Notes for Remarks

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# What’s Ahead for Ontario’s Electricity Sector

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Thanks very much. The APPrO conference has always been one of my "can't miss" conferences so I am pleased to be here, not just to deliver this presentation, but also to listen to and learn from the other speakers.

My topic today is the IESO's vision for the province's electricity sector.

But before I get to that, let's look at where we are today.

## Today's Situation

Many things are working well today. That doesn't mean there aren't issues that need to be dealt with but a number of the concerns we identified in our first two Ontario Reliability Outlooks are being addressed … from the planning and construction of new generation in Toronto to additional generation and transmission enhancements in west GTA.

A new schedule for the shutdown of the coal facilities is being developed and new market mechanisms, such as the Day-Ahead Commitment Process (DACP), have been adopted to enhance reliability.

## Day-Ahead Commitment Process

Let me talk about the Day-Ahead Commitment Process for a moment. We put in place the DACP following the tight situation we faced in the summer of 2005, a situation created in part because of the intertie transaction failures. For a province that continues to be dependent on imports during periods of high demand, we knew this had to be addressed.

The results of the DACP over the summer were impressive. In its first real test during the peak week covering late July-early August, the DACP successfully met each of its intended objectives. It economically committed resources one day in advance and cut in half the import failure rate compared to 2005.

This reduction in failure rate not only helped reliability, but also helped to keep down the wholesale price.

The benefits of the DACP are not only evident in the summer. Over the last few weeks, we have had a lot of generation out of service and have needed a higher level of imports, many of which are secured a day ahead.

Later this week we will be going to our Board with a recommendation to continue with the DACP.

I mentioned that new generation is being constructed or planned.

We heard from Duane Cramer last week about the Goreway projects and I expect that Jim Hankinson will give us an update on the Portlands project when he speaks at the Ontario Energy Network luncheon later this month.

We have also seen the impact of wind in meeting power needs this year. Over 300 MW is in service today … and on a recent weekend, 323 MW were being fed into the grid. Another 1,000 MW of wind is on the way, demonstrating that it is not only the large generator members of APPrO that are important for Ontario's supply but small operators too.

While there has been a significant amount of new supply either introduced or announced, enhancing our transmission system remains a priority. Ontario is not alone in that respect. In its recent Reliability Assessment, NERC said the transmission system in many parts of North America requires significant investment to address reliability issues and economic impacts. According to NERC, expansion and strengthening of the transmission system is not keeping pace with demand growth and expansion of generating resources in most areas.

DACP, the announcement and work on Portlands, progress on the Sithe plant in Brampton, new wind generation, the change in timing for the coal shutdown … these reliability-related measures have all been announced or occurred in the past 12 months.

When we look at some of the benefits that have occurred since restructuring of the industry took place in 2002, the list grows even longer.

**Generator Reliability**

On the supply side, 3,500 MW of generation has been added to Ontario's system since market opening.

We have also observed significantly improved generator performance since 2002. Both forced and planned outage rates for Ontario's nuclear and fossil fleets have declined in the past four years. Ontario's generators are more available to supply power, which in turn means less reliance on imports and reduced potential for price spikes due to insufficient internal supply.

This improved efficiency is influenced by the competitive and transparent environment in which generators operate today as compared to five years ago. It reflects, in part, the operating risks that generators bear. They need to produce to be paid.

**Impact on Trade**

The design of our competitive electricity market has enhanced the flexibility for real-time trade between Ontario and neighbouring markets.

It has had benefits for Ontario from both reliability and economic perspectives.

Under tight supply conditions, such as those experienced during the summers of 2002 and 2005, we were able to attract imports at unprecedented levels to help maintain reliability in Ontario.

More recently, as a result of our improved supply conditions, Ontario has become a net exporter of energy, which has many benefits for you as generators and for the province. First, Ontario generators can increase their output and sell energy into other markets, which contributes to the recovery of their fixed costs. Secondly, the ability to export excess output provides generators with more demand certainty. As a result, they are more likely to ramp up in the morning and remain on-line during the day, which has significant reliability benefits for the Ontario system.

At times this summer we were able to help our neighbours meet their needs … a sharp contrast to recent summers.

In fact, the supply in the entire Northeast and Midwest markets, representing over half of the supply in North America, was tighter this summer than I have seen it in five years. If we had needed the level of help we needed in 2005, I'm not sure we could have gotten it. This demonstrates just how important the Ontario generator additions have been.

But once again, the markets worked as they should this summer. The Ontario, New England, New York, PJM and MISO markets ensured that available power flowed to where it was needed. And it was needed in different places at different times and the transparent market prices indicated those needs.

## Demand Response

Benefits of the restructured environment we now operate in are also apparent on the consumer side. One of these has been the response of consumers to price signals provided by the market.

Since the market opened in 2002, ten market participants have registered over 700 MW of their load as dispatchable. These customers are active participants in the demand side of the market as well as valuable sources of operating reserve. The use of dispatchable loads as reserve is often more efficient than using generating resources and this additional source has led to falling operating reserve prices. This is good for consumers and good for the market as a whole, even if reserve providers are not always pleased.

In addition, we continue to observe price responsive behaviour from customers that are not registered as dispatchable loads or participants in OPA or IESO demand response programs.

In particular, on the record setting day of August 1, pre-dispatch prices prompted several large customers to shift their load to lower priced hours or turn on back-up generators. This is exactly the type of behaviour that should be expected in an efficient marketplace. And it demonstrates the importance of good, transparent price signals.

While we have seen some progress on the demand response front, clearly there is room for more.

The next step is to ensure that all consumers, large and small, have the necessary tools to actively participate in this market. The smart meter initiative now under development will go a long way towards making that happen. The government has committed to installing 800,000 smart meters by 2007, with a smart meter in the homes of all residential customers by 2010.

The smart meter has the potential to bring the low volume residential customer to the demand response table. It can enable conservation, help the environment and help customers manage their bills. And, as the system operator, I would have loved to have had smart meters available to help reduce peak demand during some recent hot summer days.

**<u>Market Evolution</u>**

Having just outlined some of the benefits of markets, and having managed this market for the past five years, it shouldn't surprise you to hear me say that I believe in markets. But I will add that I am not a market idealist. It is not a market for market's sake.

My belief in the market is based on what it can do for this sector, indeed what it can do for this province. It is based on what I have actually observed for the past four years. Simply put, I believe a market is the most effective means to a reliable, efficient supply of electricity with competitive, predictable prices.

The hybrid market is working today but we can't lose sight of the need to develop this market over time. We also can't structure things in a way that precludes continued development of the market. We will need to move further toward competitive markets with less reliance on centralized contracts and regulation.

But I am also pragmatic. I understand that we need to make incremental change, recognizing the impact that change will have on our participants and on the consumers of electricity and what impact that change will create in the political arena.

This sector has undergone major change in the past decade. That isn't going to change over the next decade either. Much of that expected change will be outlined in the OPA's Integrated Power System Plan (IPSP). Recent discussion papers give a sense of the scope of change.

We will continue to have an interest in the success of the IPSP. We don't want to have a power system in the future that can't be operated reliably. The old adage of "it doesn't matter what the planners give us, we operators will make it work" never was a viable business model.

There are competing priorities that we all face. A lot of us will be focused on the IPSP over the next 12 months or so as we need to be. That will impact the amount of time available to properly stakeholder initiatives that will further develop this market.

There is, from what I am hearing anyways, a consistent view among participants that there should be competitive drivers that define our market. We need to continue to see movement towards that but also recognize that we have a busy landscape that is facing us right now, with important discussions and initiatives on the immediate horizon.

With all of this activity, it will be hard to focus the attention of stakeholders and of ourselves on future market initiatives. We have to be realistic about this and proceed at a pace that we and others can actually accommodate given all that is going on.

## Institutional Inertia

But I am concerned that we don't fall prey to what I will call "institutional inertia." For example, the inertia that can be created from the continued reliance on the contracting approach that the OPA has taken may be difficult to move away from.

As Jan Carr has noted, we have to take advantage of the opportunity we have … to build within the hybrid structure a competitive marketplace.

There can also be inertia created by government's continued role in taking care of this sector. We are never going to have a government that is not worried about reliability or prices or the environment … nor do we want that. But we need to find a way for government to be satisfied that they do not need to be involved in every facet of this business.

I think they are moving in that direction. To that end I note Jake Brooks' piece in IPPSO Facto recently noting positively the decision of the government to place the coal replacement timing in the hands of the OPA. Government set the policy direction as they should … and have now turned it over to industry experts to execute.

What can we do to continue to move in that direction? As we go forward implementing market based solutions and initiatives, we need to ensure that we have effective guard rails in place to demonstrate to government and to the industry that things will not go off track. Certainly, as we have learned over the past five years, governments and consumers, for good reason, have a fear of extremes when it comes to price and reliability. We need to ensure that the market has self-correcting measures in place to prevent those extremes from occurring.

When I think of self-correcting measures, I am reminded of my kids' birthday party at a bowling alley. Bumper pads in the gutters directed the kids' balls back into the lane. Unfortunately this self correcting measure wasn't used for the parents.

The same holds true for the market. We need self-correcting measures to keep it from going off track. The three year review cycle of the IPSP is an example of a self correcting mechanism. The 20 year plan will get regular adjustments to reflect changing realities.

**<u>Not Just a Spot Market</u>**

You have heard me talk about my belief in competitive markets. Let me be clear about what I mean by competitive markets. We cannot rely on a real-time spot market to drive everything. It was never our intention. We need to move beyond the spot market that we have in place.

We need long term forward contracts and a first step in that direction has been the auctions of forward energy conducted earlier this year by the OPA and NGX.

The development of Load Serving Entities (LSE) is another important initiative. The OPA has initiated a pilot program to test the concept of load serving entities. This pilot can provide valuable learning for us, in particular by examining procurement, pricing, implementation and settlement issues around long-term LSE development.

We also need a day-ahead market (DAM). There are many aspects to the current state of the industry that present significant challenges to creating a full featured DAM in a single step. We don't believe there is a strong stakeholder appetite to tackle this at this time.

We will continue to test this belief in the coming months with stakeholders and our own Stakeholder Advisory Committee.

But right now, it looks to me that a more appropriate approach would be to proceed by taking a series of small steps that will provide demonstrable benefits over time without imposing significant costs or considerable time requirements on participants. We will still get that Day-Ahead Market … but with small steps, not one giant leap.

Finally, let me say a brief word about the environment.

Environmental objectives will have an increasing effect on the development of the Ontario market. Environmental objectives have been driving this industry for some time now, from acid gas emissions, to off-coal targets, to carbon free technologies.

In moving forward, we need to recognize that environmental considerations will continue to factor into … and perhaps drive even more.… energy decisions and directions. One of our challenges is to demonstrate that our markets can effectively facilitate the implementation of these objectives.

## Final Remarks

As I said earlier, all of us have a lot on our plates right now with more portions being added quickly.

The physical infrastructure that we are operating now will be very different in the future … we are facing the biggest infrastructure change in Ontario's history.

While the hybrid market structure we have in place is working today, we also recognize the need to continue to move towards a more competitive market … albeit at a pace that can be accommodated by generators, by customers, and by others in this sector.

We won't get there overnight and when we do get there, inevitably we will have more ground to cover. Our future will continue to change, driven by what we learn along the way, by innovation in technology and by external factors and pressures. But we will keep moving forward.

Thank you very much.