ONTARIOPOWER GENERATION

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VIA EMAIL

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 26th Floor
Toronto, ON
M4P 1E4

Dear Ms. Walli:

Re: MSP Monitoring Document
Submission of Ontario Power Generation Inc.

Please find attached Ontario Power Generation Inc.'s submission responding to the Market Surveillance Panel's Draft Monitoring Document: *Monitoring of Offers and Bids in the IESO-Administered Electricity Markets*.

If there are any questions with respect to this notice, please do not hesitate to contact me at (416) 592-3326.

Best Regards,

Colin Anderson

ATTACHMENT - OPG COMMENTS: MSP MONITORING DOCUMENT

OPG appreciates the opportunity to comment on the Market Surveillance Panel's Draft Monitoring Document: *Monitoring of Offers and Bids in the IESO-Administered Electricity Markets* (the "Monitoring Document"). OPG had previously submitted comments to the Market Surveillance Panel (the "MSP" or "Panel") on a proposed Market Power Framework document that was under consideration in the spring of 2007. In OPG's view, the new Monitoring Document is an improvement over that earlier approach.

In particular, OPG supports the Panel's decision "not to adopt comprehensive quantitative indicators or require additional data from market participants on a routine basis at this time".[1] That more comprehensive data are unnecessary is further supported by the findings in the most recent Market Surveillance Panel Report which states "Spot market prices generally reflected demand and supply conditions" and the MSP "did not find gaming or abuse of market power to be occurring...".[2]

OPG supports the less intrusive approach set out in the Monitoring Document. The Document is also helpful in that it sets out the manner in which the Panel proposes to assess market participant behaviour with respect to market power.

OPG's comments on the current version of the Framework are grouped into two broad categories; Abuse versus Exercise of Market Power and Short-Run vs. Long-Run Marginal Costs.

[1] The Monitoring Document, page 1.

[2] Market Surveillance Panel, Monitoring Report on the IESO-Administered Electricity Markets, for the period November 2008 - April 2009, page ix. The same report provides further evidence of the competitiveness in the Ontario market stating that "For several years, energy prices in Ontario have been generally lower than energy prices in most neighbouring jurisdictions. Over the latest six-month period, this continued as prices in Ontario were lower when analyzed over all hours as well as on-peak and off-peak hours.", pages 85-86. Moreover, spot prices have been found to be responsive to declining economic conditions.

1. Abuse versus Exercise of Market Power

In Section 6 of the proposed Framework, the Panel outlines its approach to the assessment of abuse of market power. OPG generally supports this approach and agrees that abuse must entail some action on the part of a market participant (or group of market participants) that lessens or prevents competition. The notion that abuse of market power must involve some anti-competitive conduct (such as exclusionary practices, collusive behaviour or disciplinary actions, such as predatory pricing) is consistent with the views of the Canadian Competition Bureau, and is supported by federal competition legislation.

In addition to this concept, OPG believes that any finding of abuse of market power needs to be based on the presence of a *systematic* practice of anti-competitive actions, not a single isolated incident. OPG's justification for this lies in Section 79 of the *Competition Act (*the *"Act")*, which deals with the abuse of a dominant position. That Section of the *Act* reads as follows:

> 79. (1) Where, on application by the Commissioner, the Tribunal finds that
>
> (*a*) one or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business,
>
> (*b*) that person or those persons have engaged in or are engaging in **a practice of anti-competitive acts,** and
>
> (*c*) **the practice** has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market, the Tribunal may make an order prohibiting all or any of those persons from engaging in that **practice**. [**emphasis** added]

Based on this language, OPG submits that a single exercise of market power (or a small number of isolated instances), even in the presence of an anti-competitive action, does not constitute abuse. For this reason, OPG believes that the Panel should make explicit in its framework the concept that abuse stems from a **practice** of anti-competitive acts, which clearly implies a systematic and sustained approach.[3]

Finally, the last paragraph of Section 6 indicates the following:

> "While a systematic exercise of market power is not abuse of market power in the absence of anti-competitive conduct, it will be reviewed to determine whether corrective competitive responses are being impeded by market structure, rules or procedures or other barriers. This could lead to recommendations that the Market Rules or aspects of market design be changed. "

While OPG agrees with this approach, it suggests that this concept may benefit from explicit extension. While a systematic exercise of market power may be appropriate for review, OPG generally questions the need for detailed assessments of isolated incidents that may or may not end up being considered an exercise of market power. As indicated in its comments on the future direction of MSP Reports (filed on October 1, 2009), OPG appreciates that all entities need to re-evaluate how they perform their work, particularly in these cost-constrained times. As such, reducing the breadth and depth of MSP reviews into "one-off" occurrences that may lead to an isolated finding of exercise of market power is a prudent course of action in OPG's view.

OPG submits that significant resources – both regulatory and utility owned - can be consumed analyzing these unique situations; a consumption of resources that is difficult to justify given that isolated exercises of market power are not an indication of wrong-doing.[4] Further, it is likely that any market design changes would be driven by a number of such occurrences, not a single isolated incident. OPG is careful to point out that if such behaviours are repeated (thereby suggesting some systematic element) then a review would indeed be warranted. OPG suggests that the Panel examine market power in a broader context, not on an isolated case by case basis.

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[3] The Competition Tribunal has indicated that "market power is the ability to set prices above competitive levels for a considerable period. "Commissioner of Competition v. Canada Pipe, at paragraph 122. Canada Pipe is one of the most recent abuse of dominance cases in which the Competition Tribunal has written that the definition of market power includes an element of sustainability.

2. Short-Run vs. Long-Run Marginal Costs as the Competitive Benchmark

OPG does not believe that a generation unit's short run marginal costs should be used as the basis for a "competitive price" because it is, quite simply, too low and not reflective of a truly competitive and sustainable market. The Monitoring Document continues to focus on short run marginal cost rather than longer term measures. Furthermore, the focus is on a relatively small number of hours during which prices are considered to be especially low or high. As explained in previous submissions by OPG and in the 2007 Trebilcock-Yatchew Report, long term measures of marginal cost represent a superior competitive benchmark.

Although short run marginal cost pricing will in general allow some recovery of fixed costs by infra-marginal firms, (the Panel makes this point at page 19), in the electricity industry, which has high fixed costs, it is not reasonable to expect that long term costs will be recovered through this approach. Thus variation in marginal suppliers – an aspect which is focused upon in the Draft - is not particularly relevant to inducing investment.

The Panel does recognize that short term marginal cost pricing is insufficient for the recovery of long term costs (page 19). However, it then suggests that the discussion of pricing-up behaviour is essentially moot because the OPA has been mandated to source new generation through procurement contracts. Despite the strong reliance on long term contracts within the Ontario industry, it is not advisable to constrain bidding behaviour in the spot market and thereby further reduce the role that this market plays in influencing investment in, and the evolution of, the industry.

There will always be a need to balance demands and supplies in a spot market, even if much of the supply is provided under contract. The structure of long term contracts will be affected by the degree to which participants foresee participation in the spot market as potentially profitable. Constraining bids in the spot market generally reduces

4 MSP Monitoring Document (page 3)

expected profitability and will therefore tend to, other things being equal, dissuade participation. Whatever the optimal mix of supply arrangements and risk bearing as between supplying through long-term contracts and supplying through the spot market, the tendency will be to bias the structure of supply against the spot market. In the result, a disproportionate share of the risk may be allocated to consumers.

Furthermore, OPG remains convinced that using a generation unit's short run marginal costs as the basis for a "competitive price" will discourage investment. Generators concerned about Panel response to any pricing up will be reluctant to do so, thereby significantly limiting scarcity pricing, which is necessary to signal the need for investment. Again, this is dealt with on pages 18 and 19 of the current Framework. OPG appreciates that a finding of pricing up within this context is a means of explanation, not a censure.

In conclusion, while OPG is generally supportive of the elements of the Monitoring Document it nevertheless sees room for improvements. A greater focus on systematic practices would not only result in more efficient resource utilization, but would also more closely reflect the intent of the underpinning competition legislation. In addition, recognition that long term marginal costs provide more realistic competitive benchmarks would send improved price signals to current and future investors.