Coral
ENERGY

March 31, 2003

Market Surveillance Panel
Independent Electricity Market Operator

via email to: Market Assessment and Compliance Division, MACD@theIMO.com

Re: Congestion Management Settlement Credits (CMSC) in the IMO-Administered Electricity Market

Coral Energy Canada Inc. is pleased to provide the attached comments regarding the Discussion Paper prepared by the Market Surveillance Panel. Please do not hesitate to contact us if any further information or clarification is required.

Sincerely,

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and

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Comments of Coral Energy Canada Inc.
On
Market Surveillance Panel Discussion Paper
Concerning Congestion Management Settlement Credits

Introduction

The Market Surveillance Panel (MSP) published a paper on Congestion Management Settlement Credits ("Paper") and has requested comments on the propriety of continuing to make Constrained Off payments to generators and importers. Clearly, the MSP is questioning the need to continue Constrained Off payments and has concerns about the incentives that they provide to market participants and the impact they may have on the operation of an efficient market.

In the long run, Coral Energy Canada Inc. ("Coral") supports the elimination of these payments but given the current state of the IMO-administered energy market and the fact that there has been no change in the design of the market to merit their reconsideration, it is premature to propose their elimination. If the MSP has concerns that certain bidding behavior may not support the original intent of these payments, it should focus on addressing these issues in the context of rules governing the monitoring of market participant behavior and not a wholesale rejection of an important feature of the market given its current state.

The Current State of the IMO-Administered Markets Supports Continuation of Constrained Off Payments.

The MSP poses a rather loaded question on page 9 of its Paper. It questions why generators or imports should be compensated for not producing. The underlying assumption is that that consumers obtain no benefits for these payments since they do not receive actual kilowatts for them. This assumption, which appears to be the foundation for much of the concern, is not correct and contrary to the Paper's own findings.

On page 12 of the Paper, the MSP reports on the results of simulation experiments conducted by the Market Assessment Unit. The conclusion is that elimination of the payments could cause an increase in the price between $1.32 and $6.73 per MWhr, on average. What the Constrained Off payments have done is induce generators and importers to offer their energy into the markets and the benefit has been lower average market prices. Accordingly, to conclude that consumers are not receiving value for these payments under the current market design is simply not correct.

As a marketer and trader of energy in the IMO-administered markets, one would think that Coral would be clamoring for the elimination of such payments as they decrease volatility of energy prices. However, Coral's interest is in the continuation and health of the markets in the long-run. Elimination of payments that in reality induce generators and importers to offer energy into a tight market, could lead to unintended consequences and will not support the policy goal of sending proper price signals to market participants until an LMP market is functioning in Ontario. In addition, without a capacity market or a day-ahead market, volatility during higher load conditions could reach levels for sustained periods of time that will, frankly, turn out to be difficult for consumers to understand and may remind everyone of recent events in California.

On page 11 of the Paper, the MSP sets forth the arguments that are used to justify Constrained Off payments to generators and importers. Without repeating them here, the arguments are as valid today as when the market opened because the IMO has not implemented new markets or mechanisms that can replace them. The benefits of eliminating Constrained Off payments cannot be realized in the absence of an LMP market. In the end, eliminating the payments in isolation does nothing to promote efficiencies the MSP desires and may only increase overall energy costs to consumers. If the IMO desires to eliminate these payments, it must ensure that systems and markets are in place to deliver the desired result or the effort will be futile.

Coral Supports Many of The Concerns About the Efficiency of the Current Market With Constrained Off Payments And Therefore Would Support Their Elimination With Simultaneous Implementation of Market Mechanisms That Can Deliver Accurate Locational Price Signals And Reliability Based Payments.

The MSP is correct in its findings that basing the market clearing price on a hypothetical market and then making Constrained On and/or Constrained Off payments based on actual system performance is not the most efficient means of running the markets. Even if these payments were the result of perfectly accurate price signals, passing them on to consumers through uplift is also contrary to the goal of operating an efficient market. The greater the uplift payments the more harm that is delivered to the market because they mask the actual spot price for energy, and, in turn the forward price on which it is based.

The markets in New York and New England have made recent attempts to reduce the amount of uplift that has been created as a result of market outcomes that fail to meet operational requirements. They, however, started from a different point in their evolution than the IMO. These markets operate day-ahead forward markets that attempt to account for many of the system security issues that give rise to the Constrained On and Off payments in the IMO and capacity markets. While some might debate the success of their capacity markets, they have provided one clear benefit. In exchange for market based capacity payments, capacity providers are committed to offer their energy into the market providing those payments. For many units that do not deliver as many megawatts, the payments help justify the economics of low capacity factors and provide a tangible reliability and energy price benefit.

As part of the Market Evolution Program, the IMO is studying the issue of long-term resource adequacy and under that umbrella, capacity markets. The approach adopted in other jurisdictions for capacity markets may not be appropriate for Ontario. What is clear, the concept of offering an incentive or payment to an entity for its commitment to offer energy into the IMO-administered market is sound. Constrained Off payments may not be the optimal approach, but in the absence of another market-based mechanism, they are necessary.

Short-Term Changes To Constrained Off Payments

Starting on page 19 of the Paper, the MSP suggests changes to Constrained Off payments if they continue. With respect to the level of payment, Coral suggests that a working group be convened to expeditiously discuss this issue. The payment should be high enough to induce offers when appropriate. The issues related to Constrained Off payments for energy limited or hydroelectric resources and for generators that fail to follow dispatch instructions would benefit from a working group discussion as the response could have an impact on other elements of the market depending on how it is crafted. This comment applies to the non-transmission related Constrained Off payments as well since the answer to these problems may not be to eliminate the payments but create a mechanism to deal with the specific situation at hand.

Market Mitigation

The MSP also seeks comment on several elements associated with mitigation of bids through "safe harbour" screens that consider certain elements such as a 90-day average for reference prices. In addition, the Paper suggests consideration of an automatic mitigation process. These proposals would create a host of problems that cannot be resolved in one response to a paper. Coral would suggest that before any changes are implemented, a group of market participants be convened to discuss this and understand the problems that have arisen with these mechanisms in other jurisdictions.

A couple of broad issues deserve highlighting. When screens that are based on a 90-day average price are used, one runs the risk of not adequately capturing scarcity pricing or unique conditions that may arise. For example, if the reference price is based on the previous 90 days, it will not reasonably reflect the conditions faced by the bidder at a given point in time. It would be more accurate to use the average price for the same month of the preceding year or a price based on similar load conditions, than to use the previous 90 days. In addition, automatic mitigation acts as a form of price control and requires tremendous oversight so that bona fide changes to reference prices can be made on a timely basis and mistakes are avoided. Failure to address these items will discourage generators from participating in the market or maximizing the operation of their units.

Coral looks forward to further discussions of these critical issues.