AMPCO Response to MSP Discussion Paper on Congestion Management Settlement Credits

AMPCO commends the Market Surveillance Panel (MSP) for raising the issue of congestion management (CMSC) payments for discussion and welcomes the opportunity to participate in the public debate. In the following we have generally followed the guidelines provided by the MSP for responses to the Discussion Paper but have also included AMPCO' views on related issues which we believe the MSP should consider in its deliberations.

Background

AMPCO's views on a number of framework issues condition its comments on the matters raised in the discussion paper. It is useful to outline these at the outset.

a) *Market Structure* – As the Discussion Paper points out the existence of CMSC payments is a byproduct of the market design adopted in Ontario, which provides for a uniform price. However, the paper also suggests that this is temporary feature which will be replaced with locational pricing, obviating the need for a resolution of the CMSC payment issue. Given the political response to price variations after just a few months of market operation, it is not clear that regionally differentiated electricity prices will be an acceptable political outcome in the near future. Consequently, the resolution of CMSC payment issues should assume that the current market design will be in place indefinitely.

b) *Non-energy costs* – Over the period under consideration (May 1 to December 31, 2002) non-energy costs accounted for 30% of the total cost of electricity for wholesale customers (before distribution costs). Since customers have no control over and cannot hedge such costs, every effort should be made to minimize them.

c) *Transparency* – CMSC charges are one more feature of the Ontario market for which customers, who in the final analysis are the source of payments for all charges, have no information. As the Discussion Paper points out, only the IMO and the MSP have access to information on CMSC payments. In fact, the IMO-administered market is characterized by a major asymmetry of information. The dominant generator has access to the same market information as loads, but also is the sole custodian of most information related to generation activities. This contrasts with loads which have access to little information on matters that are critical to the determination of costs borne by them. Measures are necessary to improve the transparency of the Ontario market on several fronts.

d) *Market Credibility* – Related to the issue of transparency is that of market credibility. The Discussion Paper points out that manipulation of congestion payments was one reason for the loss of credibility of the market in England and Wales and its ultimate replacement. The wild gyrations in hourly prices in Ontario and the subsequent imposition of a price freeze for some customer classes have already damaged the credibility of the Ontario market. Market participants must feel reassured that the potential for CMSC manipulation has been minimized.

e) *Appropriate Market Signals* – Whatever remedial actions are introduced should contribute to the objective of providing signals that move the market in the direction of improved efficiency and a greater dependence on decisions made by individual market participants rather than market planners.

f) *Semantic Clarification* – The Discussion Paper could have been clearer in its description of constrained off payments. Such payments to generators and dispatchable loads are not comparable. Dispatchable load provides the same service as generation. Constraining off dispatchable load has the same effect as constraining on generation. ***Therefore, constrained off dispatchable load payments should be treated conceptually in the same manner as constrained on generation payments.***

The Case for Eliminating Constrained Off Payments

In AMPCO's view the arguments raised in the MSP's Discussion Paper make a compelling case for the elimination of constrained off payments. For completeness a summary of these arguments is provided in the following:

- The payment is made for not producing; since the generator is not contributing to meeting market demand there is no basis for a payment.
- Constrained off payments represent an arbitrary shift of risk of transmission and other constraints from the generator to the consumer;
- Generators in areas of known transmission constraints can maximize constrained off payments by manipulating their offer prices during periods when there is a likelihood they will be constrained off. The opportunity to manipulate the system is even greater when a single generator owns all or most of the generation assets in the area.
- Constrained off payments mute market signals that encourage the reallocation of generation investment to areas with generation asset deficits by reducing the financial penalties associated with misallocated assets.
- Constrained off payments also dampened the signal for investment in transmission assets to relieve constraints; owners of bottled generation assets are likely to be less vocal in supporting actions to relieve constraints if they are receiving such payments.

The Discussion paper limits its recommendations to constrained off payments, since it is evident that the facilities involved are not providing supplies to meet market needs. ***However, the potential to manipulate CMSC payments also exists in the case of constrained on payments.*** The MSP pointed this out in its first report on October 7, 2002, "For example if a generator knows that transmission conditions are such that it is highly likely to be constrained on or constrained off, it can manipulate its offer price so as to maximize its congestion management payment – offering exceptionally high prices when it believes it will be constrained on and at exceptionally low (even negative) prices when it believes it will be constrained off." (P.33).

The paper goes on to reassure the reader that the MAU monitors CMSC constrained off payments diligently and has not found instances warranting investigation. It makes no such assurance with respect to constrained on payments but we are presumed to be reassured by this ongoing monitoring and by the existence of local market power mitigation rules. The customer, the ultimate bill payer, has no information to permit an assessment of the size of such payments or the extent to which the MAU is adequately undertaking it responsibilities.

Consideration should be given to a maximum allowable constrained on payment. Since the intent of constrained on payments is to ensure that costs are covered for the constrained on facility the payment limit would be based on the cost characteristics of the facility. This would reassure market participants that the potential for congestion payment manipulation is circumscribed within acceptable limits. Customers would not be asked to place unquestioning faith in the MAU or any other group and market credibility would be enhanced.

Arguments in Favour of Constrained Off Payments

In the Discussion Paper several arguments were posited as possible justifications for constrained off payments. Each of these is discussed below:

- By encouraging bottled generation to offer, even at deliberately low prices, the uniform price is lowered; the net effect of a lower MCP and higher CMSC payments is that the consumer is better off.
  Discussion: It does not follow that the consumer is always better off. It depends upon the magnitude of the price drop (if there is one) relative to the CMSC payments. However, more fundamentally the uniform price is an artificial price and should not be used as a reference for the assessment of CMSC payments. Consistent with the objective of providing correct market signals, the relevant comparison is with locational prices. Under uniform pricing generators in the constrained off region are receiving a price higher than that which would prevail under LMP. The constrained off generator would not have been scheduled under LMP because it is uneconomic. Despite this it is receiving a payment from consumers. All of the incentives in the constrained off region are in the direction of encouraging more generation. In the constrained on region generators receive a price lower than the locational price that would prevail but still at or above marginal cost (including the CMSC payment to the constrained on unit). If incentives are to be provided they should be in this region.

- Constrained off payments are necessary to maintain facilities in the constrained off region.
  Discussion: This argument has a couple of interpretations. The first is that the constrained off unit is an independent unit and is needed in certain periods to meet

local demand. The responses to this argument are three fold. Firstly, the fact that the uniform price is higher than the locational price suggests that the region has excess supply, not a shortage. Secondly, the excess of the uniform price over the locational price already provides an incentive for generation to locate in the area, an incentive which has already been argued is perverse. Finally, if there are brief periods when the identified generation is needed then they can receive necessary compensation through contractual arrangements. A second interpretation of the argument is that constrained off payments balance the revenue loss to the generator in the constrained on region of prices below the locational price in that region. This assumes that the generation assets in each region have the same owner. This may be the case but it is a fundamental market design flaw that is intended to be corrected by the MPMA. There is no reason to assume such payments balancing will result. Each type of CMSC should be looked at on its own merits.

- Constrained off payments provide a signal indicating where transmission investment is required.
  Discussion: Since CMSC payments reflect both transmission constraints and other factors and since CMSC data are not available in any case, this is not a convincing argument. Moreover, as has been argued above constrained off payments, if they do provide market signals, are in the direction of reducing the need to eliminate the constraint. A more effective signal of a constraint is in the existence of a locational price differential. This information is currently provided in the form of shadow prices. However, the effectiveness of this information is questionable.

- Constrained on payments encourage compliance with dispatch instructions.
  Discussion: As the Discussion Paper points out, the constrained off payment makes the generator indifferent to producing and not producing at any price between its offer price and the market price, the amount of the constrained off payment. Since there is nothing to be gained by not following dispatch instructions, the generator is more likely to follow to comply with them. This argument suggests that market participants require additional incentives, other than their agreement to follow market rules and penalties for non-compliance to adhere to market rules. The deficiencies of the argument are evident.

- The dispatch algorithm, which is based on minimization of constrained on and off payments, would have to be changed if constrained off payments are not made.
  Discussion: The MSP points out that no change in the algorithm is necessary. It would operate in the same way with the same scheduling decisions. The only difference is that the payments would not actually be made.
- The Legacy Argument. The present configuration of generation assets is inherited from another era. Unbundling the integrated utility has left some assets in bottled regions. Such generators should be compensated for the results of these policy decisions.

Discussion: The MSP points out that this argument is not based on notions of efficiency or reliability but on some concept of fairness. In effect it is a stranded assets or stranded debt argument. There are two possibilities here. Either the debt associated with the assets in question has been already paid off through consumer payments, in which there is no possibility of stranded debt, or it has not and is included in the guaranteed debt acquired by the OEFC. Ontario consumers are already liable for stranded debt of Ontario Hydro in the debt assumed by OEFC. While the DRC has been set a level to ensure the OEFC can meet the obligations of the guaranteed debt, the government has the flexibility to change the DRC if the initial estimate of stranded debt was erroneous. The point is that the consumer is already burdened with the obligation of the legacy stranded assets and there is no need for additional charges for this purpose. With respect to constrained off payments for imports or new investment, the legacy argument does not apply.

Summary

AMPCO agrees with the position taken in the MSP report that constrained off payments are not only unnecessary but provide market signals that discourage the reallocation of assets to appropriate locations. These payments should be discontinued.

AMPCO also believes that constrained on payments remain subject to manipulation and should be carefully monitored by the MSP. Further, data underlying charges that are included in uplift (such as CMSC payments and IOG charges) should be readily available to the market participants who ultimately pay these charges.