NYISO and the Midwest ISO will not change except in the following respect: During reliability related events as declared through System Status Reports (SSR), the safe harbours in the guidelines will not be available to market participants whose imports fail on economic grounds three or more times during the period of the emergency declaration. The third and subsequent failures will proceed directly to compliance investigation. The specific communication trigger through SSR is yet to be determined. The latter applies to those transactions that fail in the hour which starts at least two hours and 30 minutes after the declared reliability event. The market participant can bring forward information regarding insufficient notification which affected their ability to have avoided the third or subsequent failures; this will be considered in the compliance case review.

The revision of the guidelines to incorporate the above-described change also affords an opportunity to clarify the inherent discretion to suspend the normal guidelines on a participant-specific basis, for example, if the participant's failure rate remains unacceptably high or if there are grounds to believe gaming or other abuses to the rules are taking place. In addition, specifically with respect to the Midwest ISO, the revised MISO guidelines will clarify that the existing screen applies not just to the Michigan interface and that the guidelines are used to screen both potential breaches of NERC tagging requirements and Chapter 7, section 7.5.8A

Settlement Proposal

Removal of all Compliance Screens and Changes to Formula-Based Penalty of Chapter 6 section 6.610A

With the implementation of a settlement solution described below, there would no longer be compliance enforcement of transaction failures and the guidelines for the MISO and New York interfaces would cease to have effect.

At present the penalty formula for 7.5.8A breaches is prescribed in Chapter 6 section 6.6.10A as the maximum of HOEP or the absolute value of $(HOEP - \text{offer} / \text{bid}) \times \text{Multiplier}$. The latter penalty formula would be replaced with a formula for a settlement amount which will apply to all import and export transactions failures that do not fail for "bona fide or legitimate reasons". The application of this formula will be considered a settlement amount and not a penalty applied through the compliance process in Chapter 3 section 6. As such, there would be no breach of the market rules for public posting on the IESO web site. The deterrence is contained in the continual risk imposed by the application of the settlement amount. The below formulas provides some indication of the general construct of the penalty or

application trigger. The precise implementation, application trigger, and settlement amount formula would require further stakeholder consultation.

Settlement Amount for Exports Failures = {Max [0, (Pre-dispatch Zonal Price – Real Time Zonal Price)] x MWh failed}

Settlement Amount for Import Failures = {Max [0, (Real Time Zonal Price – Pre-dispatch Zonal Price)] x MWh failed}

MACD would reserve the right to exercise the compliance process and apply a penalty in addition to the settlement amount if it is found that a market participant used transaction failures to unjustly acquire market revenues. This ability to recover monies gained presently exists through the application of a multiplier to the formula-based penalty, however, the ability of MACD to recover the monies gained will continue. The multiplier has been removed from the settlement formula amount.

5. VIEWS OF WORKING GROUP MEMBERS

This report is heavily based on the active and constructive advice of working group members throughout the exercise. We would like to acknowledge their efforts and express our appreciation. Their written comments on an earlier draft of this report will be posted in full.

As already noted we have elected to pull back from a radical overhaul of the NYISO guidelines, at this time, in the face of the universal concerns of working group members regarding an earlier draft proposal and advocacy for a settlement option. , Three members stated that the supply tight days proposal was ‘reasonable’ or words to that effect and we have elected to proceed with this change. Powerex and HQ Energy Marketing oppose compliance enforcement as a remedy for intertie failures, except “truly abusive market behaviour” (HQ Energy Marketing). As noted below in our response to Powerex, such an interpretation is simply at odds with a plain reading of the market rules.

With respect to the settlement proposal it is worth briefly quoting the views of four market members of the working group because they constitute a strong endorsement:

Brascan

“We believe that option #3 [the settlement option] is a good long-term solution that provides the correct market-based incentives to drive appropriate market participant behaviour. This option provides a direct link between an intertie trader’s actions and their affect on the market. We believe implementation of this option will improve the accuracy of pre-dispatch prices, increase use of the transmission system and help protect system reliability.”

Coral

“Coral agrees with MACD’s strong support for a market-oriented approach to addressing transaction failures. Further efforts should be dedicated towards discussion, design, and implementation of a formulaic approach, as described in Proposal 3 that provides the appropriate and proportional disincentive for failures during times when our reliability is most at risk.”

DTE Energy Trading

“DTE ET strongly supports a market-based solution to intertie failure administration as detailed in ‘Proposal 3’. DTE ET does realize that there is a lot of work to do in order to put forth an acceptable ‘to the market’ solution/alternative to the current or revised guidelines set forth by the IESO MACD to address intertie failures. Thus, DTE ET will not present comment on Proposal 3 at this time, other than to reiterate its support for such a proposal. DTE ET commits to remaining on the ITFWG [Intertie Transactions Failure Working Group] and assisting in reaching an acceptable market based solution for MACD and other Market Participants.”

OPG

“OPG is in favour of Proposal 3. We think that market based solutions and payments for damages are preferable to regulations, breaches and penalties as have been used to date. While we cannot endorse any specific proposal at this time without further study, we feel that the almost unanimous support of the subcommittee behind such proposals make the development of an acceptable proposal in time for spring implementation to be quite probable. We strongly suggest that the subcommittee be used to work with you to develop an acceptable proposal ASAP.”

The remaining members of the working group, Powerex and HQ Energy Marketing pointed to trading ‘seams’ issues and market design as the principal causes of intertie failures. Both spoke against more stringent compliance enforcement but did not comment specifically on the settlement proposal. Powerex commented as follows:

Powerex

“As an active participant in the Ontario market, particularly in the Inter-jurisdictional markets, Powerex is very concerned over the direction MACD has taken with its [draft] recommendations and interpretation of ‘failures within the control of market participants.’ It is Powerex’s opinion that Compliance penalties are meant to penalize market abuse behaviours, Inter-jurisdictional transactions which fail due to economics or physical scheduling limitations such as ramp constraints in neighbouring regions reflect ‘Seams issues’ (ie: different markets clearing at different times) and fundamental market design problems and should not be addressed with a compliance program but via Market Design reform.

...Powerex believes the suggested impact on market performance of those intertie failures which are arguably the result of seams failures is not compelling, particularly as the proposed guidelines will further restrict the potential for the market participants to respond to price divergence between markets.

We believe that MACD should remain with the status quo until there can be a review of Inter-jurisdictional Trade within broader discussion around market design and addressing seams issues.”

We accept Powerex's observation on the role of seams issues as a source of intertie failures. And the working group was updated on the status of IESO discussions with representatives of NYISO and the Midwest ISO. Members of the working group also made specific suggestions to the IESO representatives involved in those discussions on changes to the scheduling protocols that might alleviate the failures. But ultimately the working group's mandate was focussed on MACD's compliance responsibilities.

We respectfully disagree with Powerex's observation that "...Compliance penalties are meant to penalize market abuse behaviours...", apparently to the exclusion of all other rationales. Simply put, the vast majority of market rule obligations in Ontario and other electricity markets are needed for the complex system of real-time electricity production and consumption to work. Compliance enforcement operates in the background to ensure the many players with different roles and responsibilities work together effectively. There are provisions in Ontario's market rules that address market abuse or egregious behaviour, but these are the exception, not the rule.

HQ Energy Marketing noted that "... we fail to see any convincing evidence regarding a direct link between failed intertie transactions and energy prices." It also observed that:

"The current IESO market design, including its two hour ahead bidding requirements, leave it out of sync with all the other energy markets in the Northeast. IESO's guidelines simply emphasize this existing disparity. The IESO actually acknowledged this inefficiency by moving from the original four hour ahead bidding requirements. It resulted in significant improvements but there is still unfinished business here.

HQEM suggest the IESO should address this underlying root cause of the problems being experienced instead of implementing new guidelines that will only exacerbate existing market issues."

In response to the call to address seams issues we reiterate our comments above and also observe that MACD feels a responsibility to move to a more immediate solution than is likely from a re-design that will require the active participation and concurrence of other jurisdictions and their market participants. Finally, we note that contrary to HQ Energy Marketing's view, there is convincing evidence of a direct link between failed transactions and energy prices. The point of disagreement is on the magnitude of the impact, an issue we intend to study further as time and other priorities permit. We do not view this as a priority matter at this time because, as stated explicitly in our report (section 2, page 6), the driver for change is the critical state of reliability in the Ontario system.

6. NEXT STEPS

The need to stakeholder the settlement solution provides an opportunity to coordinate with development of the Day Ahead Commitment initiatives. MACD is committed to collaborating with the working group members and other market participants to achieve this end. We expect to do this within the consultative structures and timetable established by the IESO's Market Evolution group; the Intertie Transactions Failure Working Group, as such, has fulfilled its mandate.

With respect to the revised guidelines presented in section 5, MACD plans to release draft documents, as time permits, in the next several weeks.