

February 12, 2013

Ms. Rosemarie T. Leclair
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Dear Ms. Leclair:

Re: Market Surveillance Panel Monitoring Report

Your letter of January 14, 2013, requests that I advise you of: a) the steps that the IESO plans to take in response to the recommendations made in the Market Surveillance Panel (MSP) *Monitoring Report on the IESO-Administered Electricity Markets* for the period from November 2011 – April 2012, and the estimated timelines for completion of those steps; and b) whether, in the IESO's view, any actions or market rule amendments, in addition to those reflected in the underlying the MSP's recommendations, should be taken or initiated. In addition, your letter requests an update on the status of actions taken by the IESO in response to the recommendations set out in the previous MSP monitoring report.

The IESO has been requested to address five recommendations in the January 2013 Report. Four of the recommendations, numbered by the MSP as 3-1, 3-2, 3-3, 3-4, pertain to the transmission rights market. Recommendation 3-5 is related to the interaction of the transmission rights market and day-ahead intertie offer guarantee. A comprehensive listing of the status of recommendations from the current and previous report is appended. The status of active recommendations from all prior MSP reports is also regularly published on our website, and can be found on the IESO's market monitoring page at: <http://www.ieso.ca/imoweb/marketMonitoring/monitoring.asp>. Closed recommendations will appear in the status report until the next update.

The most recent MSP recommendations, and recommendations from the previous report, are discussed below.

Transmission Rights

Recommendation 3-1, MSP Monitoring Report for November 2011 – April 2012
The IESO should reassess the design of the Ontario transmission rights market to determine whether it is achieving its intended purpose.

The IESO agrees that this recommendation warrants further review and will perform a comprehensive review of the transmission rights market to determine whether the transmission rights market is achieving its intended purpose, and to determine what improvements can be made. This overall review is a longer term commitment expected to commence in Q2 2013.

Recommendation 3-2, MSP Monitoring Report for November 2011 – April 2012

The IESO should limit the number of transmission rights auctioned to a level where the congestion rent collected is approximately sufficient to cover the payouts to transmission right holders.

The IESO agrees that this recommendation warrants further review. This review will get underway immediately as the first stage of the comprehensive review (refer to recommendation 3-1). The findings at this first stage and any resultant changes to the stabilization design will go through our normal stakeholder process with the intent to return to the IESO Board of Directors with a recommendation by this summer.

Recommendation 3-3, MSP Monitoring Report for November 2011 – April 2012

(A) The IESO Board of Directors should authorize the disbursement of the portion of the Transmission Rights Clearing Account balance that currently exceeds the Reserve Threshold to reduce the transmission charges payable by loads.

(B) In the future, the IESO Board of Directors should authorize disbursements of Transmission Rights Clearing Account balances in excess of the Reserve Threshold after each year end.

The IESO Board of Directors will consider the matter of disbursement of a portion of the Transmission Rights Clearing Account balance at its meeting later this week, being its first regular meeting since the MSP Report was issued. Following that meeting I will advise you of any decisions taken in this regard. Consideration of annual disbursements, as noted in Recommendation 3-3(B) will be part of the comprehensive review.

Recommendation 3-4, MSP Monitoring Report for November 2011 – April 2012

The IESO policy of selling only long-term transmission rights on single-circuit interfaces should be replaced by a policy of reserving a significant portion of the available transmission rights for sale at short-term transmission right auctions.

The IESO does not have a policy of selling only long-term transmission rights on single-circuit interfaces. The IESO's procedure is to sell a combination of long-term and short-term transmission rights on every interface. This procedure is implemented by offering only a portion of the long-term transmission rights available in each long-term auction. Any additional rights available in a specific month (due to higher monthly transmission ratings), along with any unsold long-term transmission rights, are then offered as short-term transmission rights. The total long-term plus short-term rights offered at an interface are capped by the available transfer capability of the interface in each month.

There may have been some instances of offering only long-term transmission rights on single-circuit interfaces. This can happen for a variety of reasons, such as short term outages or lower monthly ratings which result in no incremental rights being available over and above the long-term transmission rights sold cumulatively in the previous auctions for that period.

Following each auction the IESO publishes a post auction sales and price report to summarize auction activity. These reports are available on the public reports site of the IESO website at: <http://reports.ieso.ca/public/>.

The IESO agrees there is merit in considering a more conservative approach to determining available long-term and short-term transmission rights for single-circuit interfaces. The IESO will investigate the merits of this option under the broader review of the transmission rights market as noted in our response to Recommendation 3-1.

Recommendation 3-5, MSP Monitoring Report for November 2011 – April 2012

As part of the IESO's planned review of the Enhanced Day-Ahead Commitment Process, the Panel recommends that the IESO examine the interplay between the day-ahead intertie offer guarantee program and the transmission rights market.

The IESO agrees with this recommendation. The IESO will review the interplay between the day-ahead intertie offer guarantee program and the transmission rights market and determine whether there is an immediate solution that does not affect reliability or market efficiency. If no immediate solution is found, the issue will be addressed as part of the review of the real-time and day-ahead guarantee programs. The IESO has commenced internal work on the review of the guarantee programs and expects to begin the stakeholder process as early as Q2 2013.

Previous Report Recommendations

Recommendation 3-4, MSP Monitoring Report for May 2011 – October 2011

The Panel recommends that the IESO improve its internal controls and external processes to ensure that all information about outages and other relevant contingencies is taken into account when establishing the level of Transmission Rights to be auctioned.

As stated in response to the previous report, the IESO agrees with this recommendation and has implemented new processes with the neighbouring jurisdictions to improve communication of outage plans, allowing this information to be considered in the sales of transmission rights. This recommendation has been completed and closed by the IESO.

Recommendation 3-5, MSP Monitoring Report for May 2011 – October 2011

The IESO should ensure that, when a trader which owns Transmission Rights has failed its intertie transactions (at the same interface in the same direction), either the Transmission Right payout should not be paid or the Congestion Rent should be charged for the quantity of the failed transactions.

The IESO agrees with this recommendation. As stated previously, the IESO has market rules in place to allow for the recovery of transmission rights payouts when the trader fails its intertie transactions, and intends to adjust settlement amounts paid or payable to traders in situations where the trader has failed to schedule the transaction with the appropriate scheduling entity other than for bona fide and legitimate reasons. This recommendation has been completed and closed by the IESO.

Electricity Market Forum

Recommendation 4-1, MSP Report for May 2011 – October 2011

The Panel recommends that the IESO proceed with development work on those recommendations of the Electricity Market Forum that are directed at improving market efficiency, including the consideration of options to replace the two-schedule structure of the current market design.

The IESO agrees with this recommendation. The IESO has initiated work based on the Electricity Market Forum's recommendations aimed at improving market efficiency, including reviews of HOEP, Global Adjustment (GA), the two-schedule system and intertie trading. Requests for Proposals (RFP's) related to the HOEP and GA recommendations were awarded in September 2012. Stakeholder engagement initiatives for reach review are underway (SE-105 (HOEP) and SE-106 (GA)). Reports for both reviews are expected to be published in April 2013. Further work may need to be initiated based on the recommendations from each report. Work on the two-schedule structure will be influenced by the results of the HOEP effort and it is anticipated that an RFP for this work will be issued by the end of Q1 2013. The current expectation is that the final report on the two-schedule structure will be completed by Q2 2014. The IESO has also begun work on the recommendations related to improving trading processes.

Regional Reserve Sharing

Recommendation 3-1, MSP Monitoring Report for May 2011 – October 2011

The Panel recommends that the IESO continue to pursue the introduction by the Northeast Power Coordinating Council of a revised Regional Reserve Sharing Program and the negotiation of any necessary implementing agreements with neighbouring ISOs as expeditiously as possible.

The IESO agrees with this recommendation and is continuing to advocate, within the relevant NPCC processes, for the reintroduction of regional reserve sharing.

Generation Cost Guarantees

Recommendation 3-2, MSP Monitoring Report for May 2011 – October 2011

The Panel recommends that the IESO implement a permanent, rule-based solution to eliminate self-induced CMSC payments to ramping-down generators.

The IESO has initiated internal work in preparation for a review of the real-time and day-ahead guarantee programs. Ramping down CMSC will be considered in the context of this broader review to ensure that generators are compensated for only legitimate costs incurred during ramp down. Stakeholder engagement is currently anticipated to commence in Q2 2013, with findings and recommendations targeted for Q4 2013. The market rules process will flow from those findings and recommendations.

Please do not hesitate to contact me should you have any additional questions on these matters.

Yours truly,



Paul Murphy
President & CEO

c: Bill Rupert, Acting Chair, Market Surveillance Panel

Attach.

IESO Response Matrix

MSP Recommendations

May 2011- April 2012



MSP Report for the period from November 2011 to April 2012 (released January 2013)

Recommendation 3-1

The IESO should reassess the design of the Ontario transmission rights market to determine whether it is achieving its intended purpose.

IESO Response

The IESO agrees that this recommendation warrants further review and will perform a comprehensive review of the transmission rights market to determine whether the transmission rights market is achieving its intended purpose, and to determine what improvements can be made. This overall review is a longer term commitment expected to commence in Q2 2013.

Recommendation 3-2

The IESO should limit the number of transmission rights auctioned to a level where the congestion rent collected is approximately sufficient to cover the payouts to transmission right holders.

IESO Response

The IESO agrees that this recommendation warrants further review. This review will get underway immediately as the first stage of the comprehensive review (refer to recommendation 3-1). The findings at this first stage and any resultant changes to the stabilization design will go through our normal stakeholder process with the intent to return to the IESO Board of Directors with a recommendation by this summer.

Recommendation 3-3

(A) The IESO Board of Directors should authorize the disbursement of the portion of the Transmission Rights Clearing Account balance that currently exceeds the Reserve Threshold to reduce the transmission charges payable by loads.

(B) In the future, the IESO Board of Directors should authorize disbursements of Transmission Rights Clearing Account balances in excess of the Reserve Threshold after each year end.

IESO Response

The IESO Board of Directors will consider the matter of disbursement of a portion of the Transmission Rights Clearing Account balance at its meeting in February. Consideration of annual disbursements, as noted in recommendation 3-3 (B) will be part of the comprehensive review of the transmission rights market (refer to recommendation 3-1).

Recommendation 3-4

The IESO policy of selling only long-term transmission rights on single-circuit interfaces should be replaced by a policy of reserving a significant portion of the available transmission rights for sale at short-term transmission right auctions.

IESO Response

The IESO does not have a policy of selling only long-term transmission rights on single-circuit interfaces. The IESO's procedure is to sell a combination of long-term and short-term transmission rights on every interface. This procedure is implemented by offering only a portion of the long-term transmission rights available in each long-term auction. Any additional rights available in a specific month (due to higher monthly transmission ratings), along with any unsold long-term transmission rights, are then offered as short-term transmission rights. The total long-term plus short-term rights offered at an interface are capped by the available transfer capability of the interface in each month.

There may have been some instances of offering only long-term transmission rights on single-circuit interfaces. This can happen for a variety of reasons, such as short term outages or lower monthly ratings which result in no incremental rights being available over and above the long-term transmission rights sold cumulatively in the previous auctions for that period.

Following each auction the IESO publishes a post auction sales and price report to summarize auction activity. These reports are available on the public reports site of the IESO website at: <http://reports.ieso.ca/public/>

The IESO agrees there is merit in considering a more conservative approach to determining available long-term and short-term transmission rights for single-circuit interfaces. The IESO will investigate the merits of this option under the broader review of the transmission rights market as noted in our response to Recommendation 3-1.

Recommendation 3-5

As part of the IESO's planned review of the Enhanced Day-Ahead Commitment Process, the Panel recommends that the IESO examine the interplay between the day-ahead intertie offer guarantee program and the transmission rights market.

IESO Response

The IESO agrees with this recommendation. The IESO will review the interplay between the day-ahead intertie offer guarantee program and the transmission rights market and determine whether there is an immediate solution that does not affect reliability or market efficiency. If no immediate solution is found, the issue will be addressed as part of the review of the real-time and day-ahead guarantee programs. The IESO has commenced internal work on the review of the guarantee programs and expects to begin the stakeholder process as early as Q2 2013.

MSP Report for the period from May 2011 to October 2011 (released April 2012)

Recommendation 3-1

The Panel recommends that the IESO continue to pursue the introduction by the Northeast Power Coordinating Council of a revised Regional Reserve Sharing Program and the negotiation of any necessary implementing agreements with neighbouring ISOs as expeditiously as possible.

IESO Response

The IESO agrees with this recommendation and is pursuing this within the requirements of NPCC's Regional Reliability Reference Directory #6. Directory #6 contains NPCC's set of requirements regarding participation in Reserve Sharing Groups (RSG). These requirements outline who can participate in an RSG, the obligations of the RSG once formed (for example each RSG will have an RSG Agreement), and the Reserve Sharing Implementation requirements within the RSG Agreement.

Recommendation 3-2

The Panel recommends that the IESO implement a permanent, rule-based solution to eliminate self-induced CMSC payments to ramping-down generators.

IESO Response

The IESO has initiated internal work in preparation for a review of the real-time and day-ahead guarantee programs. Ramping down CMSC will be considered in the context of this broader review to ensure that generators are compensated for only legitimate costs incurred during ramp down. Stakeholder engagement is currently anticipated to commence in Q2 2013, with findings and recommendations targeted for Q4 2013. The market rules process will flow from those findings and recommendations.

Recommendation 3-4

The Panel recommends that the IESO improve its internal controls and external processes to ensure that all information about outages and other relevant contingencies is taken into account when establishing the level of Transmission Rights to be auctioned.

IESO Response: Closed

The IESO agrees with this recommendation. Since the event referenced in the MSP Report, the IESO has and will continue to implement new processes with the neighbouring jurisdictions to improve communication of outage plans, allowing this information to be considered in the sales of Transmission Rights.

Recommendation 3-5

The IESO should ensure that, when a trader which owns Transmission Rights has failed its intertie transactions (at the same interface in the same direction), either the Transmission Right payout should not be paid or the Congestion Rent should be charged for the quantity of the failed transactions.

IESO Response: Closed

The IESO agrees with this recommendation. The IESO currently has market rules in place to allow for the recovery of transmission rights payouts when the trader fails its intertie

transactions, and intends to adjust settlement amounts paid or payable to traders in situations where the trader has failed to schedule the transaction with the appropriate scheduling entity other than for bona fide and legitimate reasons. Refer to the Market Rules Chapter 3, section 6.6.10A and Chapter 7, sections 7.5.8A and 7.5.8B.

Recommendation 4-1

The Panel recommends that the IESO proceed with development work on those recommendations of the Electricity Market Forum that are directed at improving market efficiency, including the consideration of options to replace the two-schedule structure of the current market design.

IESO Response

The IESO agrees with this recommendation. The IESO has initiated work based on the Electricity Market Forum's recommendations aimed at improving market efficiency, including reviews of HOEP, Global Adjustment (GA), the two-schedule system and intertie trading. Requests for Proposals (RFP's) related to the HOEP and GA recommendations were awarded in September 2012. Stakeholder engagement initiatives for each review are underway (SE-105 (HOEP) and SE-106 (GA)). Reports for both reviews are expected to be published in April 2013. Further work may need to be initiated based on the recommendations from each report. Work on the two-schedule structure will be influenced by the results of the HOEP effort and it is anticipated that an RFP for this work will be issued by the end of Q1 2013. The current expectation is that the final report on the two-schedule structure will be completed by Q2 2014. The IESO has also begun work on the recommendations related to improving trading processes.