

ONTARIO ENERGY BOARD

ASSOCIATION OF MAJOR POWER
CONSUMERS IN ONTARIO (AMPCO)

Application for Review of an Amendment
to the Independent Electricity System Operator Market Rules

AMPCO SUMMARY OF FINAL ARGUMENT

Unjust Economic Discrimination

1. AMPCO supports and welcomes greater competition in the IESO Administered Electricity Market (IAM) in general, and in future capacity auctions in particular. As representative of the largest electricity consumers in the province, AMPCO believes that robust competition is the best way to maximize market efficiency and minimize electricity prices. AMPCO supports expansion of the historical Demand Response Auction (DRA) to a capacity auction (CA) which incorporates a broader range of capacity resources, including off-contract electricity generators.
2. The impugned Market Rule amendments MR-00439-R00 to –R05 (Amendments) effect an expansion of the historical DRA, in which Demand Response (DR) resources competed against each other for capacity commitments and associated availability payments from the IAM, to a CA in which off-contract generators are invited to compete with DR resources for the provision of capacity going forward.
3. DR resources can provide energy market services which balance supply and demand, as can generation resources. Accordingly, DR resources can provide capacity resources, as can generation resources.
4. Generation resources incur costs to be available for energy market activation. So do DR resources. The Amendments provide for availability payments to generators participating

and clearing the CA, and for the same availability payments for DR resources clearing the CA.

5. Generators incur costs when activated in the energy market. So do DR resources. Generators receive payments for the provision of energy to the IAM, in the form of energy payments and supplemented by a “Generator Cost Guarantee” (GCG) framework which ensures generators recovery of costs of activation. DR resources do not receive any payments when activated in the IAM energy market.
6. DR resources must include forecast activation costs in their CA capacity offers, or risk non-recovery of costs when activated. Generators, on the other hand, need not factor forecast activation costs into their CA bids since they have an opportunity to recover activation costs in the energy market when activated.
7. Therein lies the discrimination resulting from the Amendments. In the circumstances where generators receive activation payments (energy payments inclusive of GCG payments as warranted) and DR resources do not, the effect of application of the Amendments is to create an IAM capacity market in which DR resources must compete with generators at a disadvantage.
8. The capacity and energy services provided by DR resources and generation resources are, in the context of capacity obligations and associated energy market activations, functionally equivalent, yet they are not equivalently compensated. In the result, the disadvantage faced by DR resources in the CA, as a result of the Amendments, is not economically justified.
9. In the ramp rate market rule review application the Board found that “discrimination” as the term is used in section 33 of the *EL Act* refers to “economic discrimination”. That is, “unjust” as used in section 33 means not economically justified.
10. Given the functional equivalence, from the market’s perspective, of the services provided, there is no economic justification for DR resources having to recover anticipated activation costs through their CA bids, or risk losses, when generators can recover costs associated with their activation in the energy market through payment streams not available to DR resources. The Amendments creating the CA are therefore, in their application, unjustly discriminatory against DR resources.

11. This unjust discrimination offends the IESO's own stated objectives of enhancing competition in the IAM in general, and in capacity auctions in particular. It is also contrary to the purposes of the Ontario *Electricity Act, 1998 (EL Act)* of;
 - (a) promoting economic efficiency in the generation and sale of electricity; and
 - (b) protecting the interests of consumers with respect to prices of electricity service.
12. Given the nature of DR resources, the competitively discriminatory impact of the Amendments also offends *EL Act* objectives of;
 - (a) encouraging electricity conservation and the efficient use of electricity in a manner consistent with the policies of the Government of Ontario;
 - (b) facilitating load management in a manner consistent with the policies of the Government of Ontario; and
 - (c) promoting the use of cleaner energy sources and technologies, including alternative energy sources and renewable energy sources, in a manner consistent with the policies of the Government of Ontario.

Infrequent DR Activation; Real Discriminatory Impact?

13. Parties opposing AMPCO's application have asserted that activation of DR resources has been infrequent, and so the "discrimination" to DR resources in the CA is *de minimus*.
14. In the ramp rate market rule review application the Board found that "discrimination" as the term is used in section 33 of the *EL Act* refers to "economic discrimination". This finding means that "unjust" in this statutory context means not economically justified. It is a qualitative, not a quantitative, test.
15. In any event the evidence indicates that;
 - (a) In the past, DR resources were incented to avoid activation, given real costs of activation without compensation or any "cost recovery guarantee".
 - (b) Nonetheless, DR resource activations have occurred historically in Ontario.
 - (c) In the U.S. markets examined by LEI where activation was also relatively infrequent, LEI concludes that "*there is still a **strong practical linkage** in these*

markets between participation on the capacity side and payments for activation or dispatch”¹ [emphasis in original].

16. There is further acknowledgement on the record that as DR related technologies change so might the frequency of investment in, and the consequent participation in the market by, DR resources.
17. Consequently;
 - (a) the past under one set of rules and conditions cannot be assumed to necessarily predict the future under another, more equitable set of rules and in light of expected advances in available DR technology and its application; and
 - (b) in any event the discriminatory competitive situation resulting from application of the Amendments is economically unjustified, and thus “undue”, regardless of which near and longer term future scenarios are assumed in attempting to quantify the potential impact of the Amendments.

Efficiency Arguments

18. In the context of a competitive wholesale electricity market, “economic efficiency” means securing required services at lowest cost. It does not mean securing a societally optimal allocation of economic surplus as between various markets considering all of their respective economic inputs and societal outputs. As Dr. Rivard testified² [emphasis added];

What the IESO is trying to do in its capacity auction is say, hey, we need someone to be available for reliability to either produce electricity or reduce demand, we want to make sure that whatever the cost of any participant is to be available to do that, we want to make sure we choose – from the standpoint of running the market fair and efficiently, that we choose the lowest cost one first.

19. Dr. Rivard provided analysis which sought to compare the economics of hypothetical DR resources with those of hypothetical generators. The purpose of these examples was to show that the Amendments are consistent with principles of horizontal and vertical equity, and to thereby show that by these principles the Amendments are not discriminatory. In respect of analysis under section 33 of the *EL Act*, and this Board’s mandate to oversee

¹ LEI Evidence, page 31, first full paragraph.

² Transcript, Volume 2, p. 79, line 25 through p.80, line 4.

the exercise by the IESO of its Market Rule making authority, these are not the applicable principles.

20. It is not within the mandate of this Board, on this section 33 application, to effect the distribution of surpluses as between DR resources and generators.
21. As FERC determined in response to the same arguments advanced in the Notice of Proposed Rulemaking (NOPR) process for Order 745³ (emphasis added):

In the absence of market power concerns, the Commission does not inquire into the costs or benefits of production for the individual resources participating as supply resources in the organized wholesale electricity markets and will not here, as requested by some commenters, single out demand response resources for adjustments to compensation. The Commission has long held that payment of LMP to supply resources clearing in the day-ahead and real-time energy markets encourages "more efficient supply and demand decisions in both the short run and long run," notwithstanding the particular costs of production of individual resources. Commenters have not justified why it would be appropriate for the commission to continue to apply this approach to generation resources yet depart from this approach for demand response resources.

22. It is also not within the mandate of this Board, on this section 33 application, to effect the distribution of surpluses as between electricity market services and the producers or consumers of the "widgets" (i.e. steel, pulp and paper, chemicals) produced by Ontario's DR resources, nor to optimize social welfare across the economy as a whole (even if that could be done effectively).
23. This Board is charged with regulating the efficiency and effectiveness of the Ontario electricity market, including in particular with reference to the interests of electricity consumers in cost effective and reliable electricity service.
24. The interests of Ontario's electricity consumers aren't factored into the allocative efficiency theories examined by Dr. Rivard's evidence. The examples which Dr. Rivard designs to illustrate what he views as optimal allocations of economic surpluses as between generators and DR resources also indicate that failure to compensate DR resources upon activation tends to produce higher capacity costs for customers.

³ FERC 745, p.49, para. 62.

Relief Sought

25. AMPCO seeks an order pursuant to subsection 33(9) of the *EL Act* revoking the Amendments and referring them back to the IESO for further consideration.
26. AMPCO has advocated for energy payments for DR resources, which would, if such payments provided a reasonable opportunity for DR resources to recover their costs of activation, rectify the unjustly discriminatory economic disadvantage faced by DR resources in competing against generation resources in the CA. Energy payments are not the only way of rectifying this discrimination.
27. There are several examples of historical programs in which DR resources were provided with administratively set (rather than market determined) activation payments.
28. The IESO is in the process of instituting out of market (i.e. test and emergency) activation payments for DR resources. In so doing, the IESO has recognized that incremental costs (as distinct from opportunity costs) incurred by DR resources upon activation are potentially “*significant*”, that there is the potential for these costs to otherwise be reflected in DR resource capacity offers and increase the cost of capacity, and “[i]n the context of the proposed capacity auctions, where [Hourly Demand Response] will be competing against other resource types, how these costs are recovered will potentially impact market efficiency”⁴.
29. AMPCO is not in this application seeking an order of the OEB directing energy payments, or any other payments, for DR resources.
30. AMPCO does, however, urge the Board, in referring the Amendments back to the IESO for further consideration, to provide guidance to the effect that in order to remove the element of unjust discrimination inherent in the CA as formulated by the Amendments, prior to proceeding with the CA the IESO should provide a mechanism through which DR resources will have a reasonable opportunity to recover their incremental costs of activation.

⁴ AMPCO Compendium for IESO Panel (Ex. K3.2), PDF page 75 (Tab 9, page numbered 38-40).

The Path Forward

31. AMPCO is confident that the issues raised in this application can be addressed by the IESO in a manner and in a timeframe which will allow for a CA to proceed on a basis that is non-discriminatory, addresses reliability requirements in 2021, 2022, 2023 and beyond, and allows for participation of KCLP and all other would be CA participants.
32. The IESO has, as of late August, 2019, launched an engagement process to address the issue of energy payments for economic activation of DR resources. The study scope and study plan for this initiative is under discussion and a final IESO decision and rationale therefore is to be made by June 2020.⁵ The IESO could, and should, focus this work on alternatives for compensating DR resources for their reasonable costs of activation, and thereby address the discriminatory impact of the Amendments and clear the path for reactivation of the CA.
33. The current CA auction schedule contemplates 3 rounds of the CA between June 2020 and the forecast date of capacity need commencing May 2023, which is 3.5 years from now. The forward periods contemplated for these auctions range from 11 to 18 months, and in each case the auction commitment period subsumes 2 separately identified seasonal commitment periods. To the extent that the IESO is concerned that 3 more auctions between now and summer 2023 may not be enough, there is flexibility within this schedule to hold additional auctions, perhaps with shorter forward periods and/or separate seasonal commitment periods (as Mr. Windsor for KCLP testified is the case in the NYISO market⁶).
34. Further, the summer, 2023 “need” currently forecast by the IESO appears to relate to a decrease (to a figure still in excess of 18%) in the Ontario electricity system capacity reserve margin⁷, and not to any critical capacity or energy shortage.
35. All of which is to say, the IESO has time to properly address the issue raised in this application, implement a solution (final or interim), and reformulate the incremental evolution of the CA to meet forecast future capacity requirements in 2021, 2022, 2023 and beyond. The sky is not falling. The pleas of DR resources for non-discrimination and the

⁵ IESO Evidence, Tab 24, page 8.

⁶ Transcript Volume 2, page 35, lines 1-3.

⁷ IESO Evidence, Exhibit 17, pages 15 and 56.

desires of KCLP and others for participation in a properly and fairly formulated forward capacity market can all be satisfied in a timely fashion.

FERC Order 745

36. AMPCO does not rely on FERC Order 745 as the legal authority for this Board to find that the Amendments are unjustly discriminatory and, in the circumstances, inconsistent with several of the purposes of the Ontario *EL Act*.

37. What FERC Order 745 indicates is;

- (a) A pre-eminent North American economic energy market regulator instituted an extensive, open, robust process to consider arguments regarding whether it is unjust and unreasonable for DR resources not to be compensated for energy services provided to the wholesale electricity market in the same manner as generation resources.
- (b) FERC considered all of the arguments echoed by Dr. Rivard regarding economic justification, or the lack thereof, for energy payments for DR resources, and what test of efficiency (allocative or functional) is appropriately applied by an economic energy regulator in considering the fair and efficient functioning of wholesale power markets.
- (c) FERC determined that, subject to a “net benefits test” designed to ensure that electricity customers are not worse off as a result;

...when a demand response resource has the capability to balance supply and demand as an alternative to a generation resource... payment by an RTO or ISO of compensation other than the LMP is unjust and unreasonable. ... As stated in the NOPR, we believe that paying demand response resources the LMP will compensate those resources in a manner that reflects the marginal value of the resource to each RTO and ISO.⁸

38. In the context of the application now before this Board, the 100 page decision by 4 of the 5 FERC Commissioners who considered the extensive record underpinning Order 745 demonstrates:

- (a) The appropriateness and wisdom of looking at economic fairness, and economic discrimination, from the perspective of the market.
- (b) The functional equivalence of DR resources and generation resources in providing services to the market.

⁸ FERC 745, p.39, in para. 47.

(c) The equity of placing the two types of resources on a level economic playing field when they provide functionally equivalent services.

39. Much has been made by those opposing this application of the fact that one of the drivers for FERC's NOPR 745 inquiry was to overcome barriers to DR, including barriers presented by large electricity consumers being subject to smoothed retail pricing rather than pricing reflecting real time energy costs such as is the case, at least to a greater extent, in Ontario. The drivers for FERC's inquiry do not in any way undermine the veracity and clarity of its key and comprehensively informed findings, or the applicability of those findings to the issues before the Board in AMPCO's application, as set out above. The drivers are irrelevant to the logic and veracity of the outcome. In this instance, it is the outcome that matters.

40. There has also been reference in this proceeding to the dissenting opinion by 1 of the 5 FERC commissioners – Philip D. Moeller – on Order 745. Commissioner Moeller's dissent was not on the basis that DR resources need not be afforded economically equivalent treatment to generation resources in wholesale energy markets. In fact, quite the opposite. While Commissioner Moeller disagreed with his 4 colleagues on the manner of compensating DR resources for energy services provided, he agreed that such compensation is appropriate:

While the merits of various methods for compensating demand response were discussed at length in the course of this rulemaking, nowhere did I review any comment or hear any testimony that questioned the benefit of having demand response resources participate in the organized wholesale energy markets. On this point, there is no debate. The fact is that demand response plays a very important role in these markets by providing significant economic, reliability, and other market-related benefits.⁹

At the outset, the concept of "comparability" is at the core of this rulemaking, i.e., whether demand response resources are capable of providing a service comparable to generation resources and if so, whether these resources should receive comparable compensation for comparable service. On this point, I believe they should.¹⁰

41. Where Commissioner Moeller differed from the majority is whether DR resources should be paid LMP, or LMP minus the smoothed retail price which they avoid when activated (LMP-G). In the circumstances of AMPCO's application, in which this Board will not

⁹ FERC 745, Dissent, page 1.

¹⁰ FERC 745, Dissent, page 3.

determine what DR resources should be paid upon activation, the debate between Commissioner Moeller and his 4 colleagues is irrelevant. What is relevant is the principle, emphasized by all 5 FERC commissioners, that DR resources and generation resources provide functionally equivalent services to the market and a lack of comparable compensation for these services would be unjust and unreasonable. (The disagreement was on what comparable compensation would be. The majority took the perspective of the market in determining this question, and in our respectful submission they were right in doing so.)

42. The IESO's 2017 Navigant Study confirms that, in addition to the FERC jurisdictional markets, the wholesale electricity markets in France, Finland, Australia and South Korea all compensate DR resources for energy market services functionally equivalent to those provided by generation resources. Non-discriminatory compensation based on functional equivalence is not a new or novel approach in designing competitive energy markets.

Conclusion

43. The Amendments create a CA that, as applied, is unjustly discriminatory to DR resources, is inconsistent with several purposes of the *EL Act*, and therefore must be revoked and referred back to the IESO for further consideration. In referring the Amendments back to the IESO for further consideration, guidance from the Board regarding the appropriateness of compensation to DR resources upon activation would allow the IESO to address the unjustly discriminatory impacts of the Amendments and reformulate the process for evolution of a CA in a manner that is both timely and fair to all would be participants.

ALL OF WHICH IS RESPECTFULLY SUBMITTED by:



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