

NOTICE TO PARTICIPANTS AND STAKEHOLDERS

May 26, 2017

Re: MSA Decision and Response to Stakeholder Comments re Revocation of Offer Behaviour Enforcement Guidelines

Overview

On November 19, 2015, the MSA gave public [notice](#) that it would hold a stakeholder meeting on December 9, 2015, to discuss its Offer Behaviour Enforcement Guidelines (OBEG), in light of the ruling of the Alberta Utilities Commission (AUC) in Proceeding 3110. The purpose of this meeting was to obtain stakeholders' views regarding a potential OBEG "refresh." On December 8, 2015, the MSA [released](#) the agenda for the stakeholder meeting. The high-level options set out for discussion in relation to the OBEG were that it be (i) maintained without change, (ii) revoked, and (iii) refreshed to account for developments since 2011. Following the stakeholder meeting, on December 11, 2015, the MSA [requested](#) written comments from stakeholders by January 29, 2016. Written comments that were received by that date were made [public](#) on February 2, 2016. Stakeholders submitted that other matters, including those related to the Climate Leadership Plan, demanded a significant amount of stakeholders' time and a consultation on the OBEG would increase those demands. On June 27, 2016, in light of other matters ongoing at the time, the MSA [announced](#) that it would delay further consultation on the OBEG until it believed that demands on stakeholders related to climate policy had been reduced. By the end of 2016, significant developments in this regard had occurred.

On March 17, 2017 the MSA [initiated](#) a Consultation re Revocation of Offer Behaviour Enforcement Guidelines and requested written comments from stakeholders by April 7, 2017. Written comments that were received by that date were made [public](#) on April 10, 2017. Further, on April 12, 2017, the MSA held a public [meeting](#) to hear from stakeholders and respond to questions that they had. The MSA's "Draft" position regarding the OBEG, along with responses to the written comments, was made [public](#) on April 21, 2017 and further comments from stakeholders were [requested](#) by May 5, 2017. The deadline for comments was later [extended](#) until May 8, 2017 following requests from stakeholders. The written comments received were made [public](#) on May 9, 2017.

Decision

The MSA has decided to revoke the *Offer Behaviour Enforcement Guidelines*, as of the date of this notice.

The revocation of the OBEG is not a prohibition on economic withholding; rather, revocation is a signal to the market that the MSA will look closely at offer behaviour and efficiency in the context of the legislative framework during the transition to a capacity market. The MSA is of the

view that the transition poses some challenges. The MSA is open to discussions with market participants about how best their concerns during the transition period could be addressed through fostering greater competition.

The rationale for the MSA's former approach to economic withholding as set out in the OBEG—conduct that often resulted in static efficiency losses—required that there be corresponding dynamic efficiency gains from innovation and investment, and thus a net efficiency gain over time that resulted (or was likely to result) from the forces of competition. Having considered the feedback from stakeholders, the MSA is still concerned that certain market participant conduct that results in static efficiency losses would now not result in dynamic efficiency gains from innovation and investment. Further the MSA is not convinced that there is an alternate rationale that would leave the OBEG unchanged.

The MSA also considered whether to maintain other parts of the OBEG that did not deal with economic withholding. There was considerably less feedback on these parts of the OBEG. While the MSA is not convinced the current sections should be maintained, it is open to further discussion with stakeholders on whether some parts of the OBEG in modified form could form part of a new guideline. Further, some stakeholders found parts of the OBEG useful in setting out the MSA's general enforcement stance, separate from guidance on specific topics. The MSA is also open to feedback on this issue and is of the view that setting out the MSA's general enforcement approach can be done separate from a guideline made under section 39(4) of the *Alberta Utilities Commission Act (AUCA)*.

A response to the written comments received on May 8, 2017 is included in an Appendix to this notice.

Next Steps

The consultation and stakeholder process on the revocation of the OBEG is now complete. The MSA is interested in feedback from stakeholders on whether setting out its general enforcement stance or providing a more formal process for seeking additional guidance are priorities for stakeholders. Feedback will help the MSA assess stakeholder interest prior to embarking on additional work. Feedback should be sent to Derek Olmstead at derek.olmstead@albertamsa.ca as we are no longer in a stakeholder consultation process; the MSA has no deadline for comments.

The MSA is planning no specific evaluation work in relation to the revocation of the guideline but will continue to monitor the market and report on its findings in its quarterly reports.

Sincerely,

/s/ Matt Ayres

Market Surveillance Administrator

Appendix: MSA responses to stakeholder comments

In some cases comments submitted following the “Draft” were similar to those submitted in the “Initial assessment.” In instances where the MSA has no further comment, we have not attempted to respond again but refer stakeholders to our previous responses.

There is no current problem with economic withholding / market power

A number of stakeholders stated that there was no current problem with economic withholding or market power and on this basis the MSA did not need to act. Stakeholders cited a variety of factors why this was the case, including the current supply / demand balance, the Balancing Pool’s control of PPA assets, forthcoming incremental generation from the Renewable Electricity Program (REP), and high levels of forecast reserve margins. Some stakeholders stated the view that the MSA had ignored the role that short-term forces would provide in disciplining the exercise of market power.

The MSA regularly reports on market outcomes and can confirm that it has not recently observed significant instances of economic withholding in the wholesale electricity market. The MSA consultation is one based on questioning whether the efficiency benefit set out in the OBEG for allowing economic withholding remains valid. Stakeholders may be correct in that no economic withholding would have occurred in the event the OBEG was maintained.

In regard to short-term forces and their ability to discipline the exercise of market power, the MSA continues to be of the view that both short- and long-term forces are needed to discipline the exercise of market power. It is the MSA’s view that those longer term forces are absent or constrained to the extent that static losses will outweigh dynamic gains.

The MSA is creating uncertainty that damages investor confidence and / or delays investment decisions

Many stakeholders articulated that revocation of the OBEG created uncertainty and for this reason should not be undertaken. At least one stakeholder articulated this in the context of regulatory uncertainty “holding-up” investment decisions. A number of stakeholders also acknowledged a significant amount of uncertainty resulted from the transition to the capacity market.

For the MSA, context is important. In the MSA’s view, uncertainty about the new market design, the transition to it, and a number of other policy initiatives are themselves causing sufficient uncertainty that dynamic efficiency gains from investment and innovation may not occur. This in turn represents a sufficient market failure that the MSA questions whether economic withholding is still consistent with a fair, efficient and openly competitive market. The MSA accepts that the revocation of the OBEG does not resolve these all uncertainties in the electricity market. While the MSA accepts the possibility that revoking the OBEG may increase market uncertainty, in the context of all the other relevant developments that have affected the electricity market, the MSA has seen no convincing evidence that its actions would have that effect. Put simply, one cannot “hold-up” investment that was already “held-up.”

As Alberta's electricity market evolves with the implementation of a capacity market, with new rules and new structures, the MSA believes that it would be preferable that market participant conduct, at least insofar as the exercise of market power is concerned, be governed by market rules rather than MSA guidelines.

The MSA ignores the fact that new investment might occur / is occurring and results in dynamic gains

A number of stakeholders advanced an argument that the MSA ignored that new investments are being made and would continue to be made. The question for the MSA is not whether investment is or might be occurring. The question is whether market participant conduct that results in static efficiency losses will result in corresponding dynamic efficiency gains from innovation and investment.

Regarding dynamic efficiency gains, the MSA has repeatedly made clear its view that it expected that the exercise of market power would, over time, be disciplined by efficient entry and exit decisions. The MSA believes that the efficiency of these decisions is adversely affected by structural elements of the market, including issues during the transition to the new market design. This means that entry and exit decisions are not likely to be efficient and therefore dynamic efficiency is significantly impaired.

Investment might occur for many other reasons unrelated to allowing economic withholding, including but not limited to the REP, government programs, or in expectation of receiving capacity payments under the new market design.

The MSA must present evidence / has an onus to provide evidence

Stakeholders presented a number of concerns that the MSA was required to provide evidence to support a change or an onus to prove change was necessary when modifying a guideline.

In making or amending guidelines, the MSA must consult with market participants (*Market Surveillance Regulation*, MSR, section 8(1)). The MSA must also make public the general process it uses make guidelines (MSR, section 8(2)). Finally, the MSA must consult if it changes the process by which guidelines are developed (MSR, section 8(3)).

Guidelines are “necessary”, or Guidelines are part of the “price setting regime”

Guidelines are not intended to restate the law; guidelines are not market rules. Guidelines are made in relation to powers given to the MSA under section 39(4) of the AUCA. In making a decision under section 56 of the AUCA, the AUC may take into consideration guidelines made by the MSA; however, final interpretation of the law is the responsibility of the AUC and the courts.

The Renewable Electricity Program structure is unfair and thus generators need sufficient offer flexibility

If the MSA understands the logic correctly, at least one stakeholder is of the view that one aspect of the market might offset the shortcomings of another part of the market. While the MSA has in past talked about a tolerance to static efficiency losses where these would be more than offset by corresponding dynamic efficiency gains, the example given here appears to be two sources that both might create static losses of efficiency. It is not at all apparent that these losses would or could be offsetting and are more likely to result in unnecessary transfers away from consumers to producers than they are to result in an improvement in efficiency. The MSA is unsupportive of maintaining the OBEG on these grounds.

Additional responses to comments on the “Initial Assessment”

The MSA asked stakeholders to, when responding to the “Draft,” whether further responses were requested on any comments previously submitted or whether the MSA had misunderstood any of the views expressed. In general, the MSA has not identified specific stakeholders when responding to comments, partly as some comments, although articulated variously, were received from multiple parties. In the cases where market participants requested additional feedback, it seems sensible to identify market participants individually.

Capital Power argued the MSA mischaracterised its comments in the section entitled “Revocation would be unfair to investors.” Capital Power expressed the view that the MSA unfairly attributed to Capital Power or others a view that they argued the OBEG had guaranteed returns to investment. The MSA did not attribute any such view to any stakeholder but included the following in its response to explain why it did not agree with why revocation was unfair:

The MSA does not agree. The OBEG neither guaranteed that investors would recover the cost of their investment nor did it guarantee that a minimum rate of return on any investment would be obtained. The absence of the OBEG no more prevents cost recovery as the presence of the OBEG assured cost recovery. The MSA’s reasoning for its enforcement stance on economic withholding was clearly articulated as the belief the dynamic gains from competition would outweigh static losses. This is now in question.

Capital Power also requested the MSA address the role of the OBEG in ensuring a high fidelity price signal. In response, the MSA notes that a high fidelity price signal is one usually thought as being based on market fundamentals not on offer behaviour. Economic withholding may not result in a price based on market fundamentals, so it is unclear to the MSA how the maintenance of the OBEG is consistent with ensuring a high fidelity price signal. The OBEG is framed in terms of concepts of economic efficiency: a market outcome in which there is no static efficiency loss is similar to what the MSA had previously articulated as a high fidelity price signal.

Other issues during a transition period

One stakeholder stated: “it is not clear the market can sustain itself to get to a new capacity market. It may be more prudent for the MSA to articulate the needed outcomes during this transition period rather than simply removing the OBEGs.” In response, the MSA notes that its attention is not limited to the revocation of the OBEG alone; it is also concerned with a number of issues during the transition. Articulating and understanding these issues is work the MSA sees as separate and distinct from the OBEG.

Sections of the OBEG rendered obsolete or unnecessary

One stakeholder asked the MSA to provide a list rule changes and AUC decisions that made sections of the OBEG “unnecessary or obsolete.” Another stakeholder provided a red-line edit of the OBEG and yet another more detailed comments on particular sections.

Section 4 of the OBEG sets out a number of fact patterns and, in this context, some ISO rules that were considered relevant (e.g., ISO rule 3.5.3.3 and ISO rule 5.2). Neither of these rules remains in existence today and, although suggested by some stakeholders, the MSA does not believe it is sufficient to simply replace an old rule number with a new one. The test for the MSA, given that this guidance is now more than six years old, is whether these examples still provide meaningful guidance to market participants. The MSA has suggested they do not and has asked stakeholders for their views.

In respect of AUC decisions, at the time that the OBEG was drafted in 2010 there were relatively few AUC decisions and the MSA believed there were some concerns over the interpretation of the recently enacted *Fair, Efficient and Open Competition Regulation* (FEOC Regulation). The intervening period has seen decisions on information sharing arrangements, ISO rules, and MSA enforcement cases, relating to rules compliance and compliance with the FEOC Regulation. Market participants have had an opportunity to observe how the MSA carries out its mandate and how, through public processes, the AUC has adjudicated matters brought before it.¹ In short, the MSA sees a much different world today than existed in 2010.

For further clarity, the MSA does not view guidelines as immutable and all guidelines should be revisited over time to make sure they are current.

Having considered the comments of stakeholders, the MSA believes that the issues around economic withholding have to some extent overshadowed a broader consideration of the merits of other guidance. While the MSA is not convinced the current sections should be maintained, it is open to further discussion with stakeholders on whether some parts of the OBEG could, in modified form, form part of a new guideline. Further, some stakeholders found parts of the OBEG useful in setting out the MSA’s general enforcement stance, separate from guidance on specific topics. The MSA is also open to feedback on this issue and is of the view that setting out the MSA’s general enforcement approach can be done separate from a guideline made under section 39(4) of the AUCA.

¹ The AUC e-filing system allows market participants to select “Decision report” from the “Markets” division to find those applications brought by the MSA, the Independent System Operator, or that relate to record sharing, rules, or reliability standards.

The fact that the MSA remains open to discussions with stakeholders is not the same as the MSA providing specific feedback on a case-by-case basis. Anyone seeking guidance on a topic can put their questions to the MSA in writing. The MSA may seek to clarify the question with the stakeholder concerned but no guidance will be given. If the MSA believes it is able to provide feedback, this would be done publicly as has been done in the past. If the nature of the requests suggests a guideline is necessary and the MSA agrees, this would be done through a public consultation process.

Benefit in developing an alternative guidelines

Some stakeholders had articulated the view that clear guidance from the MSA was necessary in a number of areas. In response, the MSA asked participants that if it was unable to provide further guidance on offer behaviour, were there other areas in which they thought guidelines should be provided.

In response to this question, a number of stakeholders reiterated the view that OBEG should be retained. The MSA is of the view that the other elements of the OBEG are not necessary at this time but, as set out in the “Next Steps” section above, is open to receiving feedback from participants about whether other guidance would be of value to market participants.

Additional comments of Church Economic Consultants

Much of the report by Church Economic Consultants (CEC) seeks to re-characterise sections of the OBEG and the MSA’s State of the Market Report 2012. The MSA does not agree that this is necessary and the MSA disagrees with some of what is discussed. For example, CEC concludes that the “data on prices and relationship between supply and demand (investment) confirm that the MSA’s 2012 assessment that electricity in Alberta was effectively competitive is still appropriate in 2017.” The evidence for this is a simplistic consideration of the trend and level of average pool price and trend and magnitude of reserve margin. This is not the approach or test for effective competition the MSA conducted in 2012.

The CEC report also includes opinions about the MSA enforcement stance, responsibilities of the MSA, and a more general opinion that the MSA should not bother to address issues where “the costs of MSA enforcement with respect to offers are likely to far exceed the benefits from controlling the inefficient exercise of market power.” The application of principle-based analysis and enforcement does not turn on cost-benefit analysis. The MSA can still exercise discretion over taking enforcement action as set out in the AUCA.