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IESO SENIOR MANAGEMENT UPDATE

To: Stakeholder Advisory Committee

Date: May 5, 2006

Subject: Constrained off CMSC Payments for Imports and Exports (SE-10)

Information Item

IESO Board Decision Date: June 8, 2006

Currently the market rules permit participants to place bids to export or offers to import at prices that fall between the hourly Ontario energy price (HOEP) and shadow price so that they are accepted in the pre-dispatch market schedule but not in the pre-dispatch constrained sequence, thereby generating a congestion management settlement credit (CMSC) payment for no movement of energy. This is considered a potential instance of gaming or a manipulation of the rules when the participant can easily identify congested zones, such as the northwest.

Although addressing this circumstance qualified as an urgent rule amendment, we decided to proceed by way of a normal rule amendment so that we could benefit from the advice of participants. In the interim the IESO's Market Assessment and Compliance Division (MACD) has monitored for the possible exploitation of this loophole. Input was received through open stakeholder engagement activities and the draft rule amendment was reviewed by the IESO technical panel in February.

A potential North American Free Trade Agreement (NAFTA) issue was identified insofar as the rule change was directed at traders and could potentially be seen as discriminating against United States entities vis-à-vis Ontario-based participants. As a consequence, more time was needed to consider alternatives.

The proposed rule amendment was modified and presented to the technical panel on April 11 and subsequently posted for comment. The current proposal is a streamlined local market review and recovery of CMSC payments to the participant's cost, where there is persistent and significant targeting of CMSC in congested areas of the province designated as constrained off watch zones. The issue with this approach is the triggering: will triggers be narrow enough to



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prevent participants obtaining significant CMSC payments with high volume transactions in separate hours? A stakeholder meeting is being held May 9 to discuss the triggers and other criteria in the process. The market rule amendment will go to the May 23 technical panel meeting and potentially to the June 8 Board meeting for decision.