Market Surveillance Panel

Proposed Monitoring Document:
Generator Offer Prices Used to Signal an Intention to Come Offline

June 16, 2011

1. Introduction

1.1 Purpose of this Monitoring Document

OEB By-law #3 authorizes the Market Surveillance Panel (MSP or the Panel) to issue monitoring documents including data catalogues, monitoring indices or other information requirements and evaluation criteria that the Panel considers appropriate to enable it to carry out its monitoring functions.[1] The Panel is also empowered to investigate any activities related to the IESO-administered markets or the conduct of a market participant where, among other things, the Panel considers such investigation to be warranted as a result of the Panel's monitoring activities.[2]

The purpose of this monitoring document is to outline evaluative criteria that the Panel will use in monitoring for anomalous or inappropriate market conduct by generators that could constitute gaming, specifically in relation to prices offered by generators in order to signal an intention to take their units offline. This monitoring document therefore also provides guidance to generators regarding the level of offer prices which normally would not trigger a gaming investigation if a generator raises its offer price to signal an intention to come offline for *bona fide* business reasons. Given the wide variety of specific factual circumstances which may arise in the market,

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[1] Ontario Energy Board, By-Law #3 (Market Surveillance Panel), Article 4.2.1, available online at http://www.oeb.gov.on.ca/OEB/_Documents/About+the+OEB/OEB_bylaw_3.pdf,

[2] *Electricity Act, 1998*, section 37 and Ontario Energy Board By-law #3, Article 5.1.

this document is not a comprehensive or binding statement of how the Panel's monitoring or investigative mandate will be exercised in specific situations.[3]

There are two potential concerns when generator offers are increased in order to signal a generator's intention to come offline. If a generator's offer price exceeds its marginal or opportunity cost, this may constitute an exercise of market power and will be assessed according to the Panel's monitoring criteria related to market power issues.[4] In addition, since the magnitude of the shut down offer price affects the magnitude of the congestion management settlement credit (CMSC) payments to the generator, gaming concerns could arise where offer prices are higher than necessary to achieve the operational objective of coming offline — thereby generating unnecessarily large CMSC payments. This Monitoring Document focuses on the potential gaming issues.

The Panel is aware that the IESO consulted with stakeholders on recommended changes to the CMSC rules applicable to generators, including during ramp down, but it is uncertain whether or when changes may be made[5]. The Panel therefore considers that it is useful to issue guidance at this time in relation to the monitoring and possible investigation of offer price levels that are used to signal an intention to come offline. The Panel will consider whether to make changes to this Monitoring Document if and when any market rule amendments relating to ramp-down CMSC payments are implemented.

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[3] Article 4.2.7 of Ontario Energy Board By-law #3 makes it clear that nothing in Article 4.2, which makes provision for the issuance of monitoring documents, should be interpreted as precluding the Panel from undertaking such monitoring, evaluation or analysis as the Panel determines appropriate for the purposes of carrying out its monitoring activities.

[4] Pricing-up or economic withholding of generation is dealt with in Market Surveillance Panel, Monitoring Document: Monitoring of Offers and Bids in the IESO-Administered Markets ("Monitoring of Offers and Bids"), March 2010. A generator's offers may be examined under this framework regardless of whether or not the same offers are being examined pursuant to the evaluative criteria for gaming set out in this Monitoring Document.

[5] IESO, Stakeholder Engagement SE-84, Congestion Management Settlement Credit (CMSC) Payments for Generation Facilities. See: http://www.ieso.ca/imoweb/consult/consult_se84.asp. The Electricity Market Forum convened by the IESO is currently examining the broader issue of whether to evolve beyond the two sequence market structure from which CMSC payments are derived.

1.2 Mandate of the Market Surveillance Panel

The Panel was established prior to the opening of the IESO-administered markets in 2002. Among other things, the Panel is mandated to monitor possible gaming or abuses of market power by market participants as well as recommending changes in market rules or design that would improve their efficiency.[6] More specifically, Ontario Energy Board By-Law #3 provides that:

> The Panel shall monitor, evaluate and analyse activities related to the IESO-administered markets and the conduct of market participants with a view to:
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> (a) identifying inappropriate or anomalous market conduct by a market participant, including unilateral or interdependent behaviour resulting in gaming or in abuses or possible abuses of market power;
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> (b) identifying activities of the IESO that may have an impact on market efficiencies or effective competition;
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> (c) identifying actual or potential design or other flaws and inefficiencies in the market rules and in the rules and procedures of the IESO;
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> (d) identifying actual or potential design or other flaws in the overall structure of the IESO-administered markets and assessing whether any one or more specific aspects of the underlying

[6] The *Ontario Energy Board Act, 1998* and the *Electricity Act, 1998* contain provisions relating to the establishment, role and powers of the Market Surveillance Panel. The duties and activities of the Panel are elaborated under Ontario Energy Board By-law # 3, including the monitoring, investigation, review and reporting on activities related to the IESO-administered markets or the conduct of market participants listed in Articles 3.1.2 to 3.1.7.

structure of the IESO-administered markets is consistent with the efficient and fair operation of a competitive market; and

(e) recommending remedial actions to mitigate the conduct, flaws and inefficiencies referred to in paragraphs (a) to (d).[7]

As noted above, the Panel may commence an investigation where warranted as a result of the Panel's monitoring activities.

2. Generator Decisions to Come Offline

The Panel generally expects that generators which are online will continue producing electricity as long as it is economic to do so. In such situations, a generator will run until dispatched off by the IESO's scheduling algorithms as demand declines and/or other less expensive sources of supply are available, thereby rendering the generator's offers no longer economic. Coming offline in this manner does not raise gaming (or market power) issues if the participant has not raised its offer price to induce the dispatching off.

In some situations, generators choose the point in time at which they want to come offline for their own business reasons. The generator may achieve this by submitting an offer price higher than its running offers to ensure that the generator is not scheduled in the constrained dispatch schedule. The Panel would normally not consider this to constitute gaming (or an exercise of market power) if (i) there are *bona fide* business reasons (such as short-term fuel or staff availability) and (ii) the submitted offers do not exceed the incremental costs of the generator continuing to operate using viable options (such as spot market fuel purchases or staff overtime).

Where the generator does not have *bona fide* business reasons for choosing to come offline or raises its offer price beyond its incremental costs of continuing to operate, the Panel would apply the evaluative criteria below to assess whether gaming is occurring (and/or apply the Monitoring of Offers and Bids Document to assess possible market power concerns).

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[7] Ontario Energy Board, By-Law #3, Article 4.1.1.

2.1 CMSC Payments During Ramp Down

The current algorithms for the unconstrained market schedule and constrained dispatch schedule implement the ramping down of a generator in different intervals and at different rates. As a result, there are quantity differences during the ramp-down period, which in turn give rise to constrained-on CMSC payments to the extent that the offer price is different from the market price. Between May 2009 and October 2010, total ramp-down CMSC payments to fossil-fired generators averaged approximately $1 million per month.[8]

The amount of the CMSC payment for a ramping down generator in any particular interval is equal to: (i) the difference between its constrained dispatch schedule quantity and its unconstrained market schedule quantity, multiplied by (ii) the difference between the generator's offer price and the uniform market clearing price (MCP). A high offer price therefore leads to a large CMSC payment during a self-induced ramp down.

In its August 2010 monitoring report the Panel observed that some generators were using very high (occasionally up to $2,000/MWh) prices to signal their intention to come offline.[9] Such prices were much higher than needed to ensure that the generating unit was dispatched off, and also resulted in very high self-induced CMSC payments for the ramp-down period. The Panel recommended that the self-induced CMSC payments resulting when a generator chooses to come offline be eliminated.[10] In addition, staff in the IESO's Market Assessment Unit (MAU) discussed these high offer price levels with various market participants, which generally led to significant reductions on a voluntary basis. [11] However, some generators are still using offer prices which are considerably higher than necessary to achieve the outcome of coming offline.

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[8] See the Panel's February 2011 Monitoring Report, p. 94.

[9] See the Panel's August 2010 Monitoring Report, p. 271.

[10] See the Panel's January 2009 Monitoring Report, pp. 216-217.

[11] Portions of CMSC payments were voluntarily paid back by various generators after the MAU has discussed the issue with them.

The IESO responded to the Panel's recommendation by commencing Stakeholder Engagement Plan 84 (SE-84). When it did so, the IESO acknowledged that it currently has no recourse to recover self-induced CMSC payments, but "indicated that [it] expects that generators will respect the intent of the market rules, and will not take advantage of any opportunities to earn self-induced CMSC while [the IESO is] in the process of addressing the issues."[12]

2.2 Potential for Gaming

The Panel has indicated that "in general the Panel regards gaming as the exploitation of opportunities to profit or benefit from defects in the design of the market, from poorly specified rules or procedures, or from circumstances that are not expressly covered by Market Rules or procedures."[13]

The Panel considers that offer prices that are higher than necessary to ensure a generator comes offline could constitute gaming activity. In order to identify offer price levels that normally would not trigger the initiation of an investigation into potential gaming conduct, the Panel has reviewed the historical pricing patterns in the wholesale market.

2.3 Offer Price Levels

To determine the offer price which will be sufficient for a generation unit to come offline, market participants can examine pre-dispatch shadow prices. In particular, the generator's 3-hour ahead pre-dispatch shadow price provides information regarding local system conditions prior to the final window for submission of an offer in which a generator would signal its intention to come offline.

Based on an analysis of historical pricing patterns, the Panel has concluded that offer price levels that are no more than 30% above a generator's 3-hour ahead pre-dispatch shadow price normally provide an extremely high degree of certainty that the facility will come offline. In a low-priced

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[12] See Congestion Management Settlement Credit (CMSC) Payments for Generation Facilities (SE-84), Session Notes, December 1, 2009**,** available online at: http://www.ieso.ca/imoweb/pubs/consult/se84/se84-20091201-session-notes.pdf , p. 2.

[13] Monitoring of Offers and Bids, p. 48.

environment, however, it is possible that the 3-hour ahead pre-dispatch shadow price may be below the generator's marginal cost. Indeed, in some instances an offer price that contains a 30% adder to the 3-hour ahead pre-dispatch price may be below the generator's marginal cost. Accordingly, where there are *bona fide* business reasons for a generator to come offline, an offer price that is the higher of either (i) the generator's marginal cost, or (ii) 130% of the 3-hour ahead constrained schedule pre-dispatch price, normally would not be regarded by the Panel as gaming.

For generators participating in the IESO's Generation Cost Guarantee (GCG) Program, the generator's Minimum Generation Block Run Time (MGBRT) offer price normally will be used as the initial measure of the marginal cost. Where the generator can document that it would incur higher marginal or other incremental costs to continue to operate beyond the MGBRT, the Panel will use such higher costs in its assessment.