

ISSUE 17: APPLICATION OF SETTLEMENT ADJUSTMENTS

Date Raised

Raised in August 2004 by the numerous participants and logged as IMO Market Participant Issue #986 in September 2004.

Description

In the event that a settlement adjustment in regards to a final settlement statement(s) requires amounts to be recovered or distributed to any or all market participants, the Market Rules provide for the IMO to do so by means of a current period adjustment applied to a subsequent preliminary settlement statement.

The application of a current period adjustment results in the adjustments being made on the basis of the activity of market participants during the billing period when the adjustment was applied, rather than on the basis of their activity over the time period that may be the subject of the settlement adjustment. While this simplifies any adjustment, it may result in other market participants receiving credits or incurring payments out of proportion to their activity during the period of the event in question.

Background

Settlement adjustments may be required after a final settlement statement has been issued for a trading day due to a number of reasons, including a notice of disagreement analysis that is completed post final, a dispute, an adjustment required from a specific market rule, etc. When these adjustments are applied to a market participant the offsetting charges are applied to all market participants through a current period adjustment on a subsequent preliminary settlement statement. Current period adjustments are based on transactions for the billing period during which the current period adjustment is effected regardless of the billing period or trading day to which the adjustment relates occurred. This straightforward manner of allocating such recoveries or distributions provides a simplification in the settlement recalculation process that was incorporated into the Market Rules prior to market opening [ref MR-00147].

Questions regarding the application of this approach to dealing with the consequences of a settlement adjustment have been raised by a number of market participants as a consequence of a significant adjustment on their July 31 2004 preliminary settlement statement (issued on August 16, 2004).

The adjustment related to a revenue meter error. This error resulted in the data collected in the metering database being different from the data that was in the metering installation. In this situation, the energy readings were incorrectly high for a significant period of time (21 months) resulting in higher energy and uplift

ISSUE 17: APPLICATION OF SETTLEMENT ADJUSTMENTS

charges to that participant and lower charges to others. Under this specific circumstance, the final settlement statements had been issued for the specified period, however, the market rules require a settlement adjustment for that participant. The reimbursement payments to this market participant - totaling \$31 Million - were collected from the market via offsetting charges applied to the energy that participants have withdrawn in July, the month of the current period adjustment.

There is an ongoing investigation by the IMO Market Assessment and Compliance Division regarding alleged non-compliance with metering obligations in an attempt to reduce the likelihood of such occurrences. The IMO Settlements Division continues to review this issue.

Why a Pricing Issue

Situations can arise that result in the need to apply a settlement adjustment (recovery or distribution) that must be offset and that may significantly impact a large number of market participants. The impacts of these settlement adjustments (and adjustments in general) on participant behaviour and market efficiency may vary according to the method by which the adjustments are made. Different methods for recovering and distributing adjustments may entail different degrees of consistency or conflict with respect to the principles of simplicity, cost causality, fairness, and equity.

In the event that it is determined that the IMO Market Rules need to expressly prescribe the method by which settlement adjustments shall be made, the Market Rule amendment process may be initiated. Consequently, there may be an opportunity in the near-term to consider the pricing implications of various adjustment recovery options so as to better inform any future deliberations on the matter.

Impacts of Issue

Market Impact

The application of a current period adjustment results in offsetting adjustments being made on the basis of market participant activity during the billing period during which the Current Period Adjustment is applied, *rather than on the basis of participant activity during the event that triggered the adjustment*. As such, current period adjustment credits or charges may be allocated to market participants that may not have been active during the relevant period, or may be allocated in a proportion unrelated to their activity during that period. Thus, while in keeping with the principle of administrative simplicity, effecting settlement corrections via the current period adjustment mechanism may entail some extent of

ISSUE 17: APPLICATION OF SETTLEMENT ADJUSTMENTS

inconsistency – depending on specific circumstances - with the principle of cost causality.

Participant Impact
[To be developed]

IMO Processes and Procedures Impact
[To be developed]

Related Issues
[To be developed]

Options Considered
[To be developed]

Selected References

Market Rule Amendment Proposal. Subject: Simplified Settlement Re-Calculation Process. MR-00147-R00 (Submitted to IMO Board November 29, 2001).

IMO Market Rules, Chapter 6: Wholesale Metering.
http://www.theimo.com/imoweb/pubs/marketRules/mr_chapter6.pdf

IMO Market Rules, Chapter 9: Settlements and Billing.
http://www.theimo.com/imoweb/pubs/marketRules/mr_chapter9.pdf