

# Memorandum

To: THE BOARD OF DIRECTORS  
of the Independent Electricity System Operator

From: Michael Lyle, Vice President, Legal Resources and Corporate Governance  
Chair, IESO Technical Panel

Date: August 20, 2019

Re: Recommendation from the Technical Panel on Market Rule Amendment Proposal

The IESO is seeking a decision from the IESO Board on the implementation of a Transitional Capacity Auction (MR-00439-R00-R05). The Technical Panel recommended this proposal to the IESO Board for consideration.

## Description and Rationale

Ontario is expected to emerge from surplus conditions in 2020 and capacity is required to meet more significant resource adequacy needs starting in 2023. This market rule amendment proposal represents the first phase of the Transitional Capacity Auction (TCA) design, which enables non-committed dispatchable generators to participate in the TCA alongside dispatchable loads and hourly demand response resources. The TCA represents an evolution of the demand response auction (DRA) into a more competitive capacity acquisition mechanism.

The TCA will be implemented in a phased approach, with subsequent phases enabling more resources to participate and new auction design features. Each phase is expected to require changes to the market rules.

## Stakeholder Engagement

The IESO has a formal stakeholder engagement initiative to capture and incorporate feedback from stakeholders on the design of the transition to a TCA. Stakeholders from all sectors of the marketplace participated in the initiative. Written submissions were received from generators, demand response aggregators, the Market Surveillance Panel, consumers and associations representing local distribution companies, generators and consumers. During the engagement, stakeholders provided feedback in the following areas.

1. Timelines: In response to stakeholder feedback, the IESO reduced the scope of TCA Phase I changes and adjusted the stakeholder schedule cycle to allow sufficient time for stakeholder input and stakeholder review of draft market rules and manual manuals.
2. Future opportunities: Some stakeholders noted that the expansion of the DRA would create an 'un-level playing field' for existing DRA participants. The IESO recognizes that there may be opportunities to remove certain barriers that demand response resources face in IESO markets and reiterated our commitment to discuss these issues with stakeholders.
3. Target Capacity Approach: Stakeholders raised questions regarding the target capacity amount to be procured and the need for the TCA to be implemented as early as the December 2019 auction. The IESO stated that the resource adequacy needs increase significantly during the TCA planning time frame and the IESO must create an appropriate business environment and confidence in the auction process to sustain and develop resources such that sufficient capacity is available when needed in the years when the capacity requirement increases significantly (2023-2026).
4. Enabling Eligible Resources: There were requests from stakeholders to include other resource types as part of Phase I. The IESO provided a proposed schedule of resource type inclusions for subsequent phases of the TCA.
5. Suggestions for material changes to the Phase I design: Suggestions included expanding capacity transfers between resource types, allowing contingent offers and recognizing economies of scale in auction offer submissions. Within Phase I, the IESO did incorporate stakeholder requests to add a clause to the market rules to transfer auction capacity to the same market participant and to reconsider the proposed changes to non-performance factors. Other suggestions will require a more thorough discussion and time to design. These other suggestions will be considered for subsequent auctions and discussed at appropriate upcoming stakeholder engagement meetings.
6. Alignment of stakeholder engagements: Stakeholders encouraged the IESO to seek efficiencies and alignment between several related stakeholder engagements.

As part of the Technical Panel process, the market rule amendment proposal was published on the IESO public website for stakeholder review and written comment for two weeks. Submissions were received from the Advanced Energy Management Alliance (AEMA), the Association of Major Power Consumers (AMPCO) and Enel X.

Enel X recommended that section 4.8 of Chapter 9<sup>1</sup>, which is already in effect as part of the DRA market rule set, be amended and then included in the TCA rule set. The basis of the recommendation was Enel X's expressed concern that the existing market rule language unfairly impacts auction participants who are subject to non-performance charges.

In response to this feedback, the IESO met with Enel X to discuss its concerns, and have since agreed that when read in the broader context of section 4 of Chapter 9, section 4.8 does not unfairly impact auction participants. The IESO explained how it has applied the provisions historically, and Enel X has communicated to the IESO that it is satisfied.

Comments from AEMA and AMPCO relate to the compensation treatment of demand response resources in the TCA. Both organizations provided feedback that energy payments provided to

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<sup>1</sup> This section of the market rules pertains to compensation for demand response market participants that is recovered from market participants.

generators without an equivalent revenue stream for demand response resources would "introduce undue and unjust discrimination against DR resources in the expanded auction program by requiring them to compete with generators prior to resolution of their eligibility for energy payments" (quoted from AMPCO's submission). AEMA and AMPCO contend that competition between DR resources and generators could be equalized by making energy payments to DR resources for in-market activations; energy payments would represent DR resource costs on activation. Subsequent to the stakeholder comment period, AEMA and AMPCO provided the IESO with a joint legal brief, further articulating their position, including concerns raised about the proposed implementation date of December 2019. That submission is included in the Board package.

The IESO has taken the position that the proposed Phase I market rules do not unjustly discriminate against DR resources. Phase I initiates a process that will allow more market participants to access a capacity auction, thereby increasing competition and providing the greatest value for ratepayers while meeting a growing reliability need.

The IESO recognizes that issues related to AEMA and AMPCO's position are contentious and complex and the IESO has not taken a formal position on the question as to whether making energy payments might result in a net benefit to ratepayers in a more mature capacity auction. In response to feedback received through the DRWG, the IESO has committed to conducting a broader stakeholder engagement on this question and will complete an in-depth assessment before deciding whether to recommend energy payments in the future.

The IESO has communicated the expectation that for the next few auction periods demand response resources are expected to be economically activated under very limited circumstances and therefore access to energy payments will not be consequential to their participation. The IESO has also communicated that it is important to begin taking steps to address forecasted capacity needs in a more cost-effective and transparent manner. The IESO has also engaged the DRWG in a proposal for cost recovery for out-of-market activations (such as test activations or emergency operating state control action activations). The IESO's intent is to implement this proposal concurrently with the TCA.

I recommend that the Board accept the majority vote and recommendation of the Technical Panel to approve market rule amendment MR-00439: Transitional Capacity Auction with an effective date of October 15, 2019. The details of the Technical Panel vote, and the rationale of each member given with their vote, is included with this package.

I look forward to discussing this item with you.



Michael Lyle

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Cc: IESO Records