



Key Note Address by

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Good morning.

Thank you for inviting me to address what I believe to be one of the most effective forums in Ontario for discussion of the success, issues, and needs, of an open, competitive electricity market.

I have always found the participants to be knowledgeable and insightful in their comments and indeed their criticisms. I note that four of my staff: Harry Chandler, Peter Sergejewich, Amir Shalaby and Derek Cowbourne are presenting and each will be addressing the ongoing developments of effective competition in one form or another. I will therefore try not to steal too much of their thunder and while I can never make an absolute promise, try not to leave them with responding to too many detailed questions or explanations, which, by the way, I will be hastily referring to them.

CHECK AGAINST DELIVERY

Let me open by making it quite clear that I believe we have the basic market design and the robust market hardware, software and procedures upon which we can and will continue to build to meet the needs of all market sectors. There is nothing that tests the structure and robustness of a competitive market as much as a tight supply/demand situation. While recognizing the issues and concerns that we faced in the first six months of operation, I have to tell you that personally I judge this to have been a period which has given me great confidence in the long term viability of the market.

Yes, we have identified some elements that require short-term attention. Yes, we have received signals that demonstrate the need for changes to ensure long term durability. But I believe that getting this learning early, while maintaining reliability and with prices that, on the whole were reflective of the value of the product in a tight marketplace, is a tremendous advantage over what has happened in other jurisdictions.

This is where the difference between Ontario and California is clearly demonstrated. Many people forget that the California market opened smoothly and did not face the tight demand/supply situation that we experienced for almost two years. Thus, the weaknesses in the design were hidden and we all know the disastrous consequences when resource inadequacy hit. Our market did not exhibit that vulnerability and as I have indicated, we have received valuable learning as to what is needed, both to fix any weaknesses and to move forward.

In both rules and structure, we have learned that virtually every issue that has arisen, be it Import Offer Guarantee payments or cash flow pressures on participants, have come to the fore because of a tight supply situation. While not getting too specific, I think we can all see that a number of factors, none of them in isolation, producing the stressed conditions we found ourselves in, did coincide and combine to produce the ultimate test of our market.

For example, in the months approaching market opening, it became apparent that there would be less generation available in Ontario than we had expected, however we had

comfort that if necessary this could be accommodated by imports since our neighbours were in a relatively comfortable situation at the time. Then, we had a dry summer which severely limited the energy available from hydroelectric production. We had just about the hottest summer on record, which led to unprecedented demand for electricity as buildings and homes were essentially treated as huge refrigerators by the almost continuous operation of power hungry air conditioners.

The high temperatures also heated up the lakes which further impacted on generation capability. These conditions also continued into September when owners expect to take outages to ensure that plants that had been operating throughout the summer can be prepared for the demands of winter – and the lights stayed on.

The market attracted sufficient supplies from inside and outside the province, allowing us to balance and optimize the use of transmission interconnections. Average prices, while they increased as one would expect under these conditions, did not get out of control and we discovered a few things that needed work. A peer review carried out by the Northeast Power Coordinating Council and signed by an NPCC Director and the Senior Operating Vice Presidents of the New York Independent System Operator and the New England System Operator noted that the IMO exceeded expectations in its management of reliability in these stressed circumstances.

So, where do we go from here? In fact, there are several initiatives underway, in several forums, to address short term and long term requirements.

I have received numerous and strong messages from all stakeholder segments that the IMO should be taking a leadership role as we move ahead and I recognize the challenges and expectations that come with such a request. Clearly, the IMO alone cannot make all of the changes needed. However, in that context, we shall not be shy when providing advice to others when we believe there is an opportunity or indeed an obligation for them to act.

Equally, the IMO cannot succeed without the support of participants. It is essential that participants position themselves as being part of the solution and not part of the problem. We in the IMO are committed to listening to participants, all participants, and to include them in efforts to enhance the marketplace. There will be trade-offs, everyone will not get everything they want, but of one thing I am certain – we will make more and quicker progress if we are all inside the tent, working together. Throwing stones is easy but never constructive.

As you are aware, there are stakeholder representatives on the IMO Board charged with promoting a successful IMO and marketplace by bringing an appreciation of stakeholder views and positions. There is a Technical Panel charged with the ongoing development of market rules that is composed of stakeholder representatives.

Yet, it became apparent that IMO staff needed an even broader interface to listen to, share experiences and to involve all parties having an interest in market success. Furthermore, some participants were feeling somewhat isolated from the selection of priorities and resolution of issues.

I have high expectations that the formation of the Market Advisory Council and related Standing Committees will lead to a common understanding of issues and priorities and will help us all to recognize our mutual dependencies, aligning us in moving forward. I anticipate that Derek Cowbourne will give more perspective on our expectations and alignment via the MAC when he speaks tomorrow.

Through these venues, we are moving aggressively to address issues such as IOG, price signals, out of market actions and so on. I dare say Peter Sergejewich will be touching on some of this work.

In our business planning and in our revenue submission for 2003, we have involved stakeholders, setting out how we intend to resource and reinforce our operation of the market and power system and how we intend to proceed with high priority items such as

DAM. Feedback from this group and the MAC has been recognized in our plans relating to resourcing and expenditures over the business plan period. We have found this works well. Our Board also has been listening to suggestions regarding the transparency of market operations and has commenced discussion of the content of the confidentiality catalogue, which, by the way was initially developed via a process that involved both stakeholder groups and the Technical Panel. Clearly, this is an area where the Board recognizes that there are significant considerations in balancing transparency and commercially sensitive information.

I would like to acknowledge that input recently received from IPPSO is very helpful in seeking some resolution to this contentious issue and while I obviously do not know where the line will be drawn, I do expect to see changes as a result of this examination. I would like to use the example of IPPSO's helpful input to reinforce that for all participants, progress and having needs and expectations met depends to a great extent on the provision of value-added suggestions.

We can, and will, address the issues that have arisen and we will make progress in ensuring that appropriate signals and results take place. However, as I see it, there are two absolute requirements that emerge to provide a robust, long-term assurance of a reliable supply at a fair price.

One is an adequate supply, i.e. – sufficient generation combined with price responsive demand. The second is a broadening of the marketplace through a combination of eliminating seams between markets and the adoption of some common market features.

Let me address the broader market first. There will always be occasions when, due to weather, general equipment problems or other limitations, conditions can exist whereby the availability of generation, or the ability to transmit it within the province will result in a deficiency of available, deliverable supply with attendant reliability and price pressures.

Furthermore, differing investment environments, policies, incentives, tax treatment, and economic growth can produce mid and longer term discrepancies between neighboring jurisdictions in terms of adequacy of supply. Strengthening the transmission interconnections is clearly one enduring way of providing the highway for mutual support and the opportunity to reduce overall costs in the region by the effective and efficient use of supply.

I was disappointed, although not surprised, to note that the proposed Lake Erie Cable Project has been put on hold due to lack of investment interest at this time. The IMO is very supportive of merchant transmission initiatives and will work with proponents to examine what incentives are required to make such projects viable and attractive. However, the advantages of being interconnected cannot be fully recognized if the rules, the design, the procedures and the processes in jurisdictions are mismatched. This is true in real time, day ahead and longer-term market operations.

In this respect, we are actively pursuing initiatives to take advantage of Ontario's key location in North America's electricity grid. In June of this year, I signed an agreement along with my peers in New England and New York to establish the Northeast Independent Market Operators Coordinating Committee with a plan to work together in developing system operation, system planning and market development over the region.

We'll be looking at such opportunities as sharing operating reserves, expanding regional planning processes, tackling congestion management, joint adequacy concerns, the potential for identical and possibly linked day ahead markets and so on. We have initiated work with MISO to develop a similar set of initiatives.

Just last week, I attended a meeting of CEO's from each of the approved ISO's/RTO's in North America. We each signed a charter document some time ago to focus on joint initiatives to further the development of competitive markets across our regions. Last week, we agreed to revisit and reinforce that charter and intend to look for sharing of

expertise, costs savings and pursuing items of common interest to enhance the development of a vibrant market. As a group, we have been preparing comments on the FERC SMD proposal. There are a significant number of areas where we have consensus in the group and it is my intention to sign a joint submission which will be consistent with the general direction that we see as being beneficial to the development of the Ontario Market and help focus on a consistent, regionally effective and efficient marketplace.

In order to both assist in the ongoing evolution of reliability and markets in North America, and to ensure the recognition and influence that needs to be afforded to the IMO and similar institutions, we the ISO/RTO's as a group, are also negotiating MOU's with NERC who determine the broad reliability standards across North America and NAESB, a nascent organization established from GISB whose role is to determine business, or marketplace standards.

I am supporting these initiatives, in the context that Ontario cannot afford to be an island in terms of electrical supply and demand, or the rules to be applied across the continent. And, to advance effective competition inside the province, we must have influence at an international level.

Now – back to adequacy. I have already noted that there are several dimensions to ensuring ongoing adequacy and that while the IMO can play a significant role in incenting new supply, it does not control the legislative, tax, environmental policy plans and other factors that make up the set. Nevertheless, we must do what we can do. And this summer's operations have shown that a combination of adverse situations can put us in a stressed, vulnerable mode based on current reserve levels.

As I reflect back to this past summer, it seems to me that even an additional 1000MW of supply, preferably base load but peaking capability would be welcome, could have made a tremendous difference in market results. Reliance on imports would not have been eliminated but it would have been reduced to the extent that there would have

been more competition that imports would have faced, particularly on those few occasions when high import prices resulted in high IOG and Uplift charges.

A long-term robust solution to the adequacy question is still being sought, not only in Ontario, but also around the world and we must stay in tune and contribute to that debate. We are plugged in through our work with other ISO/RTO's, APEX and CIGRE. My own perspective is that a robust solution to the adequacy question will require obligations on a segment of participants who serve customers. It will require contracting to both provide cash flow assurance to generators and hedges to those with obligations. It will require clear direction on plans to manage environmental concerns such as emissions and require building of confidence in the signals and consistency of the market.

The long-term solution does not appear likely to converge overnight and I believe it is prudent to introduce a tool to bootstrap us toward the enduring market solution. In this context, the IMO can work with participants to recognize the value in providing more immediate, new capacity onto the system.

My own thoughts are that such incentives should be specifically targeted at capacity that would not otherwise be available, hence limiting any cost impact across the customer base. Furthermore, as I have already indicated, additional capacity can in fact help to drive out costs that were experienced this summer at times when available import opportunities were maxxed out and high IOG and Uplift payments resulted.

Thus, I expect such an initiative to be cost effective. Of course, in order to qualify for such an incentive, the new generation has to come on-line. I confess that I have not worked through the specifics of this option but then again, that is why I have competent staff and, I trust, participants who can help put more shape to the proposal to make it an attractive and successful tool. A similar incentive must also be pursued to increase the number of load customers who offer demand reduction into the marketplace.

I am certain that as we move ahead, there will be more discoveries, more ideas and more initiatives to continue to shape competitive supply, to drive out costs, to facilitate transactions and to give comfort regarding future adequacy and fair prices.

One example that I am currently trying to get my head around relates to “how do we incent transmission operations” such that decisions are made in the overall best interest of participants while producing a benefit to the owner of the transmission assets. The IMO, quite rightly, is not empowered to take actions for the sake of driving price. We do have an accountability to take actions, including the approval of transmission and generation outages, to ensure that reliability is maintained. While this can often have a secondary impact on prices, the action is taken solely from a reliability perspective.

Now if the IMO were charged with managing price in the market, and I am not proposing that we be given this accountability, we would be in a position to develop the processes to examine and co-optimize generation and transmission outages from an economic perspective as well as reliability. I believe there has to be a way to translate the process we would use into one that allows the generators, loads and transmitters to work together whereby, subject to the IMO reliability test, there would be both cost reductions in the market and economic rewards to the transmitter. We are not there today.

In closing, I have asserted that Ontario has the basis for a strong, vibrant, robust, competitive electricity marketplace. I have recognized that there are short and long-term items that have to be addressed. I have given my assurance that the IMO will accept the challenge to play a leadership role in moving forward. But most of all, I have asserted that we all need to work together in order to provide the environment and results that all participants and stakeholders desire. We are with you but we are also in your hands.

Thank you.