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Discussion Paper

ISSUE 17: APPLICATION OF SETTLEMENT ADJUSTMENTS

INTRODUCTION

Settlement adjustments may be required after a final settlement statement has been issued for a trading day due to a number of reasons, including a notice of disagreement analysis that is completed post final, a dispute, an adjustment required from a specific market rule, etc. When these adjustments are applied to a market participant the offsetting charges are applied to all market participants with load. Presently the current period adjustment is utilized to determine these offsetting charges. Current period adjustments are based on transactions for the billing period during which the current period adjustment is effected regardless of the billing period or trading day to which the adjustment relates occurred. This straightforward manner of allocating such recoveries or distributions was incorporated into the Market Rules prior to market opening [ref MR-00147]. However, this method does have some shortcomings, which are discussed later in this paper along with two other methods for effecting settlement adjustments (Adjustment Period Allocation and Adjustment Allocation by Charge Type Resolution or Complete Recalculation).

Questions regarding the application of the current period adjustment in effecting a settlement adjustment have been raised recently by a number of market participants, largely in reaction to a significant adjustment on their July 31, 2004 preliminary settlement statement (issued on August 16, 2004). The adjustment related to a revenue meter error. This error resulted in the data collected in the metering database being different from the data that was in the metering installation. In this situation, the collected energy readings were incorrectly high for a significant period of time (21 months) resulting in higher energy and uplift charges to the associated market participant and consequently lower charges to all others. Under this specific circumstance, final settlement statements had been issued for the specified period. However, the market rules require that settlement adjustments be made. The reimbursement payments to the market participant that had been overcharged due to the metering error - totaling \$31 Million - were collected from the market via a current period adjustment wherein offsetting charges applied to the energy that participants have withdrawn in the month of the adjustment (i.e. July 2004).

Two other methods are considered below for the allocation of settlement adjustments along with the current period adjustment, which is the method used now.

Allocations of Offsetting Charges for Settlement Adjustments

1) Current Period Adjustment (currently used)

DESCRIPTION:

The application of a current period adjustment allocates the adjustments on the basis of the activity of market participants during the billing period when the adjustment was applied. While this simplifies any adjustment, it may result in other market participants receiving credits or incurring payments out of proportion to their activity during the period of the event in question. Current period adjustment is the method currently available under the Market Rules to apply settlement adjustments. Definition 1.1.1.74 in the Market Rules for the Ontario Electricity Market define a current period adjustment as an adjustment that is effected against amounts owing or payable in respect of transactions reflected in a settlement statement issued for the billing period or trading day during which the current period adjustment is effected regardless of the billing period or trading day during which the preliminary settlement statement to which the adjustment relates occurred. These adjustments are applied to a market participant using the following calculation:

$$A_{MP_j} = \frac{\text{Energy Withdrawn For Current Month by } MP_j}{\sum_{k=1}^n \text{Energy Withdrawn For Current Month by } MP_k} * A$$

A = Total Adjustment Amount in Dollars

A_{MP_j} = Adjustment Amount in Dollars for Market Participant “j”
(Current period adjustment)

n = total number of market participants present at the time of the adjustment period

ADVANTAGES/DISADVANTAGES:

At the time that the current period adjustment was implemented, it was concluded that this method was the fastest and simplest way to allocate the adjustment amount.

As previously mentioned, the current period adjustment method is currently the method specified in the Market Rules because of its simplicity relative to the other methods outlined in this discussion paper. It uses the current month of energy withdrawal when determining the adjustment amount, which is information that is readily available. However, this may result in a different allocation than what the financial impacts (payments or charges) to an “other” participant would have otherwise been if the error or cause of the need for a settlement adjustment had not arisen. The reason is a market participant may have withdrawn less during the period when the error occurred yet they would have to pay the current period adjustment, which is a function of what they have withdrawn in the current month, rather than during the period of interest. Furthermore, a new market participant that was not present during the adjustment period would still have to pay the current period adjustment regardless of their presence in the market at the time of the fault. This raises questions of fairness in the allocation and the relative trade-off with simplicity.

This potential drawback with this method was recognized when the rules were developed. However, for the following reasons it was determined that the current period adjustment method was appropriate:

- To place practical limitations on requests for *preliminary settlement statement* adjustments, in order to balance the needs of market participants to address issues with their statements and the need to ensure the overall efficiency of IMO settlements operations.
- To allow for the more efficient application of a settlement statement recalculation within the current billing period.
- To simplify the information required for a notice of disagreement. Under this proposed amendment, market participants would simply have to identify erroneous input data and or a calculation of a specific settlement amount – as opposed to calculating the amount of the adjustment themselves.

Moreover, adjustments of the magnitude experienced with the July 2004 adjustment were not contemplated. It was felt that the other checks and balances in the market rules should have prevented an error event of the duration experienced with the event referenced above.

2) Adjustment Period Allocation

DESCRIPTION:

This alternative to the current period adjustment is an allocation that is calculated using the historical energy withdrawal values and the historical adjustment amount. Hence, it may be referred to as the adjustment period allocation. This allocation could either be distributed on a monthly basis within the settlement statement or as a lump sum of the entire adjustment amount within one settlement statement. For an adjustment period that spans more than one month, the adjustment could either be determined as one lump sum or split into monthly sums.

After gathering the relevant values, the calculation of the adjustment period allocation is similar to current period adjustment. The difference is that adjustment period allocation, unlike current period adjustment, likely deals with the period of the event causing the need for an adjustment rather than the current period. This is more reflective of the adjustments and offsetting charges since it uses the historical values of energy withdrawal (adjustment period allocation) rather than the current values of energy withdrawal (current period adjustment) for each market participant since it is calculated for the historical adjustment period. The offsetting charges for each market participant are determined by taking their energy withdrawal during the adjustment period as billed, dividing it by the total energy withdrawal as billed to all market participants involved during that same period, and multiplying by the total adjustment amount for that period. The following is a mathematical expression describing the calculation of the offsetting charge for each market participant:

$$A_{MP_j} = \frac{\text{Energy Withdrawn For Period of Adjustment by } MP_j}{\sum_{k=1}^n \text{Energy Withdrawn For Period of Adjustment by } MP_k} * A$$

A = Total Adjustment Amount in Dollars

A_{MP_j} = Adjustment Amount in Dollars for Market Participant “j”

n = total number of market participants present at the time of the adjustment period

ADVANTAGES/DISADVANTAGES:

One of the benefits of this method is that it allocates charges in a manner that better reflects what the financial impacts (payments or charges) to an “other” participant would have otherwise been if the error or cause of the need for a settlement adjustment had not arisen. This method does not charge market participants who did not exist at the time of the fault. In other words, if a market participant joins the market after the occurrence of the fault, they will not be held accountable for the period of the fault.

However, if a market participant (present at the time of the fault) leaves the market (e.g. as a result of bankruptcy) at a point after the fault period and is unable to pay the adjustment, then a necessary cost will be calculated. This liability issue would need to be addressed, however the end result would be one of two possibilities. This cost may either be distributed amongst the remaining market participants to account for the adjustment by that participant or the cost may be accrued by the absent market participant if they have been located and are able to pay.

As well, one must realize that the IMO will, and market participants may, incur costs when changing their systems from the current period adjustment to this method.

This alternative is more reflective of the true adjustment amount than the first method (current period adjustment) because it is a function of the energy withdrawn during the adjustment period. The method of distribution of this extra cost is yet to be determined.

3) Adjustment Allocation by Charge Type Resolution (Complete Recalculation)

DESCRIPTION:

Another alternative to the current period adjustment is an allocation that is calculated based on a complete recalculation of all settlements for the adjustment period.

ADVANTAGES/DISADVANTAGES:

This is the only method that results in the allocation that would have occurred in the absence of the error responsible for the adjustment.

If, for example, the adjustment period were one year in length it would take a significant amount of time to calculate the allocation, which would involve correcting all the data within the adjustment period.

The settlement recalculation associated with this allocation method would require a substantial amount of resources and time for the IMO to perform and for participants to verify. This may also result in complicated processes for participants that have contracts with others that would need to be correspondingly adjusted.

As well, one must realize that market participants may also incur costs when changing their systems from the current period adjustment to this method.

As with the first alternative to the current period adjustment, if a market participant (present at the time of the fault) leaves the market (e.g. as a result of bankruptcy) at a point after the fault period and is unable to pay the adjustment, then a necessary cost will be calculated. This liability issue would need to be addressed, however the end result would be one of two possibilities. This cost may either be distributed amongst the remaining market participants to account for the adjustment by that participant or the cost may be accrued by the absent market participant if they have been located and are able to pay.