

Introduction

On July 25, 2019 the AESO received direction from the Alberta Minister of Energy (the “Minister”) to provide advice regarding market power and market power mitigation by Nov. 29, 2019.

In providing its advice to the Minister on this matter, the AESO wishes to ensure that it has considered the perspectives of the Market Surveillance Administrator (MSA), market participants and other interested parties (“stakeholders”). The AESO put out a request for information to seek input from stakeholders regarding market power and market power mitigation in the context of Alberta’s energy-only and ancillary services markets.

The AESO thanks all those who submitted their feedback. Each submission was reviewed in detail and the input received will be considered in developing the AESO’s advice to the Minister regarding market power and market power mitigation.

Summary of Stakeholder Feedback from Market Power Mitigation Comment Matrix

On Oct. 8, 2019 the AESO posted on www.aeso.ca a letter requesting input from stakeholders on market power and market power mitigation by Oct. 29, 2019.

Respondents

A total of 19 submissions were received from stakeholders including:

- 13 power industry
- 4 associations/organizations
- 1 individual
- 1 agency

The AESO summarized the feedback received from stakeholders into the following sections:

1. Effectiveness of historical approach in the energy market
2. Future changes to the energy market
3. Effectiveness of historical approach in markets for operating reserve
4. Future changes to markets for operating reserve
5. Criteria for change
6. Roles of MSA and AESO

1. Effectiveness of historical approach in the energy market

The majority of stakeholders were generally aligned in the view that the historical approach to market power mitigation in the energy market has been effective. Supporters of the historical approach highlighted that the energy-only market to date has:

- produced fair and reasonable prices for generators and consumers,
- fostered effective competition,

- provided reliable power by attracting efficient investment,
- allowed prices to reflect market fundamentals, and
- disciplined the undue exercise of market power.

It was emphasized that these outcomes occurred as the result of a strong framework (including the *Electric Utilities Act* (EUA), fair, efficient, and open competition (FEOC) regulation, the MSA, and the Alberta Utilities Commission (AUC)) that defined an environment where market participants could engage in robust competition and rely on market forces to drive short- and long-term decisions.

While most submissions were supportive of the historical approach, some common criticisms were raised by multiple parties:

- First, there was a concern that the historical success of the energy-only market was driven by the existence of the power purchase arrangements (PPAs). The virtual divestiture of these assets changed the incentives of market participants, and therefore it is difficult to distinguish whether historical outcomes were due primarily to the presence of the PPAs or the market power mitigation framework.
- Second, some parties raised concerns that ex-post enforcement was not applied in a fair and equal manner to all market participants. In particular, it was suggested that government agencies were not subject to the same enforcement standards as other parties, and that downwards price influences were not treated with the same rigor as upwards price manipulation.

2. Future changes to the energy market

While most stakeholders agreed that the historical approach performed well, there was a greater range of opinions regarding the need for an updated approach moving forward. The model of ex-post enforcement was still preferred, with modifications to the historical approach suggested by some stakeholders:

- Re-evaluation of the 30 per cent market share offer control threshold set out in the FEOC regulation. This threshold could be modified directly, or market participants that approach the threshold could be subject to increased mitigation measures (e.g., forward contracting requirements, participant-specific mitigation plans, etc.).
- Clarification and stability regarding the treatment of unilateral economic withholding. The MSA's Offer Behaviour Enforcement Guidelines could be reinstated and subject to a more formal and transparent process or the practice of unilateral economic withholding could be enshrined in legislation such as the FEOC regulation.

Most stakeholders believed that the expected future market conditions were not different enough from historical conditions to warrant a drastically revised approach to market power mitigation. However, some stakeholders had significant concerns that the expected increase in market concentration and expiry of the PPAs would require substantial reforms. As a result, a minority of stakeholders suggested that implementation of an ex-ante mitigation framework would be appropriate.

3. Effectiveness of historical approach in markets for operating reserve

Most stakeholders stated that, similar to the energy market, the historical approach in place for market power mitigation in the operating reserve (OR) market (the combination of legislation, regulation and market rules) has been effective in creating a competitive OR market.

Stakeholders had some different views on the role of participation limits in the market. Some viewed the 80 MW threshold per asset for participation in any one market as an effective form of mitigation that limits market power while others questioned it as an unnecessary restriction on competition.

Stakeholders did not pinpoint any areas of concerns or issues that have emerged relating to market power in OR apart from the early structure of the hydro PPA. The initial format of the hydro PPA interfered with rational price setting in the market and this concern was remedied when the PPA was revised in 2004.

Stakeholders noted that the energy and OR markets are related and that the threat of entry into the OR market was a factor in competitive outcomes, as rents from high prices due to an exercise of market power would attract new entrants.

Stakeholders remarked that the OR market has been effectively competitive and the use of competitive processes to procure operating reserve is sound and should be continued.

4. Future changes to markets for operating reserve

Several stakeholders stated that no changes are needed to the OR market because there have not been concerns with the current approach. The current mechanisms are simple and transparent and are operating efficiently and consultation and implementation of a new design will be costly.

Stakeholders noted that the backstop of ex-post investigation and enforcement is already in place and sufficient to handle any future issues of market power and anti-competitive conduct that could arise. Stakeholders recognized that the expiry of the PPAs, and in particular the hydro PPA, will likely have an impact on the energy and OR markets but competition will continue.

With regard to all of these competitive considerations, several stakeholders saw no need to adopt additional mitigation measures in the OR market.

For those who did see a potential for changes, stakeholders noted that they should be consistent with the market philosophy of ensuring fair, efficient, and open competition, and that any changes should target a specific need. Several specific changes were identified including an auction to provide some portion of reserves through a contractual arrangement, enhancing efficiency by jointly optimizing both energy and OR products, and ensuring the market rules are not limiting entry to the current market. All suggestions suggested the goal was to encourage and support competition.

Clarity and transparency were mentioned as key to the success, so that any changes result in a simple, understandable framework in which participants know with certainty what is and is not permissible.

Other stakeholders remarked that the marketplace needs additional information on the historical performance of the OR markets, including the post-PPA period, and that the AESO should evaluate and report on the efficiency of day-ahead procurement of OR.

5. Criteria for change

Stakeholders commented that Alberta's energy-only market structure is unique, few jurisdictions are directly comparable. Market design alternatives should be evaluated solely on their applicability to Alberta's specific market structure.

In Alberta energy prices must provide appropriate pricing signals to either incent or deter new generation. Prices must be sufficiently high to allow generators to recoup their cost and earn a reasonable rate of return (or risk early retirement). The energy-only market is fundamentally different from the capacity markets found in many jurisdictions limiting the extent to which their approach to mitigation is compatible with Alberta.

Stakeholders identified that Alberta's market is unique even in comparison to other energy-only markets. Alberta is a small market with little in common with other jurisdictions. Demand is met by several large individual players. There is a high load factor. Alberta has a congestion-free transmission policy. Alberta's market is not as highly regulated as in other jurisdictions, but the regulatory environment has not been stable.

Stakeholders provided an extensive list of criteria with which to evaluate potential changes to the mitigation framework, which can be summarized in the following categories:

- **Support competition:** Maintain a competitively driven energy price (allowing for dynamic and static efficiency to be reflected in the price). Competition should be encouraged as it provides the most efficient results. The framework should reflect that Alberta uses an energy-only market and recognize that proper pricing signals are of vital importance to the success of the market. The market should continue to promote dynamic efficiency and provide generators the opportunity to earn a fair return to ensure future investment. The framework should create a market that provides proper incentives to both existing and potential new entrants to the market through clear market signals. The historical approach has delivered on both reliability and competitive price outcomes, and can continue to do so. The focus should be on measures that promote competition, rather than administrative measures that interfere with the market.
- **Maintain stable framework:** Allowing the market to continue operating as intended and avoiding regulatory interference will help restore investor confidence in the Alberta electricity market. Policy certainty should be prioritized in evaluating any changes to the mitigation framework. Very important criteria is maintaining regulatory stability with as little regulatory burden as possible. If there is a valid concern around market power that should be addressed, any solution should fit within the existing market structure.
- **A mitigation framework should be fair, transparent, simple and clear:** There should be low administrative burden and stable rules. There should be clarity and transparency in design, market rules and interpretations of legislative/regulatory mandates by agencies. The framework should be practical, and allow execution without creating excessive administrative burden. Simple designs are preferred. If there is an issue, any changes should be carefully considered, targeted, and specific to the issue.
- **Any mitigation measures that are introduced should be considered and coordinated within the market framework as a whole:** Market power mitigation should be limited to circumstances where it can be demonstrated that interference in the market is warranted, or else risk creating unintended consequences. Mitigation measures that are introduced could cause a number of other market design elements to be redesigned, which would increase complexity and potentially add costs. Changes should be considered against criteria that evaluates broader context and not simply follow a bright-line test. For example the FEOC regulation provides the context of fair, efficient, and open

competition; these have been and continue to be effective criteria for the market. Market rules and any additions to the mitigation framework should not interfere with Alberta's competitive retail market.

6. Roles of MSA and AESO

Stakeholders submitted a wide range of opinions regarding the appropriate roles for both the AESO and the MSA in the market power mitigation framework. These suggestions vary in their specificity and they relate to market power mitigation in differing degrees. Some of the suggested roles are listed below in no particular order:

AESO

- Implementation of government policy
- Ongoing assessment of dynamic efficiency
- Enabling and fostering competition
- Designing rules
- Designing rates
- Designing markets
- Collecting and dispensing information
- Administering databases and information systems
- Informing government and market participants
- Developing technical standards
- Procuring operating reserves
- Supporting public interest
- Reducing regulatory burden
- Operating the electric system
- Administering the energy and ancillary services markets
- Stakeholder consultation
- Supporting policy
- No role

MSA

- Enforcement of the FEOC regulation
- Ex-post monitoring for anticompetitive conduct
- Enforcement of AESO rules
- Investigations into market participant conduct
- Assessment that the market design achieves desirable outcomes
- Reporting on market outcomes

The submissions of many stakeholders could be summarized as having the AESO responsible for market design, policy implementation, and ongoing operation, while the MSA is responsible for ongoing monitoring, enforcement, and investigations. Many stakeholders specifically emphasized that the MSA should not be responsible for market design or the design of rules and guidelines.

A common theme of submissions was increased clarity regarding the roles of agencies, regardless of the roles themselves.