

SSM January 30 Presentation Feedback

Distribution of Residuals to Loads under Zonal Pricing

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The 30 January slides explore the options regarding the distribution methodology for load pricing residuals. The stated motive for this distribution is to mitigate the impact on loads that face a higher zonal price and to preserve the marginal incentives of the zonal price signal. (Slides 38, 39) Slide 45 states that the distribution ‘should not materially impact marginal consumption incentives.’ Yet slides 45 and 46 show that the disbursement would result in a zonal price after rebate that is virtually identical to the uniform price for zones that represent a substantial majority of load. I realize that hourly prices may be more varied than these monthly averages but these data suggest that the distribution will tend to push prices back toward the uniform price. Preserving marginal incentives will be a challenge.

The only option that appears certain to preserve marginal incentives in most zones is option A, assuming that ‘static allocation’ means that the allocation is based on some fixed historical share and does not vary over time with consumption. While a fixed historical share does not adapt to changing consumption by the loads, it is precisely this non-response that preserves marginal incentives.

Options B distributes the residual in relation to consumption for the month, so in a high-priced zone the cost of consumption will be reduced by the amount of the residual, while in a low-price zone the cost of consumption will be increased. This will not eliminate the incentive, but it will reduce it. The amount of the residual distribution may not be known until the end of the month, but I would expect loads to develop some expertise at predicting residual amounts and then to respond to the net price after residual distribution.

Option C distributes the residual in relation to expenditure for the month. This raises the same problem as in Option B but because it responds to expenditures it will reduce the incentive more than option B.

The main purpose of zonal pricing is to create efficient incentives. Option A does this better than the other two options. If we adopt distribution of residuals to loads the efficiency goal suggests that it should be as a transitional measure, for a few years, when we should have enough experience to be confident about the impact of zonal pricing on loads.

Respectfully submitted,

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