

# Market Surveillance Panel

## Report on an Investigation into the Electricity Trade Agreement between the Ontario IESO and Hydro- Québec

September 2018

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In this report, the Market Surveillance Panel (Panel) provides its findings further to its investigation into the Electricity Trade Agreement (HQ Agreement) between Hydro-Québec Energy Marketing (HQEM) and the Ontario Independent Electricity System Operator (IESO).

The Panel is a panel of the Ontario Energy Board (OEB). Its role includes monitoring and investigating activities related to – and behaviour in – the wholesale electricity markets administered by the IESO. The Panel does not have the legislative mandate to impose sanctions or other remedies in response to issues identified during its monitoring or investigative work, but it does report on the results of that work and makes recommendations for remedial action as it considers appropriate. Panel investigations are governed principally by section 37 of the *Electricity Act, 1998* and Article 5 of the OEB’s By-law #3.<sup>1</sup>

The Panel has concluded that the HQ Agreement operates within the Market Rules that govern the IESO-administered markets. As part of its regular market monitoring responsibility, the Panel is monitoring whether and how the HQ Agreement may be affecting efficiency or effective competition in the IESO-administered markets, and will report on that in the normal course as may be warranted.

Prior to finalization of this report, a draft was given to the IESO to provide it with an opportunity to comment on matters of factual accuracy and confidentiality. The IESO confirmed that it had no comments.

### ***The HQ Agreement***

The HQ Agreement, which comprises three separate contracts, was entered into in the fall of 2016 pursuant to a Direction issued by the Minister of Energy to the IESO.<sup>2</sup> The Direction in

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<sup>1</sup> By-law #3 sets out the general process applicable to Panel investigations. Section 5.1.1(b) of that By-law contemplates that an investigation may be commenced upon receipt of a complaint. By-law #3 is available online at: [https://www.oeb.ca/oeb/Documents/About%20the%20OEB/OEB\\_bylaw\\_3.pdf](https://www.oeb.ca/oeb/Documents/About%20the%20OEB/OEB_bylaw_3.pdf)

<sup>2</sup> Available online at: <http://www.ieso.ca/-/media/files/ieso/document-library/ministerial-directives/2016/directive-ontario-quebec-20161021.pdf?la=en>

question, dated October 21, 2016, directed the IESO to negotiate and enter into one or more contractual agreements based on a Memorandum of Understanding (MOU) dated September 11, 2015 between the governments of Ontario and Québec.<sup>3</sup> Both the Direction and the MOU make it clear that one of the purposes of the agreement to be negotiated between the IESO and Hydro-Québec is to structure the delivery of electricity from Québec to Ontario to displace Ontario natural gas-fired generation.

### *Origin and Scope of the Investigation*

The investigation in relation to the HQ Agreement was commenced by the Panel in August 2017, under section 5.1.1(b) of the OEB's By-law #3 further to a formal request for an investigation.

As set out in its request, the focus of the complainant's concerns regarding the HQ Agreement were as follows:

- potential detriments to the efficiencies of, and the effectiveness of competition within, the IESO-administered markets;
- unfair discrimination against IESO market participants, and more specifically Ontario natural gas-fired generators;
- independence of the IESO; and
- consistency with the Market Rules.

Given the basis for and purpose of the HQ Agreement as described above, the Panel advised the complainant that it would not commence an investigation into the HQ Agreement insofar as the effect of displacing Ontario natural gas-fired generation is concerned, nor into whether the HQ Agreement is affecting the IESO's independence by reason of such effect.<sup>4</sup> The Panel also advised the complainant that it would be premature to launch an investigation into the potential, if any, for the HQ Agreement to have a detrimental effect on market efficiency or effective

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<sup>3</sup> Available online at: <https://news.ontario.ca/opo/en/2015/10/memorandum-of-understanding-between-the-government-of-ontario-and-the-government-of-quebec-regarding.html>

<sup>4</sup> In the intervening period, the Financial Accountability Office of Ontario released a report that provides a financial assessment of the effect of the HQ Agreement on Ontario ratepayers and reviews the impact of the HQ Agreement on Ontario-based natural gas-fired generation and greenhouse gas emissions. That report, which describes elements of the HQ Agreement in some detail, is available at: [https://www.fao-on.org/en/Blog/Publications/Electricity-Trade-0418](https://www.fao.on.org/en/Blog/Publications/Electricity-Trade-0418).

competition within the IESO-administered markets, but that the Panel expected to monitor the situation in the normal course.

The Panel did, however, determine that it would investigate whether the HQ Agreement is operating within the Market Rules, and this report sets out the Panel's findings on that issue. For greater clarity, the Panel notes that this investigation is not about the conduct of either the IESO or HQEM whether under the HQ Agreement or otherwise; rather it is an examination of the terms of the HQ Agreement against the context of the Market Rules.

### *The Panel's Findings*

For the purposes of its investigation, the Panel obtained from the IESO, on a confidential basis, the three contracts that make up the HQ Agreement.

As noted above, the scope of the Panel's investigation was to consider whether the HQ Agreement operates within the Market Rules. In other words, the Panel considered whether the HQ Agreement requires HQEM to participate in the IESO-administered markets in a manner that is contrary to or that falls outside of existing market mechanisms, and whether the HQ Agreement requires the IESO to treat HQEM in a manner that is contrary to or that falls outside of existing market mechanisms. The fact that settlements to HQEM under the HQ Agreement may comprise payments from both the market and from other sources was not considered contrary to existing market mechanisms, as the same may be said for contracts that are currently in place between the IESO and other market participants. Similarly, if and to the extent that the HQ Agreement incents or requires HQEM to make offers different from what they might otherwise have been, this was not considered contrary to existing market mechanisms although this may be germane to the question of whether and to what extent the HQ Agreement may be affecting efficiency or effective competition in the IESO-administered markets.

The HQ Agreement contains provisions that require HQEM to operate within the Market Rules, and provisions that obligate HQEM to use existing market mechanisms to meet its obligations under the HQ Agreement. The principal contract, called the "Energy Sales and Energy Cycling

Agreement”, states that “HQEM shall offer Energy into the IESO-administered markets in accordance with the Market Rules and in the manner set forth below”. Generally speaking, the “manner set forth below” describes the process by which HQEM is contractually bound to offer into the IESO-administered markets. Specifically, HQEM must submit import offers to the Ontario market in order to participate in the market. When doing so, HQEM is required to use offer prices and quantities specified in the principal contract for the contracted imports (2 TWh of electricity per year). Those offer prices are determined using a formula set out in the principal contract that targets natural gas-fired generation based on heat rates, gas prices, and a carbon index. There is nothing in the HQ Agreement that requires or permits the IESO to treat HQEM’s import offers any differently from import offers made by other market participants.

Accordingly, the Panel is satisfied that the HQ Agreement operates within the Market Rules.

As noted earlier, the impact, if any, of the HQ Agreement on market efficiency or effective competition within the IESO-administered markets is being monitored by the Panel as part of its regular market monitoring responsibility, and will be reported on in the normal course as may be warranted.

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