

Day Ahead EFM

Sithe Global comments arising from the tsg meeting on 29th July

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Sithe Global fully supports steps to evolve a more rational and economically efficient electricity market in Ontario. With this goal, and as previously indicated, Sithe Global's preferred solution is the development of a day ahead market which would be integrated with day ahead commitment processes and which would be one leg of a comprehensive two-settlement system. We believe that this would represent a major maturation of the Ontario electricity market and yield the greatest overall economic benefit.

The IESO appears to believe that the inefficiencies of a uniform price approach based on an unconstrained day-ahead market schedule are a serious handicap of a UDAM. We are not however convinced that the inefficiencies associated with the unconstrained market schedule should be attributed to the development of a comprehensive day-ahead market within the pre-existing uniform price paradigm, but rather to that paradigm itself.

We understand that, in recognition of concerns raised by some stakeholders, the IESO is reviewing some of the assumptions behind its preliminary assessment of options, and we look forward to the outcome of such review. Pending such review we are asked to comment on the merits, and the relative merits, of EFM alternatives under option 2. Our comments address this particular request, and are not intended as endorsement of any EFM option. Until two fundamental market framework issues (load participation and regulated out-of-market price hedges) are addressed, we do not see any EFM as having significant natural liquidity. And without very significant natural robustness and liquidity, any EFM is incidental to needed market evolution. We have to view with scepticism any suggestions of incented (potentially amounting to coerced) participation in an EFM.

Referring to the IESO's 1st August tabulation of the EFM options, we note the need to address the following choices, and comment on each in turn:

IESO vs external exchange / broker

It has been suggested that an external exchange such as NGX would attract greater liquidity to the market. We are sceptical of the validity or value of the liquidity that this would bring. ISO administered markets have generally won the confidence of participants. In Ontario we understand that the financial market in transmission rights, presently administered by the IESO, attracts external participants including those without positions in the physical markets. This would likely carry over to any sound EFM. Moreover, the participation of purely financial participants will do nothing to address the lack of depth amongst those natural participants with net positions in

the physical market. External participation does not resolve any imbalance on participation amongst physical market participants.

We expect and understand that the IESO still contemplates the ultimate development of a day ahead market which would be integrated with day ahead commitment processes and which would be one leg of a comprehensive two-settlement system. As indicated above, we support this. Any external exchange invited to create an EFM platform meanwhile could have an investment in the interim status quo thus created, and this could be an obstacle to further development.

We suspect that the reconciliation of prudential obligations would be more complex if the EFM trades are made on one or more external exchanges, particularly with respect to those participants who are not IESO market participants. This might well result in an increase in the overall costs of prudential support.

Finally on this issue, we question whether any hourly electricity price index created by an external exchange has the necessary credibility for use in settlement of other transactions. We are not aware of any North American exchange that has created meaningful hourly electricity indices, even in mature traded markets. We would not give weight to any arguments that support external exchanges for the purpose of creating indices for use in default Ontario electricity pricing or settlement of other transactions.

Financial swap vs “physical” contract

We note that Ontario “Physical Bilateral Contracts” are in fact settlement instruments, and have no impact on scheduling or dispatch of electricity or reserves. They are thus “physical” in name only.

The benefits of such “physical” contracts, as advanced in discussions to date, seem to derive from the ability to price a portion of the uplift charges into the EFM price, and to relieve physical flows matched to EFM transactions from the corresponding uplift obligation in real time. This benefit of day ahead EFM participation would naturally be limited to physical load participants. It is unclear how such an EFM would reconcile between Ontario physical participants and others; it seems likely that there would in effect be parallel trading in two products; those linked to actual physical flows, and those not so linked. Given this unresolved complexity, we see no benefit at this stage in use of a “physical” contract.

Price settlement method and timing

We see no benefit to use of a continuous bid/offer matching process in the concurrent trading of 24 separate hourly products.

We would be concerned at the complexity and workload that this might involve, and the distraction of load and generator efforts from physical economics.

From a generator perspective, there is clearly a potential interaction between the IESO's day ahead commitment process and the market. Without the benefit of

discussion or analysis of the impacts, the EFM process and the commitment process seem to be incompatible as concurrent processes. Careful consideration needs to be given to the potential interactions.

Incentivisation

While not raised by the IESO, there has been some discussion of the use of uplift and contract settlement provisions to strongly encourage load and contracted generation respectively to use the EFM as a primary market. While Sithe Global endorses the need to address certain fundamental market framework issues, we do not support incented or potentially coerced participation in any EFM as a means to achieve this. We do not therefore endorse any suggestion that the IESO should base its selection of EFM platform or design on such concepts.

Summary

Sithe Global has no objection in principle to the development of an EFM. We see it as largely incidental to the market. We would see an EFM as counterproductive if it were seen as a substitute for the development of a day ahead market integrated with day ahead commitment processes and which would be one leg of a comprehensive two-settlement system.

In this context we do not see any merit in the use of one or more external exchanges as a platform for an EFM. The IESO financial swap / clearing price model as set out in existing rules seems adequate, subject to reconciliation of prudential requirements for those with positions in the physical market and the EFM. This would be an adequate platform for enabling (as opposed to driving) other market framework initiatives pending a comprehensive integrated day ahead market.