

Capacity Auction | March 2021 Auction Design

Stakeholder Feedback Form

Date Submitted: March 31, 2020

Feedback Due: March 26, 2020

Feedback provided by:

Company Name: TransAlta Corporation

Contact Name: Chris Codd

Email: [REDACTED]

The IESO released a [draft design document](#) for the March 2021 Capacity Auction on March 5, 2020 that is available on the engagement webpage (under March 12).

Stakeholder feedback on the document is being requested by **March 26** to engagement@ieso.ca.

This feedback form is intended to help organize stakeholder feedback in two key areas:

1. **General feedback on the March 2021 Capacity Auction design:** *Is the overall design implementable? Does the March 2021 Capacity Auction design provide the appropriate level of certainty, increase competition, and enable participation from the eligible resources for the March 2021 auction and 2022 commitment period?*
2. **Detailed comments on specific elements of the design:** *Are there any specific design elements that would prevent a successful auction from taking place or a particular resource from meeting a capacity obligation?*

General feedback on the March 2021 Capacity Auction design

TransAlta supports the new number naming scheme for the capacity auctions (CA#1, CA#2, etc.). This establishes a clear name that does not change with scheduled auction dates or other changes and makes it easier to discuss auctions within the industry.

The design document for CA#2 makes an important step to open capacity imports from neighbouring jurisdictions, where there is significant excess capacity that could serve Ontario’s needs as a capacity shortfall emerges in the next few years. TransAlta supports the IESO’s decision to allow generator-backed capacity imports from these jurisdictions to participate in CA#2.

TransAlta is concerned, however, that there is not enough information about the IESO’s plans beyond CA#2 and that many of the decisions for CA#2 will need to be reviewed and changed in the future. The IESO has indicated that it intends to run CA#3 in late 2021 but the structure and design of that auction has not been disclosed. A lack of information about future auctions makes it difficult for all capacity resources, including generator-backed capacity imports, to make decisions about committing time and effort to participate in CA#2.

In addition, there are over 3,000 MW of generation in Ontario that have contracts expiring before the end of 2025. The owners of these facilities will need to make decisions about capital maintenance plans that will be based on a facility’s expected future operations and revenues. Currently, it is not clear whether it will be profitable to continue operating these facilities. There is a risk that the current ambiguity will lead to these resources reducing sustaining investment and ultimately retiring.

TransAlta supports starting the Resource Adequacy engagement as soon as possible to provide clarity on future mechanisms used to address the missing money problem in Ontario’s electricity markets. In addition, the IESO should provide a clear vision for the capacity auction – both with and without complementary mechanisms – to allow participants to understand how the capacity auction is expected to function in the future.

Chapter/Design Element	Detailed Comments on Design Phase (Areas of Support or Concern)
<p>Auction Overview and Timelines</p> <ul style="list-style-type: none"> • Pre-Auction Period • Auction Period • Forward Period • Commitment and Obligation Periods 	

Chapter/Design Element	Detailed Comments on Design Phase (Areas of Support or Concern)
<p>Expanding Participation</p> <ul style="list-style-type: none"> • Generator Backed Capacity Import • Capacity Self-Scheduling Resources 	<p>TransAlta supports allowing generator-backed capacity imports to participate in CA#2. TransAlta is seeking clarification of some elements of the draft design document.</p> <p><u>Deliverability to Ontario Border</u></p> <p>Section 3.1 states that a generator-backed capacity import must “be able to transmit energy from the generation facility to the Ontario border”. How will a CAP demonstrate that it is able to transmit energy from the generation facility to the Ontario border? Further information is needed about this requirement.</p> <p>For example, the IESO could require that a generator-backed capacity import purchase long-term transmission service as done in some other jurisdictions. It would be helpful to understand this requirement to assess the economics of potential generator-backed capacity imports.</p> <p>Another potential requirement is a system study demonstrating deliverability of a resource to the Ontario border. This would require time and resources to conduct and complete the studies as part of the pre-auction activities.</p> <p><u>Written Approval from Sourcing Jurisdiction</u></p> <p>Section 3.1.2 states that a generator-backed capacity import could require written approval from the sourcing jurisdiction and that the written approval must contain certain information. Some neighbouring jurisdictions do not have approval processes for export capacity and may instead simply provide acknowledgment of a decision to export capacity from a specific resource. It may not be possible to obtain written approval in the form described by the IESO.</p> <p>TransAlta suggests that the requirements for written approval for generator-backed capacity imports be aligned with the market rules and practices of neighbouring jurisdictions.</p>

Chapter/Design Element	Detailed Comments on Design Phase (Areas of Support or Concern)
	<p><u>Interfaces Eligible in Pre-Auction Report</u></p> <p>Capacity auction participants seeking to offer generator-backed capacity imports from neighbouring jurisdictions will need to undertake activities prior to the pre-auction report being published. TransAlta suggests that the IESO should provide an update on the likelihood each interface could be used for capacity imports approximately 9 months prior to the auction.</p> <p><u>Dispatch Data</u></p> <p>In section 3.1.6, the design document states, “depending on the generator type, the IESO will complete an hourly assessment of availability, and consider the <u>minimum offer into the energy market</u> in day-ahead through to pre-dispatch” (emphasis added). Could the IESO confirm that this is the import offer into Ontario’s day-ahead and real-time processes/markets and not the backing generator’s offer into the neighbouring jurisdiction’s DA and RT markets?</p>
<p>Consolidation of Resources</p> <ul style="list-style-type: none"> • Offer Submission and Auction Clearing • Forward Period Obligations • Dispatch Data Submission • Resource Dispatch • Testing 	
<p>Capacity Qualification Process</p>	<p>TransAlta agrees with the data requirements for generator-backed capacity imports. However, it may not be possible to have the data validated or verified by neighbouring balancing authorities. Further discussion may be needed on how to validate or verify the data for generator-backed capacity imports.</p>

Chapter/Design Element	Detailed Comments on Design Phase (Areas of Support or Concern)
<p>Market Power Mitigation Process</p> <ul style="list-style-type: none"> • Exemptions • Determination of Market Power • Market Power Mitigation Mechanisms 	<p>Exemption for Generator-Backed Capacity Imports</p> <p>TransAlta supports not including generator-backed capacity imports within the market power mitigation scheme because of the complexity with calculating risk costs and opportunity costs. However, we recognize that there will likely need to be some market power mitigation mechanism for capacity imports in the future.</p> <p>General Comments on MPM</p> <p>Market participants in the U.S. have recognized the importance of creating lasting market designs when markets are first developed because this avoids the uncertainty created by ongoing regulatory review creating by gaps in market policy. PJM’s ongoing buyer-side market power mitigation issues relating to the Minimum Offer Price Rule is just one such example.</p> <p>Future participation in the capacity auction would be best supported by developing lasting seller-side and buyer-side market power mitigation policies that will provide capacity auction participants with certainty about how they will be treated in CA#2 and beyond.</p> <p>The proposed seller-side market power mitigation (the 1-firm Pivotal Supplier Test) is an acceptable compromise for CA#2. However, it will likely need to change in future capacity auctions regardless of whether the auction is expanded to include new capacity (greenfield or uprates), limited to existing resources, or limited to resources that prefer short-term commitments.</p> <p>Buyer-side market power mitigation will be needed to reduce the substantial risk faced by suppliers in Ontario’s small capacity auction. Failing to address this risk will likely increase prices in the capacity auction or lead to retirements.</p>

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	<p>Default Offer Cap for MPM</p> <p>Further detail is needed about the proposed default offer cap calculation and how an “estimated competitive auction outcome” will be determined. It would be helpful to explain how the value of \$350/MW-day from the January 2020 session was derived. It appears to be based on 60% of the reference price, which may not be an appropriate approach in future auctions.</p> <p>Brattle Report on ACR</p> <p>TransAlta thanks the IESO for providing Brattle report on ACR. Materials such as this document are important to further discussions to inform the IESO’s decision on market policy.</p> <p><u>Amortization of Capital Expenditures</u></p> <p>Brattle has proposed a mechanism based primarily on the PJM ACR that amortizes capital over several auctions. There are several issues with implementing this proposal in Ontario.</p> <p>First, the amortization schedule includes an implicit assumption that future capacity auctions will be held but only two capacity auctions are currently scheduled in Ontario. Without clarity regarding future capacity auctions, this amortization does not address the missing money problem with respect to recovering the return on and of capital expenditures. Market participants should be permitted to include 100% of capital expenditures needed to provide capacity in the CA#2 obligation period in their offers for the CA#2 auction.</p> <p>Second, the Ontario market is not like PJM. Ontario is not proposing to adopt a Minimum Offer Price Rule that exists in PJM or other similar buyer-side market power mitigation mechanisms. In addition, the Ontario capacity auction will only cover a small part of Ontario’s supply compared to PJM where the RPM includes most supply resources. There is a significantly higher risk of not clearing a future capacity auction in</p>

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	<p>Ontario than in PJM, and this means that a resource is at higher risk of not being able to collect future revenues, including amortized capital expenditures. Currently, resources in Ontario’s capacity auction are analogous to PJM’s “at-risk” resources that are permitted to amortize capital expenditures over one year under the “40 Plus Alternative”.</p> <p>Third, this amortization schedule is being set based on “the existing resources in Ontario that are expected to participate in the March 2021 Capacity Auction” (p. 18) and therefore will need to be updated for each subsequent auction if additional resources participate. It would be preferable to create a lasting solution to seller-side market power instead of updating these rules for each subsequent auction.</p> <p>Fourth, Brattle recommends that “only capital expenditures that are incurred after the resource comes off of supply contract should be eligible for inclusion in the Resource-Specific Offer Caps” (p. 19). TransAlta agrees that there shouldn’t be any double payment towards capital expenditures under both a contract and the capacity auction. However, some supply agreements will not cover all capital expenditures, particularly towards the end of a contract. Brattle’s recommendation will likely lead to under-recovery of capital expenditures towards the end of contracts that will disincentivize investment as resources enter the capacity auction. A better option needs to be developed to understand how capital expenditures should be recovered at the end of a contract’s term.</p> <p>Fifth, the amortization is based on an ATWAAC of 8.5% calculated for Alberta, which is likely too low for merchant investment in Ontario. Brattle notes that Ontario’s market is larger than Alberta’s, but this ignores that the capacity auction contemplated for Ontario will be smaller than Alberta’s abandoned capacity auction until the late 2020s or the early 2030s. Brattle’s claim that the Ontario market’s larger size offsets the significant uncertainty about the Ontario market design is not an accurate claim.</p> <p>TransAlta recommends holding a separate engagement on offer caps, ATWAAC, CONE and ACRs to address these issues.</p>

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	<p><u>E&AS Offset</u></p> <p>Brattle’s proposal to use historical data to determine the E&AS offset is reasonable for obligation periods prior to the implementation of the single schedule market. There are certain nuances for gas-fired generators that need to be considered for both CA#2 and future auctions.</p> <p>First, historical revenues under a contract may not be representative of future revenues once off-contract, if the contract was incentivizing the generator to operate in a different manner than it would operate without the contract. This could exaggerate or understate the E&AS offset.</p> <p>Second, the 3-year historical period prior to the CA#2 auction could include a combination of cap & trade, no carbon price and the carbon tax. However, all these carbon prices will likely be lower than the carbon price that applies during CA#2 obligation period. Further, the IESO’s current proposal to address the carbon tax within existing contracts may incentivize offer behaviour that is very different than offer behaviour in the merchant market.</p> <p>In addition, the historical approach will likely encounter significant challenges for all fuel types in areas that are expected to have frequent negative prices under the single schedule market. Further discussion will be needed to understand whether the E&AS offset can be an adder to the ACR in such regions or whether negative energy prices are viewed as a retirement signal, and therefore the E&AS offset would have a zero-dollar floor.</p>
<p>Pre-Auction Period</p> <ul style="list-style-type: none"> ● Determination of Auction Parameters ● Pre-Auction Reporting ● Authorization Process ● Consolidation of Resources 	<p>Further discussion is needed about the processes to establish the minimum capacity, target capacity, maximum capacity, reference price and maximum clearing price. The IESO should be aiming to incorporate these processes into the Market Rules to provide participants with more clarity and certainty about how future auctions would be run.</p>

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<ul style="list-style-type: none"> • Capacity Qualification and Performance Assessment • Market Power Mitigation 	
<p>Auction Period</p> <ul style="list-style-type: none"> • Offer Submission • Auction Clearing and Price Setting • Post Auction Reporting Obligations 	
<p>Forward Period</p> <ul style="list-style-type: none"> • Participant Authorization in Auction • Resource Registration • Capacity Prudential Support • Capacity Obligation Transfers • Buy outs 	
<p>Commitment Period</p> <ul style="list-style-type: none"> • Energy Market Participation • Payments (Settlement Process) • Performance Obligation Assessment and Associated Charges or True-Ups 	<p><u>True-up</u></p> <p>The true-up mechanism is a reasonable approach to incentivize over-performance and allow a resource to mitigate the risk of under-performance due to forced or planned outages.</p> <p>The proposed 15% cap is reasonable for dispatchable generators but may not be appropriate for energy-limited or variable generators that could participate in future auctions. Further discussion is needed about how to assess performance penalties and rewards for those resources.</p>

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Chapter/Design Element	Detailed Comments on Design Phase (Areas of Support or Concern)
Cost Recovery	

Thank you for your feedback!

IESO Engagement