

## NOTICE TO PARTICIPANTS AND STAKEHOLDERS

April 21, 2017

**Re:** Consultation re Revocation of Offer Behaviour Enforcement Guidelines – MSA “Draft” Position and Response to Stakeholder Comments from the “Initial Assessment” Phase

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### Overview

On March 17, 2017 the MSA [initiated](#) a Consultation re Revocation of Offer Behaviour Enforcement Guidelines (OBEG) and requested written comments from participants and stakeholders by April 7, 2017. Written comments that were received by that date were made [public](#) on the MSA’s website 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 responses to the written comments received by April 7, 2017 as a result of its March 17, 2017 notice are set out in the Appendix. The next section sets out relevant background material. It is followed by the MSA’s “Draft” position on this matter and request for further comment by stakeholders.

For greater clarity, this is the “Draft” stage of the MSA’s [stakeholder consultation process](#) and are moving to the next comment stage.

### Background

In its March 17 notice the MSA stated:

The analytical approach set out in the OBEG is based on efficiency being the core objective of the legislative framework that underpins the Alberta electricity market. In evaluating efficiency, the MSA distinguishes between static efficiency and dynamic efficiency, noting that the true benefits of competition will accrue from dynamic gains over time that outweigh static efficiency losses.

The MSA then cited the OBEG:

Given the absence of capacity markets or other mechanisms in Alberta the MSA believes giving too much weight to static efficiency concerns is not appropriate. Such an approach could chill the incentive to innovate or invest and therefore may harm dynamic efficiency. Conduct inconsistent with static efficiency can be acceptable so long as there is a corresponding benefit to dynamic efficiency, and thus a net efficiency gain, that results (or will likely result) from the forces of competition. The MSA will monitor the market for static efficiency losses caused by market

structure, rules and / or market participant behaviour. Where static efficiency losses appear to have no corresponding dynamic efficiency gain the MSA will make recommendations aimed at eliminating or reducing efficiency loss.<sup>1</sup>

The March 17 notice continued:

While Alberta has not yet implemented a capacity market, it is clear to the MSA that we are in a transition from one market design to another. The MSA is concerned that certain market participant conduct that results in static efficiency losses will now not result in dynamic efficiency gains from innovation and investment. [Underline emphasis is the original]

To be clear, concern over dynamic efficiency does not require that investment ceases. This only requires that investment be undermined to such an extent that dynamic efficiency gains will not exceed static efficiency losses.

The MSA concluded that:

The practical implication of this to market participants is that the exercise of market power, including “economic withholding” may no longer be consistent with achieving efficiency set out in the legislative framework. Simply, such conduct now would likely result in a loss of static efficiency with no corresponding benefit to dynamic efficiency. In addition, some other sections of the OBEG have since 2011 been rendered unnecessary or obsolete given changes in market rules and AUC decisions, most notably AUC Decision 3110-D01-2015. For these reasons the MSA is considering the revocation of the OBEG. While the exercise of market power may no longer be consistent with achieving efficiency, the question of whether the MSA would take enforcement action in a given set of circumstances would depend on whether the conduct had a deleterious effect on market outcomes.

## **MSA “Draft” position**

Based on the written comments received by April 7, 2017 the MSA is of the view that the OBEG should be revoked.

The MSA remains of the view that the true benefits of competition will accrue from dynamic gains over time that outweigh static efficiency losses. However, some significant changes to the Alberta electricity market have either been announced or have occurred recently—specifically the announcement and ongoing discussions about the implementation of a capacity market and the Renewable Energy Program—that make clear to the MSA that we are in the transition from one market design to another. As such, as stated in the March 17 notice, the MSA is concerned

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<sup>1</sup> MSA, “Offer Behaviour Enforcement Guidelines.” January 14, 2011, p. 9.

that certain market participant conduct that results in static efficiency losses will now not result in corresponding dynamic efficiency gains.

The MSA has not made a final decision to revoke the OBEG as we are in the “Draft” stage of our consultation. Revocation of the OBEG, should that decision be the final result of this stakeholder process, does not imply that energy and ancillary services offers should be made in another particular manner. That is, revocation of the OBEG would not replace the guidance provided by the OBEG with alternative guidance; it would simply remove the guidance provided by the OBEG.

## **Request for public comment**

The next step in the MSA’s [stakeholder consultation process](#) is for the MSA to request comments from stakeholders regarding its “Draft” position. Comments are requested by 4 p.m. on May 5, 2017 and should be sent to [stakeholderconsultation@albertamsa.ca](mailto:stakeholderconsultation@albertamsa.ca). Comments that are received will be made public on the MSA’s website. In accordance with the stakeholder consultation process this may be the final opportunity for stakeholder comment, or the MSA may decide the consultation would benefit from further stakeholder input.

The MSA requests that stakeholders specifically comment on the following, in addition to commenting otherwise as they see fit:

- Are there comments from the “Initial Assessment” phase of the consultation that stakeholders would like the MSA to further respond to or where the MSA has misunderstood comments received?
- Can stakeholders articulate an alternative argument why economic withholding, at the current point in time, remains consistent with achieving an economically efficient allocation of resources?
- In light of the ongoing transition to a capacity market, including uncertainty about its design and other market changes, is there reason to believe that the exercise of market power (and consequent static efficiency losses) will be disciplined by incumbent or entrant investment?
- Some stakeholders saw benefit in developing an alternative guideline. If the MSA believes it is unable to issue further guidance on offer behaviour are there other areas in which guidelines should be provided?

Sincerely,

/s/ Matt Ayres

Market Surveillance Administrator

## **Appendix: MSA responses to stakeholder comments**

### **The implementation of a capacity market in Alberta has been announced and the market is in transition but details are unsettled at present**

A number of stakeholders linked the possible revocation of the OBEG to the implementation of a capacity market and were concerned that the MSA had moved too early or prejudged the outcome of capacity market consultations. For example, one stakeholder stated that “[t]he applicable legislation has not changed and therefore permissible behaviour under the legislation has not changed.”

By way of clarification, the MSA is not stating a position that would apply once a capacity market is in place; the MSA’s concern is whether economic withholding is consistent with an efficient energy-only market during the transition to a capacity market. The MSA does not foreclose the possibility that new guidelines might be needed once a capacity market has been designed but is hopeful that rules and legislation will be sufficiently clear that this is not the case.

### **Discussions regarding the OBEG are not a priority given that active discussions regarding the capacity market and other matters are on-going at present**

Stakeholders raised a variety of concerns over the timing and / or scope of the consultation, including but not limited to (i) limited stakeholder resources given other initiatives, (ii) minimal risk of economic withholding at the current time, (iii) better to wait until details regarding the capacity market design are clearer, (iv) should be combined with consultation on other discussions, and (v) should be considered concurrent with other market changes.

Regardless of other discussions that are ongoing at this time, the MSA believes that it should promptly tell stakeholders when it believes its published enforcement stance articulated in a guideline may have materially changed. Such a change is then subject to stakeholder consultation. The MSA understands that stakeholders are busy on other matters and intends to conduct this process in a timely manner. The MSA has sought to coordinate with other agencies in order to prevent comment deadlines on multiple consultations occurring at the same time.

While the MSA views its enforcement guidance as distinct from other consultations that are occurring, or likely to occur, as a result of the transition to the capacity market, the MSA continues to be willing to meet with interested stakeholders on those other issues. Such discussions would not be part of the current stakeholder process.

### **Uncertainty**

The MSA further understands that stakeholders may see the potential revocation of an MSA guideline as increasing uncertainty as to the MSA’s enforcement stance. Some stakeholders went further to describe a revocation of the OBEG without replacement as undesirable or unacceptable.

The MSA would like to remind stakeholders that since the publication of the OBEG in 2011 there have been a number of decisions from the Alberta Utilities Commission which provide

much more certainty to stakeholders than can be provided by an MSA guideline. Further, prior to 2011 no equivalent guidance existed and in the past other guidelines have been issued and revoked as circumstances and / or the MSA's understanding of competition has changed.

Through the consultation the MSA is seeking to understand stakeholder perspectives on the rationale for economic withholding and is open to suggestions as to an amended guideline. The OBEG strived to provide transparency and predictability regarding the MSA's assessment of market participant offer behaviour so that participants could govern themselves accordingly. The OBEG noted they would remain in effect until overtaken by jurisprudence, new legislation / regulation or amendment by the MSA. Ultimately, at any given time, the MSA must decide what guidance it is or is not able to give on a particular topic.

### **Consultation should occur expeditiously v. limited consultation is unacceptable**

One stakeholder presented the view that the MSA should clarify its position in a timely manner to mitigate market impacts. Another suggested a "sudden and limited consultation is unacceptable." Others suggested the consultation be withdrawn without further process steps.

In response, the *Market Surveillance Regulation* (MSR) requires the MSA to consult with market participants on new or materially changed guidelines. The MSA must also make public the general process used to develop such guidelines. The MSA has published such a process on its website and is following that process in this consultation. In that process the MSA notes that it understands that certain projects may result in some market uncertainty, so will endeavor to complete them in a timely manner. That is the intent in this consultation. Further, the process sets out that there will be at least two opportunities for stakeholder comment and at least two weeks will be provided for each consultation stage. The process also sets out a means whereby stakeholders may request extensions to deadlines.

### **Revocation would be unfair to investors**

Many market participants commented that the OBEG was necessary for investors to recover the cost of their investments and others commented that the OBEG provided investors the opportunity to recover the cost of their investments. As such, revoking the OBEG would be unfair to investors.

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.

## **The broadly defined market structure has not changed but the MSA is reconsidering its view of the effect on static and dynamic efficiency of economic withholding**

The MSA's views on the concepts of static and dynamic efficiency have not changed. However, the signal for investment in incumbent and entering assets has changed as a result of recent announcements. Because this critical part of an energy-only market design has been impacted, the possibility that static efficiency losses associated with economic withholding will be more than offset by dynamic efficiency gains (that are contingent on those losses) is diminished during the transition period. As such, it is likely that economic withholding during the transition period will result in efficiency losses that are contrary to existing stated objectives of the market.

## **Does revocation of the OBEG, should that occur, imply that market participants must offer at their short-run marginal cost?**

No. Revocation of the OBEG, should that decision be the final result of this stakeholder process, does not imply that energy and ancillary services offers should be made in another particular manner. That is, revocation of the OBEG would not replace the guidance provided by the OBEG with alternative guidance; it would simply remove the guidance provided by the OBEG.

## **Relevance of other sections of the OBEG**

There was relatively little stakeholder comment on sections of the OBEG that did not deal with economic withholding. One stakeholder indicated that it had not identified any elements of the OBEG that were inconsistent with AUC decisions. Another stakeholder noted that the OBEG contained "noteworthy insights" on the application of legislation but provided no specifics. One stakeholder noted that several sections of the OBEG had become obsolete as a result of AUC Decision 3110-D01-2015 and they should be clarified or removed.

If stakeholders believe that there are sections of the OBEG that still provide useful guidance, the MSA asks that those be identified explicitly in the next round of comments.

## **Revocation would have other implications**

At least one stakeholder commented that the MSA should consider other implications of the revocation of the OBEG, these included future supply adequacy and suppressed prices coupled with higher emissions costs could significantly impact the economic viability of coal units. The MSA is mindful that in a transition from one market structure to another there is the possibility of transition issues. The MSA is of the view that the potential for these issues exists in the presence or absence of the OBEG. As noted above, the MSA feels it reasonably required to inform market participants about its enforcement stance and has limited ability to address other issues raised by stakeholders.

## **In some areas the MSA and stakeholders may have to agree to disagree**

One stakeholder noted "[i]t is inappropriate to exploit the transition period to put pressure on the earnings potential of sunk investment."

The MSA disagrees with this characterization. The MSA is conducting a stakeholder consultation where it has set out its rationale for a proposed change in enforcement stance and does not believe that can, in any way, be characterized as “exploitation.”

Another stakeholder stated “[a]n announcement that Alberta will transition to a capacity market structure does not fundamentally alter the current basis for making investments.”

The MSA respectfully disagrees. Investments in generating units typically are recovered over a number of years; announcements of future market structure would be important to many, if not all, investors.