

ISSUE 32: ROLE OF IOG

Date Raised

[Noted early in the operation of the IMO Administered Markets and First raised again](#) by the Market Surveillance Panel in its June 14, 2004 Report.

Description

The MSP, in its June 14 2004 Report, found that there are persistently high Inter-tie Offer Guarantee (IOG) payments made to importers during the delivery hour 22 through 24. ~~The IOG protects importers against the risk that the real-time price is lower than its offer price as was accepted in pre-dispatch. A key reason for the IMO's implementation of this guarantee to importers was that it wanted to make sure that it attracted sufficient imports to Ontario, particularly at times when the lack of imports would result in potential reliability concerns due to a relatively scarce amount of available domestic generation.~~

As part of its discussion of this anomalous outcome, the MSP posed the question~~ed~~ as to whether the IOG was necessary in these hours and possibly other hours. In particular, if the IOG represents a form of insurance to the IMO - a payment made to importers to assure that sufficient supply is available to avoid shortages, is there a significant enough risk of a shortage in these hours that would warrant such an insurance payment. Or as the MSP put it, "are we paying more for this 'insurance policy' than we should be." Second, the IOG payments serving as a premium to imports, may actually encourage the investment of generating capacity in neighboring jurisdictions, which is in contradiction to one of the purposes of Ontario electricity market, i.e., to encouraging new investments in Ontario to maintain system reliability.

Background

The market rules distinguish the scheduling treatment of inter-connection transactions and domestic generation. Unlike domestic generation, the real-time dispatch schedules (constrained and unconstrained) of imports are fixed one hour before real-time in the hour ahead pre-dispatch. Imports are scheduled therefore on relation to the prices determined in pre-dispatch. Furthermore, by fixing the real-time schedules, these imports are precluded from setting the real-time prices.

Prior to market opening, the IMO recognized that this scheduling difference could ~~generate~~create a profit risk (e.g. a financial loss) to the importers; importers would be committed to the market in pre-dispatch but would then be exposed to the potential risk that the real time prices ~~would~~may be lower than the pre-dispatch price and more significantly, lower than their accepted offer price. To

provide importers with protection against this risk the Market Rules Chapter 9, Section 3.8A determines a compensation mechanism called Inter-tie Offer Guarantee, and describes the method to calculate this payment. The IOG guarantees that an importer receives a price that is no less than its offer price over the hour; the importer is paid the higher of the real-time price or its offer price across the hour. A key reason for the IMO's implementation of this guarantee to importers was to ensure that market participants would be encouraged to import to Ontario, particularly at times when the lack of imports would result in potential reliability concerns due to a relatively scarce amount of available domestic generation. ~~The primary intent behind implementing the IOG was to reduce importers trading risk to encourage imports to Ontario during periods of tight supply or supply shortages in Ontario.~~

Why a Pricing Issue

The IOG rule is applied in all hours, even when there are abundant offers in the market from Ontario generation. When the Ontario supply is tight, imports may be very important to meet the Ontario demand, and any significant loss of them could have critical implications to the system reliability. The IOG payment, by eliminating the real-time price risk, guarantees that importers ~~to be~~ paid at least their offer price ~~the what price the importers offered~~ expected, and thus discourage them from withdrawing their real time offers when they expect to be exposed to a lower real-time price. Given the current tendencies of our pre-dispatch price to persistently exceed the real-time price, this price risk is likely to be very real to importers. However, during the times when Ontario has sufficient supply, the IOG payment may have little implications for system reliability. In these hours, the IOG may represent an unnecessary insurance payment.

The MSP also noted that in hours when the pre-dispatch to real-time price difference was persistent, the IOG payment may create artificial arbitrage opportunities that leads to more imports (which are paid relative to the higher pre-dispatch price) and more exports (which pay the relatively lower real-time price), with the two offsetting each other with no efficiency benefit to the Ontario market. The outcome is that Ontario loads pay an additional premium (essentially to importers) for the imports.

Finally, the IOG payments ensure that the an importer is paid the higher of the real time price or their offer price, which may give the importer a profit advantage over the domestic producer who is only paid the real time price. As a result, demand for electricity produced outside Ontario may increase, and investments in new generating capacity in neighbouring jurisdictions would be more profitable than favoured over investments in Ontario. This contradicts

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at odds with one intent of the electricity market which is to attract new investment in power generation to maintain system reliability in Ontario.

Impacts of Issue

Market Impact

This issue impacts the guiding principle of efficiency, fairness, ~~and~~ transparency, and reliability.

Participant Impact

TBD

IMO Processes and Procedures Impact

Significant impact identified. Market Rule changes would be required To eliminate or limit the IOG payments, as well as Settlements tool and procedure changes. in certain hours such as hour 22 through 24 needs a change in the market rule.

Related Issues

- Issue 09: Use of Peak Demand Load Forecast in Pre-dispatch
- Issue 10: Over-forecasting, especially in hours 22 through 24
- Issue 24: Reducing Frequency of Failed Inter-tie Transactions
- Issue 7: Imports/Exports setting Price

Selected References

1. The Market Surveillance Panel Report of June 2004,
http://www.theimo.com/imoweb/pubs/marketSurv/ms_mspReport-20040614.pdf

Market Rule Amendment MR-00177