

January 31, 2014

Ms. Rosemarie T. Leclair
Chair & CEO
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Independent Electricity
System Operator
655 Bay Street
Suite 410, PO Box 1
Toronto, Ontario M5G 2K4
t 416 506 2800
www.ieso.ca

Dear Ms. Leclair:

Re: Market Surveillance Panel Monitoring Report

I am writing in response to your letter of January 3, 2014, requesting 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 2012 – April 2013, and the 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 MSP recommendations, should be taken or initiated.

The most recent report included four recommendations, one relating to constrained-off Congestion Management Settlement Credit (CMSC) payments at the interties and the other three relating to the IESO's real-time and day-ahead guarantee programs.

Constrained-off CMSC Payments

Recommendation 2-1, MSP Monitoring Report for November 2012 – April 2013:

The Panel recommends that the IESO eliminate constrained-off Congestion Management Settlement Credit (CMSC) payments for all intertie transactions, with due consideration to the interplay between the elimination of negative CMSC payments and Intertie Offer Guarantee payments.

The IESO has previously assessed that constrained-off payments for import transactions into designated chronically congested zones are not consistent with justifications outlined in the MSP's discussion paper, Congestion Management Settlement Credits in the IMO Administered Electricity Market.¹ The market rules were subsequently amended to eliminate these payments. However, the remaining CMSC payments continue to play an important role in the existing Ontario market structure. The IESO has launched a review of the energy market pricing system under Stakeholder Engagement 114 to identify the potential for a more efficient approach, and

¹ MSP Discussion Paper, 2003 - Section 3.1 The Role of Constrained Off Payments

this effort could result in changes to, or potentially elimination of all CMSC payments. The results from SE-114 will provide input into a broader IESO consultation that will prioritize potential enhancements to improve the efficiency and effectiveness of Ontario's electricity market.

Assessment of the Need for a Real-time Generator Guarantee Program

Recommendation 3-1, MSP Monitoring Report for November 2012 – April 2013:

The Panel recommends that the IESO provide a detailed analysis to confirm whether the real-time generation cost guarantee (RT-GCG) program continues to be needed in light of the implementation of the enhanced day-ahead commitment process (EDAC), of changes in Ontario's generation capacity, and of other changes in the market since the RT-GCG program was introduced.

The IESO has considered, and reported through Stakeholder Engagement 111: Review of Generation Guarantee Programs, that a mechanism to ensure resource availability to meet the change in demand between day-ahead and real-time is both desirable² and consistent with industry practice. The current mechanism for this purpose is the real-time generator cost guarantee.

The IESO holds the obligation to produce and assess day-ahead and real-time operating plans and those plans are used to position the system for reliable real-time operation. The IESO uses the Day Ahead Commitment Process, the Real Time Generator Cost Guarantee, and Intertie Offer Guarantees to ensure a good starting position for operations as the system moves from day-ahead, to pre-dispatch, and then to real-time. The change in import offers and export bids between the day-ahead and real-time along with changes to other key inputs such as forced outages to generation and transmission elements, demand forecast errors, and variable generation forecast errors can all drive the need to commit additional generation in real-time.

A majority of Independent System Operators (ISO) and Regional Transmission Organizations have a process in place to commit non-quick start generating capacity in real-time through real-time commitments and/or guarantees to supplement the day-ahead processes. A review of these processes at the Midcontinent ISO (previously Midwest ISO), California ISO, PJM and New York ISO was included in Scott Harvey's *Review of the Efficiency of the Hourly Ontario Energy Price*³. The IESO's real-time generator cost guarantee program serves this purpose in Ontario.

In contrast to neighbouring ISO's the IESO's day-ahead process does not provide financially binding prices and schedules for any day-ahead participants - which makes the IESO more dependent on real-time processes to manage the gap from day-ahead to real-time. The IESO is concerned that removal of the real-time generator cost guarantee would increase the frequency with which the IESO must constrain on units for reliability and take other out of market control

² SE-111 Presentation - Assessment of the Need for RT-GCGs - Slide 17 & 18

³ Scott Harvey – FTI Consulting – *Review of the Efficiency of the Hourly Ontario Energy Price*, see page 83 Section 4 Intra-day Unit Commitment Mechanisms

actions to manage the gap. The removal of the real-time guarantee program would also mean greater uncertainty in the IESO's process for managing the transition from day-ahead to real-time operation, impacting the current proactive approach to planning and executing power system operations.

Taking all of these factors into account, the IESO is unwilling at this time to eliminate the program, but is committed to considering improvements to its structure and implementation, including the expansion of offsetting revenues proposed in Recommendation 3-2 below.

Real-time Generator Guarantee Program – Revenue & Guaranteed Costs

Recommendation 3-2, MSP Monitoring Report for November 2012 – April 2013:

If the IESO, after performing its detailed analysis, determines that the RT-GCG program continues to be needed, the Panel recommends that the IESO modify the RT-GCG program such that the revenues that are used to offset guaranteed costs under the program are expanded to include any profit (revenues less incremental operating costs) earned (a) on output above a generation facility's minimum loading point during its minimum generation block run time (MGBRT), and (b) on output generated after the end of the facility's MGBRT.

The IESO will assess this proposal in 2014, including whether this change would materially impact the incentive for generators to participate in the real-time generation cost guarantee program rather than the day-ahead commitment process.

Enhanced Day-Ahead Commitment Program and Exports

Recommendation 3-3, MSP Monitoring Report for November 2012 – April 2013:

The Panel recommends that the IESO re-examine the question of integrating exports into EDAC to reduce the need to commit additional generation in real-time to meet export demand that currently only appears in the market in real-time. While the Panel is not recommending a specific approach for integrating exports, the following have been identified as potential options:

- a) introduce a mechanism that encourages exports to bid in EDAC; or*
- b) include a forecast of exports when commitments are made under EDAC.*

The IESO has explored options to induce exports to participate in the day-ahead commitment process while assessing the advantages and disadvantages to the market along with the attractiveness of potential options to exporters. The IESO determined and reported its findings through Stakeholder Engagement 21: Day-Ahead Market Evolution that it was not feasible to develop a mechanism to incent exports to participate in the day-ahead process.⁴

The IESO agrees that there could be benefits realized for real-time operations with the inclusion of an export forecast during the day-ahead process (option 'b' of this recommendation). The

⁴ EDAC - Options for Export Incentives

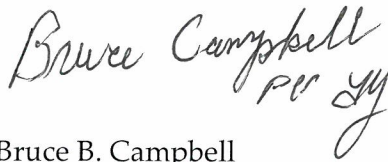
IESO will assess the feasibility of developing an export forecast to integrate into the day-ahead commitment process in 2014.

Status of Actions Taken

As noted in your letter, the Board has received the IESO's filing regarding the implementation status of recommendations made by the MSP in 2013 and the preceding four years. That document is published on the IESO's Market Monitoring webpage.

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

Yours truly,

A handwritten signature in cursive script that reads "Bruce Campbell" with "per GL" written below it.

Bruce B. Campbell
President and CEO

c: Glenn Leslie, Chair, Market Surveillance Panel