

Report to the Minister

For the Year Ending December 31, 2017

April 19, 2018

Taking action to promote effective competition and a culture of compliance and accountability in Alberta's electricity and retail natural gas markets

www.albertamsa.ca

MARKET SURVEILLANCE
ADMINISTRATOR

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April 19, 2018

The Honorable Margaret McCuaig-Boyd
Office of the Minister of Energy
408 Legislature Building
10800 - 97 Avenue
Edmonton, Alberta T5K 2B6

Dear Minister:

Re: Annual Report for 2017

I am pleased to submit the Annual Report of the Market Surveillance Administrator for the year ending December 31, 2017. This report is provided to you pursuant to subsection 38(1) of the *Alberta Utilities Commission Act*.

Yours truly,



Wayne Taylor
Market Surveillance Administrator

cc: Willie Grieve, Chair Alberta Utilities Commission

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1 Introduction

This Annual Report for 2017 is provided pursuant to section 38(1) of the *Alberta Utilities Commission Act* (AUCA) which directs the Market Surveillance Administrator (MSA) to provide the Minister of Energy with an annual report that reports on the MSA's activities in the fiscal year and contains the audited financial statements for the fiscal year.

As set out in section 39 of the AUCA, the MSA's mandate is to promote the fair, efficient and openly competitive operation of the electricity and retail natural gas markets. The MSA is empowered to investigate market conduct, bring enforcement actions before the Alberta Utilities Commission (AUC) and publish guidelines to support the fair, efficient and openly competitive operation of these markets. The MSA may investigate and seek administrative penalties or other remedies before the AUC for contraventions of the market rules, the Alberta Reliability Standards, the *Electric Utilities Act* (EUA), or the *Fair, Efficient and Open Competition Regulation* (FEOC Regulation). The MSA also has a role in bringing matters to the AUC if the MSA believes there may be an adverse effect on the structure and performance of the electricity market.

2 Market Monitoring

Key to the MSA's yearly activities are the actions taken to promote effective competition. These activities include fostering confidence in the market by transparent reporting on both market events and MSA activities; taking action to ensure market structure does not adversely affect competition; and taking action to ensure appropriate market participant conduct.

2.1 Fostering market confidence through transparent reporting

For many years, the MSA has published [Quarterly Reports](#) that comment on market trends, specific events, assessment of possible contraventions of regulations and other activities of the MSA. These are supplemented by annual reports, which focus on retail markets, offer control in the wholesale market, and an annual assessment of trends with respect to compliance with ISO rules and Alberta Reliability standards. The purpose of these reports is to be transparent about how Alberta's electricity markets function so that stakeholders can be confident that the markets are competitive and that the MSA is performing its role appropriately.

During 2017 the MSA's Quarterly Reports contained analyses and recommendations on several matters including:

- High pool price hours;
- Cost of procuring ancillary services; and
- Forward market response to the announcement of mothball outages.

In 2017 the MSA continued its focussed reporting on the retail market with two reports. The first report, [Regulated Rate Option in Alberta's Rural Electrification Associations and Municipalities](#), examined the processes used by REAs and other municipalities to set RRO rates and provided data on RRO prices, customer counts and consumption volumes.

The second report, [Options for Enhancing the Design of the Regulated Rate Option](#), was prepared in response to a request to the MSA from the Minister of Energy. The scope of the request was to provide options for enhancing the design of the Regulated Rate Option (RRO) to provide long-term predictable, stable and affordable electricity rates with minimized regulatory and administrative costs. In the course of preparing this report, the MSA engaged with stakeholders to obtain feedback at the outset and again at the draft stage. Rather than endorse one approach, the report focussed on articulating the advantages and disadvantages of several options that could enhance the stability and predictability of electricity rates.

2.2 Taking action to ensure market structure does not adversely impact competition

Part of the MSA's work is to pro-actively assess whether market structure, rather than participant conduct, impedes competition to the detriment of Albertans.

Market Transition

In 2017 the MSA continued its involvement with the Capacity Market Transition project led by the Alberta Electric System Operator (AESO). For the purpose of informing the capacity market design process, the MSA released four reports during 2017.

The first report was an independent expert report prepared in 2015 by Charles River Associates titled "Can the Electricity Market Structure Accommodate Significant Levels of Renewable Generation ? An Evaluation of Carbon Policy Options for the Alberta Electricity Sector". While the report was prepared prior to the release of the Climate Leadership Plan and the decision by the Government of Alberta to move to a capacity market, the MSA was of the view that sections of the report pertaining to the integration of renewables remained relevant.

The second report was an independent expert report prepared by Monitoring Analytics LLC titled "Design Considerations for an Alberta Capacity Market". The report discussed capacity markets within an overall wholesale power market design framework as well as design considerations for the capacity market itself. Monitoring Analytics LLC is the market monitor for the PJM interconnection.

The third report was prepared by the MSA titled "Mitigation in Electricity Markets". This report summarized market power mitigation mechanisms utilized in US capacity markets.

The final report was an independent expert report prepared by Potomac Economics Ltd. titled "Report on Best Practices in Wholesale Electricity Market Design". This report was

commissioned by the MSA to enhance understanding of the interdependencies between energy, ancillary services and capacity markets. Potomac Economics Inc. is the market monitor in four major US electricity markets.

As per its [mandate letter](#) from Alberta Energy, the MSA participated in the transition to a new capacity framework by providing market-related expert advice as required. This included the production of the above mentioned reports and interactions with Alberta Energy, the AESO and other agencies.

Historical Trading Report

In December 2015 the MSA applied to the AUC requesting a hearing in relation to the MSA's assessment that the AESO's Historical Trading Report (HTR) undermined the fair, efficient and openly competitive nature of the wholesale electricity market and adversely affected the structure and performance of the market. Several procedural matters including data requests occurred during 2016, including the hearing and dismissal of a request for a judicial review. Ultimately, the MSA's application (AUC Proceeding 21115) was heard by the AUC in early December 2016. On May 17, 2017 in Decision 21115-D01-2017, the AUC found the ongoing publication of the HTR to be inconsistent with the fair, efficient and openly competitive operation of Alberta's electricity market and ordered the AESO to cease publication of the HTR by no later than May 23, 2017. Following release of the AUC's decision, TransAlta Corporation and TransCanada Energy each filed an application before the AUC to Review and Vary Decision 21115-D0102017. On December 11, 2017, the AUC found that neither review application demonstrated the existence of an error of law, fact or jurisdiction that could lead the AUC to materially vary or rescind Decision 21115-D0102017 and dismissed the two review applications.

Information sharing between market participants

The regulations governing the Alberta electricity market place a number of requirements on market participants. One such requirement is that before certain information can be shared between market participants, perhaps as the result of a joint venture or other commercial arrangement between the market participants, approval must be granted by the AUC. The MSA plays a key role in these proceedings, both in assisting potential applicants and by participating to ensure there are sufficient safeguards in place to ensure that shared information will not be used for purposes inconsistent with the competitive market. In 2017 the MSA worked with a number of market participants who were preparing information sharing arrangements.

2.3 Taking action to ensure market participant conduct supports fair, efficient and open competition

In March 2017 the MSA initiated a consultation process with market participants and stakeholders to consider the withdrawal of its Offer Behaviour Enforcement Guidelines (OBEG), originally released in 2011. Given the announced implementation of a capacity market in Alberta, the MSA's view was that the basis for the OBEG had fundamentally changed due to the

expected shift in market design. The foundation of the OBEG had been that conduct inconsistent with static efficiency can be acceptable provided 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 became concerned that certain market participant conduct that results in static efficiency losses would no longer yield dynamic efficiency gains by way of innovation and investment during the design and implementation of a capacity market. Accordingly, the OBEG was revoked as of May 27, 2017.

3 Promotion of Compliance and Accountability

The MSA promotes compliance and accountability through a variety of means including investigations, adopting processes that encourage accountability and, where necessary, issuing fines where rules or reliability standards have been breached.

3.1 Investigations

The MSA was engaged in a number of investigations during 2017, two of which the MSA considers complex investigations. Of these two matters, one was initiated late in 2016 and remains active. The second was publically disclosed by the MSA in May 2017 as an investigation of the Balancing Pool arising from complaints about the Balancing Pool's conduct related to Power Purchase Arrangement terminations. This matter remains an active investigation.

With respect to other investigation matters, the MSA concluded two retail investigations relating to the Code of Conduct Regulation in which the MSA's conclusions were published without enforcement action. An additional investigation was concluded relating to contraventions of AUC orders approving preferential sharing of records between parties. This latter matter led to an application to the AUC for approval of a settlement agreement setting out administrative penalties of \$68,750. The settlement agreement was approved by the AUC in early 2018.

3.2 Compliance with market rules and reliability standards

The MSA's approach with respect to compliance with market rules and reliability standards is focussed on the prevention of future harm through the enforcement of appropriate standards of conduct and care. The MSA has established a process that, in conjunction with AUC rules, provides incentives for robust internal compliance programs, self-reporting and mitigation plans.

Since 2008, the MSA's work enforcing market rules and reliability standards has resulted in approximately \$1.7 million in financial penalties being levied on market participants. Detailed results for 2017 are the subject of a separate MSA report, [Compliance Review 2017](#), published

on February 27, 2018. MSA compliance enforcement responsibilities increased in 2017 with the October 1, 2017 effective date of the suite of critical infrastructure protection (CIP) reliability standards applicable to both market participants and the AESO.

3.3 Retail rate cap regulation

On November 22, 2016 the Government of Alberta announced that Regulated Rate Option (RRO) rates would be capped at 6.8 cents per kWh from June 2017 to June 2021. As set forth in the *Rate Cap (Board or Council Approved Regulated Rate Tariffs) Regulation*, the MSA is the approving body for deferral account statements (DAS) submitted by municipalities and REAs. The MSA is also the approving body for DAS submitted by the City of Medicine Hat under the *Rate Cap (City of Medicine Hat) Regulation*. An MSA approved DAS serves as the basis for municipalities, REAs and the City of Medicine Hat to seek compensation from the Government of Alberta under these two regulations when the AUC posted Reference Rate exceeds 6.8 cents per kWh. Following the release of a DAS template by the Department of Energy in August, 2017, the MSA consulted with stakeholders to establish the process the MSA will follow to approve each DAS. The MSA finalized this process in October 2017 and subsequently conducted a trial run with municipalities and REAs to ensure all participants were familiar with the process. The AUC posted Reference Rate did not exceed 6.8 cents per kWh in 2017.

4 Financial Statements

During 2017 the MSA continued to benefit from a recovery of \$4.3 million in costs late in 2015 in respect of an enforcement action before the AUC. After meeting all of its 2016 operating and capital expenses by way of this cost recovery, the MSA deferred a further \$1.9 million of the cost recovery into 2017. This \$1.9 million offset approximately half of the MSA's 2017 operating budget. At the end of 2017, the MSA had a funding surplus of approximately \$500,000 principally due to lower than expected legal expenses incurred during the year. The MSA's forecast financial position at the end of each year end is factored into its budget request for the subsequent year.

The MSA's audited financial statements for the year ended December 31, 2017 follow. The format of the financial statements reflects accounting standards for not-for-profit organizations.

**Market Surveillance
Administrator**

Financial Statements
December 31, 2017 and 2016



February 20, 2018

Independent Auditor's Report

To the Management of Market Surveillance Administrator

We have audited the accompanying financial statements of Market Surveillance Administrator, which comprise the balance sheets as at December 31, 2017 and December 31, 2016 and the statements of operations and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian accounting standards for not-for-profit organizations, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Market Surveillance Administrator as at December 31, 2017 and December 31, 2016, and the results of its operations and its cash flows for the years then ended, in accordance with Canadian accounting standards for not-for-profit organizations.

PricewaterhouseCoopers LLP

Chartered Professional Accountants

Market Surveillance Administrator

Balance Sheets

As at December 31, 2017 and 2016

	2017 \$	2016 \$
Assets		
Current assets		
Cash	1,017,056	2,458,330
Contributions receivable	355,986	-
Prepaid expenses and deposits	33,475	35,417
	<u>1,406,517</u>	<u>2,493,747</u>
Capital assets (note 3)	45,662	73,138
	<u>1,452,179</u>	<u>2,566,885</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	581,225	440,219
Deferred contributions (note 4)	870,954	2,126,666
	<u>1,452,179</u>	<u>2,566,885</u>
Net assets (note 1)	<u>1,452,179</u>	<u>2,566,885</u>

On behalf of the Corporation

/s/ Tudor Beattie

Tudor Beattie
Market Surveillance Administrator

/s/ Doug Doll

Doug Doll, Chief Financial Officer
Market Surveillance Administrator

The accompanying notes are an integral part of these financial statements.

Market Surveillance Administrator

Statements of Operations

For the years ended December 31, 2017 and 2016

	2017 \$	2016 \$
Revenue		
Contributions from the Alberta Electric System Operator (note 4)	3,607,083	3,196,426
Interest and other income	3,103	7,485
	<u>3,610,186</u>	<u>3,203,911</u>
Expenses		
Salaries and benefits	2,751,759	2,182,107
Consultants and audit	122,852	35,708
Legal fees	284,578	524,414
Operating, office and administrative	416,100	428,299
Amortization	34,897	33,383
	<u>3,610,186</u>	<u>3,203,911</u>
Excess of revenue over expenses	<u>-</u>	<u>-</u>

The accompanying notes are an integral part of these financial statements.

Market Surveillance Administrator

Statements of Cash Flows

For the years ended December 31, 2017 and 2016

	2017 \$	2016 \$
Cash provided by (used in)		
Operating activities		
Excess of revenue over expenses	-	-
Item not involving cash		
Amortization	34,897	33,383
Changes in non-cash working capital		
(Increase) decrease in contributions receivable	(355,986)	15,555
Decrease (increase) in prepaid expenses and deposits	1,941	(2,323)
Increase in accounts payable and accrued liabilities	141,006	164,048
Decrease in deferred contributions	(1,255,712)	(3,013,270)
Cash used in operating activities	<u>(1,433,854)</u>	<u>(2,802,607)</u>
Investing activity		
Expenditures on capital assets	<u>(7,420)</u>	<u>(44,221)</u>
Decrease in cash	(1,441,274)	(2,846,828)
Cash – Beginning of year	<u>2,458,330</u>	<u>5,305,158</u>
Cash – End of year	<u>1,017,056</u>	<u>2,458,330</u>

The accompanying notes are an integral part of these financial statements.

Market Surveillance Administrator

Notes to Financial Statements

December 31, 2017 and 2016

1 Nature of business

The Market Surveillance Administrator ("MSA") was incorporated as an independent, stand-alone entity on June 1, 2003 under the *Electric Utilities Act* of the Province of Alberta.

The business and affairs of the Market Surveillance Administrator are overseen by an individual appointed as Market Surveillance Administrator by the Minister of Energy for the Province of Alberta.

As of January 1, 2008, the Market Surveillance Administrator was continued under the *Alberta Utilities Commission Act* with a broad mandate including surveillance, investigation, and enforcement to help ensure fair, efficient, and openly competitive electricity and retail natural gas markets in Alberta. The Market Surveillance Administrator is responsible for keeping a close eye on the behaviour of market participants and the overall performance of the market to ensure there are no anti-competitive activities and that rules are appropriate and are working as intended. The Market Surveillance Administrator communicates information arising from the various activities of the Market Surveillance Administrator within its mandate, to foster transparency and confidence for stakeholders. It responds to matters brought to the attention of the Market Surveillance Administrator through complaint or referral, and resolves issues before they become complaints. It examines the conduct of market participants to ensure compliance with legislation, regulations and rules; making sure sufficient remedies exist to avoid untoward market behaviour or activity. The Market Surveillance Administrator also issues guidance to the market and makes recommendations to the Department of Energy and other parties where appropriate, toward the development and operation of a fair, efficient and openly competitive market.

The Market Surveillance Administrator has no share capital. The *Alberta Utilities Commission Act* requires that the Market Surveillance Administrator prepare a budget for each fiscal year, for approval by the Chair of the Alberta Utilities Commission. Once approved, the Alberta Electric System Operator is required to pay the Market Surveillance Administrator the budgeted costs and expenses, net of any other revenues. The Market Surveillance Administrator is to be managed so that no profit or loss results on an annual basis from its operations.

2 Summary of significant accounting policies

Basis of preparation

These financial statements have been prepared in accordance with Canadian Accounting Standards for Not-for-profit Organizations (ASNPO).

Cash

Cash consists of cash held with chartered financial institutions.

Market Surveillance Administrator

Notes to Financial Statements

December 31, 2017 and 2016

Capital assets

Capital assets are stated at cost less accumulated amortization. Amortization is provided using the following methods and annual rates:

Computer hardware	Straight-line	3 years
Computer software	Straight-line	3 years
Furniture and equipment	Straight-line	5 years

Income taxes

No provision has been made for income taxes as the Market Surveillance Administrator is a not-for-profit organization as set out in the *Alberta Utilities Commission Act* of the Province of Alberta.

Financial instruments

The MSA's financial instruments consist of cash, accounts receivable, accounts payable, and accrued liabilities. Due to the current nature of the MSA and its financial instruments, fair value approximates the carrying value. It is management's opinion that the MSA is not exposed to significant interest rate, currency or credit risks associated with these financial statements.

Revenue recognition

The MSA follows the deferral method of accounting for contributions.

Consistent with the requirements of the *Alberta Utilities Commission Act* that the Market Surveillance Administrator operates with no annual profit or loss, contributions from the Alberta Electric System Operator are recognized as revenue to the extent of annual operating costs, including amortization of capital costs. In circumstances where annual contributions are in excess of annual costs, the excess is deferred and recognized in future periods. In the event of a shortfall between contributions and costs, the shortfall in revenue will be accrued and collected in a subsequent period from the Alberta Electric System Operator.

Measurement uncertainty

These financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. Because the precise determination of many assets, liabilities, revenues and expenses are dependent on future events, the preparation of financial statements for a period necessarily includes the use of estimates and approximations which have been made using management's best judgement. Actual results could differ from those estimates.

Market Surveillance Administrator

Notes to Financial Statements

December 31, 2017 and 2016

3 Capital assets

			2017	2016
	Cost \$	Accumulated amortization \$	Net \$	Net \$
Computer hardware	154,299	148,055	6,244	12,041
Computer software	76,049	64,839	11,210	24,071
Furniture and equipment	166,515	138,307	28,208	37,026
	<u>396,863</u>	<u>351,201</u>	<u>45,662</u>	<u>73,138</u>

4 Deferred contributions

Contributions from the Alberta Electric System Operator are set to recover the operating and capital costs of the Market Surveillance Administrator. Any excess or shortfall in contributions are deferred to or accrued for future years.

	2017 \$	2016 \$
Opening balance – January 1	2,126,666	5,139,936
Add: Contributions	2,014,716	-
Less: Revenue recognized in the year	<u>(3,607,083)</u>	<u>(3,196,426)</u>
	534,299	1,943,510
Contribution for January	<u>336,655</u>	<u>183,156</u>
Closing balance – December 31	<u>870,954</u>	<u>2,126,666</u>

5 Commitments

The Market Surveillance Administrator is committed under a lease agreement for its current premises until October 2019. Total lease costs including estimated operating costs are approximately as follows:

	\$
2018	288,195
2019	252,353

The Market Surveillance Administrator has entered into a service agreement with the Alberta Electric System Operator, under which the Market Surveillance Administrator receives certain information technology and office services. These services are provided for a monthly fee of \$3,860, plus an hourly fee for special projects.

Market Surveillance Administrator

Notes to Financial Statements

December 31, 2017 and 2016

6 Credit facility

The Market Surveillance Administrator has a demand operating facility. Under the terms and conditions of this facility, the Corporation can borrow up to \$300,000 at the prime rate plus 0.75% of interest. No pledges of security are required from the MSA for the facility and no amount was drawn on this facility at year-end.