Statement of Approach

Affiliated Entities Participating in the Capacity Auction

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1. Introduction

Within the IESO, the authority to conduct investigations and make determinations related to compliance with, and enforcement of, the market rules, has been delegated to the Vice-President of the Market Assessment and Compliance Division ("**MACD**"). Complementing its enforcement role, MACD aims to enable a better understanding of the requirements of the market rules, including reliability standards, through education, so that market participants and the IESO may take actions towards being compliant. Compliance with the market rules and reliability standards supports the efficient and reliable operation of the IESO-controlled grid and the integrated power system.

As part of its efforts to enable compliance MACD may, upon request or on its own initiative, provide Compliance and Enforcement Guidance ("**CEG**") with respect to specific provisions of the market rules. As applicable, a CEG will reflect MACD's view as to the meaning of specific provisions and their potential application to compliance and other enforcement determinations. MACD may provide CEG on a market-wide basis or, where appropriate, to individual market participants.

2. Capacity Auction Participation

Chapter 0.7, sections 18 and 19 of the *Renewed Market Rules* govern participation in the capacity auction. Section 19.2 sets out the eligibility requirements for hourly demand response resources to participate in the capacity auction. Section 19.2.1.2 provides that a capacity market participant with an hourly demand response resource must register its facilities and demand response contributors in accordance with the applicable market manual:

> 19.2.1 A *capacity market participant* is eligible to satisfy its *capacity obligation* with an *hourly demand response resource* provided that the *capacity market participant*:
>
> 19.2.1.2 <u>registers its *facilities* and *demand response contributors* as applicable, to the satisfaction of the *IESO*, in accordance with the applicable *market manual*</u>. The *capacity market participant* shall not modify, vary or amend in any material respect any of the features or specifications of any *facility* without first requesting *IESO* authorization and approval in accordance with the applicable *market manual*;
>
> [Underlining added; italics in original]

The applicable market manual is market manual 0.12.0. Section 5.2.2 of the manual addresses the registration requirements for hourly demand response resources. Among other requirements, it limits capacity market participants for hourly demand response resources to a maximum of one resource for each contributor type per zone:

> A *capacity market participant* providing *demand response capacity* with both residential and commercial/industrial/institutional demand *response contributors* in the same zone must

register two separate *hourly demand response resources* in that zone (with a maximum of one resource for each contributor type per zone).

[Underlining added; italics in original]

Chapter 0.7, section 19.4.11A of the *Renewed Market Rules* authorizes the IESO to test the capacity of hourly demand response resources:

> The *capacity market participant* shall perform a *capacity auction capacity test* once per *obligation period* for each *hourly demand response resource*, in accordance with the applicable *market manual*. The *capacity auction capacity test* shall occur within a five *business day* testing window determined by the *IESO*. The *IESO* shall provide notification to a *capacity market participant* of the *capacity auction capacity test* no less than ten *business days* prior to the first day of the testing window.
> [Italics in original]

If a capacity market participant fails a capacity auction capacity test, the IESO applies a performance adjustment factor when calculating the capacity that the market participant is permitted to offer in the capacity auction for the next obligation period.[1] The intent of the performance adjustment factor is to ensure that the auction only procures capacity demonstrated to be deliverable.

Chapter 0.7, section 18.7.5 of the *Renewed Market Rules* provides that, in the event of a tie between capacity auction offers for the last available quantity in the capacity auction, the earliest capacity auction offer will prevail:

> If two or more capacity auction participants submit a capacity auction offer at the same price, for the last available quantity, the capacity auction offer with the earlier time stamp shall be selected as the successful capacity auction offer, in accordance with the applicable market manual.

The IESO has now proposed market rule amendments to adopt a new tie-breaking methodology. Under the Enhanced Tie-Break Methodology, the IESO would apply the following approach:

Step 1: Divide the tied capacity by the number of offers involved in the tie, to determine an equal share of capacity to allot to each offer (resource).

Step 2: Determine and award a proportional share of the remaining tied capacity after Step 1. Each resource's proportional share is based on the remaining capacity left in its offer after Step 1 relative to the remaining quantity of all tied offers after Step 1.

Step 3: Any tied capacity remaining after Step 2 is awarded based on time stamp.[2]

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[1] See MR Ch. 0.7, s. 18.2A.1.4 and Market Manual 0.12.0, s. 3.3.2.

[2] These steps are subject to additional qualifications, including rounding down to the nearest one decimal place, maintaining a minimum capacity threshold of 1 MW, and ensuring that the results do not violate system operating limits. For additional information, see the IESO staff's memorandum to the Technical Panel: Capacity Auction Tie-Break Methodology (September 2, 2025).

Capacity auction participants are subject to the General Conduct Rule under chapter 0.1, section 10A of the *Renewed Market Rules*, which prohibits exploiting or manipulating the IESO-administered markets, circumventing the market rules, undermining the IESO's ability to carry out its functions, and interfering with the determination of a market price or dispatch outcome by competitive market forces. Section 10A.1 provides:

> Market participants and the IESO shall not directly or indirectly engage or attempt to engage in conduct, alone or with another person, that they know, or ought reasonably to know:
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> 10A.1.1 exploits the IESO-administered markets, including by, without limitation, exploiting any gap or defect in the market rules;
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> 10A.1.2 circumvents any of the market rules;
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> 10A.1.3 manipulates any of the IESO-administered markets, including by, without limitation, manipulating the determination of a settlement amount;
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> 10A.1.4 undermines through any means the ability of the IESO to carry out its powers, duties or functions under the Electricity Act, 1998 or the market rules; or
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> 10A.1.5 interferes with the determination of a market price or dispatch outcome by competitive market forces.

3. Compliance and Enforcement Guidance

This Statement of Approach sets out MACD's enforcement approach regarding market participants with hourly demand response resources registering affiliated entities as market participants with their own hourly demand response resources. This conduct raises two concerns under the General Conduct Rule, discussed in greater detail below. First, participating in the capacity auction with multiple affiliated entities may allow market participants to game the Enhanced Tie-Break Methodology. Second, participating in the capacity auction with multiple affiliated entities may allow market participants to avoid the application of performance adjustment factor. This avoidance is even more concerning where the market participant reallocates its demand response contributor portfolio between affiliated entities. Accordingly, MACD will carefully monitor the participation of affiliated entities in the capacity auction. Furthermore, where market participants engage in the conduct described in this Statement of Approach, they may be subject to compliance investigation and sanction under the General Conduct Rule.

Use of Affiliated Entities to Game the Enhanced Tie-Break Methodology

Under the Enhanced Tie-Break Methodology, all resources involved in the tie-break will be awarded a share of the tied capacity subject to some limitations, such as the requirement to award no less than 1 MW. Creating affiliated entities and registering new resources to those entities would give a market participant another opportunity to clear a share of the tied capacity.

For example, the Enhanced Tie-Break Methodology design memo includes an example of a tie between three capacity auction offers for 40 MW of capacity. At step 1, the available capacity is divided by the number of offers in the tie break and rounded down to one decimal place to give the equal share of capacity per offer. The equal share is 40 MW divided by three offers, which is 13.3 MW. If there are any offers that are equal to or less than 13.3 MW, they receive their offered capacity. If there are any partial offers greater than the equal share, they receive the equal share:

Resource	Offer Price ($)	Offer Quantity (MW)	Full/Partial	Step 1 Allocation (MW)
A	50	25	Partial	13.3
D	50	5	Full	5
F	50	40	Partial	13.3

Resource D offered 5 MW, which is less than the equal share determined in step 1. Accordingly, Resource D receives the full 5 MW indicated in the offer quantity. The other two offers are greater than 13.3 MW, so they each receive 13.3 MW. That leaves 8.4 MW unallocated, which will then move to step 2.

In step 2, the remaining tied partial offers are awarded their proportional share of the capacity remaining after step 1. The proportion is determined using the following formula:

(Remaining Offer Quantity after Step 1 / Total Remaining Offer Quantity of Remaining Partial Offers) x Remaining Capacity to be Awarded

Each resource receives the calculated proportion of the available capacity, rounded down to the nearest 1 decimal place. In this example, there is 8.4 MW of remaining capacity and two partial offers to consider. Following the formula, Resource A receives an additional 2.5 MW while Resource F receives an additional 5.8 MW:

Resource	Offer Price ($)	Remaining Offer Quantity (MW) after Step 1	Proportion (MW)	Step 2 Allocation (MW)
A	50	11.7	2.559375	2.5
F	50	26.7	5.840625	5.8
Total	**-**	**38.4**	**8.4**	**8.3**

In total, Resource A receives 15.8 MW and Resource F receives 19.1 MW. After the proportional allocation, 0.1 MW remains unallocated due to rounding down. Under step 3, this capacity is awarded based on which offer had the earliest time stamp.

Now suppose that Resource A's market participant creates an affiliated entity that registers as a market participant and receives its own hourly demand response resource, Resource B. Resources A and B now both offer the same capacity (25 MW) into the same zone at the same price ($50/MW). At step 1, the IESO divides the remaining capacity (40 MW) by the number of tied offers (4) to derive the equal share of capacity per offer (10 MW). Applying this approach yields the following results:

Resource	Offer Price ($)	Offer Quantity (MW)	Full/Partial	Step 1 Allocation (MW)
A	50	25	Partial	10
B	50	25	Partial	10
D	50	5	Full	5
F	50	40	Partial	10

Resources A, B, and F are each awarded 10 MW, while Resource D is awarded 5 MW, leaving 5 MW to be allocated in step 2. Following the formula in step 2, Resource A and B each receive an additional 1.2 MW and Resource F receives an additional 2.5 MW:

Resource	Offer Price ($)	Remaining Offer Quantity (MW) after Step 1	Proportion (MW)	Step 2 Allocation (MW)
A	50	15	1.25	1.2
B	50	15	1.25	1.2
F	50	30	2.5	2.5
Total	**-**	**60**	**5**	**4.9**

After the proportional allocation, 0.1 MW remains unallocated due to rounding down. Under step 3, this capacity is awarded based on which offer had the earliest time stamp. In steps 1 and 2, Resources A and B each receive 11.2 MW, increasing the total capacity allocated to the group of affiliated entities to 22.4 MW, up from the 15.8 MW it received by offering with only one entity. Meanwhile, the group's competitor, Resource F, sees its capacity allocation reduced to 12.5 MW, down from the 19.1 MW it received when not competing against affiliated entities.

In MACD's view, offering in this way gives the affiliated entities an unfair advantage and appears to manipulate the IESO-administered markets and interfere with the determination of a market price or dispatch outcome by competitive market forces, contrary to chapter 0.1, sections 10A.1.3 and 10A.1.5 of the *Renewed Market Rules*, respectively. Furthermore, it appears to circumvent the requirement for market participants with hourly demand response resources to only register only one resource for each contributor type per zone, contrary to chapter 0.1, section 10A.1.2 of the *Renewed Market Rules*.

Where affiliated entities participate in the capacity auction in a manner that confers an unfair advantage to the group at the expense of competition, they may be subject to compliance investigation and sanction under the General Conduct Rule.

<u>Use of Affiliated Entities to Avoid the Application of the Performance Adjustment Factor</u>

Resources that fail a capacity test will receive a performance adjustment factor when qualifying capacity for next capacity auction. However, resources that are new to the auction do not receive a performance adjustment factor.

A market participant with an hourly demand response resource that fails a capacity test will be subject to a performance adjustment factor. However, if that market participant creates a new affiliated entity, it could register a new resource under that entity and then be able to offer capacity under that new resource without the application of a performance adjustment factor. Compounding the problem, the market participant might even reallocate demand response contributors from a penalized resource to a non-penalized resource. This would allow the market participant to avoid the application of the performance adjustment factor, even where the resources' portfolio of contributors is the same or substantially the same.

In MACD's view, using affiliated entities to avoid the application of the performance adjustment factor appears to circumvent the market rules and interfere with the determination of a market price or dispatch outcome by competitive market forces, contrary to chapter 0.1, section 10A.1.2 and 10A.1.5 of the *Renewed Market Rules*.

Where affiliated entities participate in the capacity auction in a manner that avoids the application of the performance adjustment factor or transfer demand response contributors among one another, they may be subject to compliance investigation and sanction under the General Conduct Rule.

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