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Market power in the electricity sector prior to the implementation of a capacity market

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Report commented on: Charles River Associates, Offer Behaviour Guidelines prior to the implementation of a capacity market, [Report Prepared for the Market Surveillance Administrator](#), December 18, 2018

On September 27, 2018, Alberta's Market Surveillance Administrator (MSA) provided [notice](#) that it was starting a process to determine if it needed to adopt guidelines for market participants in the electricity sector in Alberta during the period prior to the implementation of a capacity market. It will be recalled that the MSA had a set of Offer Behaviour Enforcement Guidelines ([OBEG](#)) that were in force until withdrawn by the MSA with the announced advent of a capacity market. For an earlier post referring to the development see [here](#) and for discussion of the transition to an energy plus capacity market see [here](#).

To initiate this process the MSA retained Charles River Associates (CRA) to address three questions:

- Could there be a problem with offer behaviour that would need to be addressed during the transition period?
- If so, could the problem identified be addressed in whole, or in part, through MSA guidelines and what form could those guidelines take?
- If guidelines were made and market participants did not follow those guidelines what remedies should the MSA seek from the Alberta Utilities Commission ("Commission") in an enforcement proceeding?

The MSA has now received that report and this post summarizes some of its key findings.

In general, the period from the first quarter of 2015 to the final quarter of 2017 was characterized by historically low pool prices driven by: the collapse in oil prices leading to declining demand; the enhanced availability of new generation; and perhaps also the conservative offer behaviour of the Balancing Pool (BP). The CRA report comments in several places on the role of the BP.

It will be recalled from previous posts (see [here](#) and [here](#)) that as a result of the 'termination' of power purchase arrangements (PPAs), the BP obtained offer control of significant legacy assets. In early 2017 the BP had offer control of more than 20% of Alberta's installed capacity. This has now declined as some PPAs have been fully terminated (see the BP's website [here](#)) but it remains above 15%. It is generally understood that the BP has offered into the pool on a conservative basis (see CRA Report at 10, the BP's offers "were essentially at variable cost")

and has thereby likely depressed prices. The Alberta Utilities Commission (AUC) has an ongoing inquiry into this matter as part of a settlement proceeding under section 44 of the *Alberta Utilities Commission Act*, [SA 2007, c. A-37.2](#) (Proceeding 23828). BP's bidding practices are of significant concern to other generators if BP's offer prices served to set the price of the pool below what it might otherwise settle at if BP were bidding on an ordinary commercial basis. While this report references that behaviour it does not otherwise comment given the AUC's continuing proceedings. Indeed, the CRA Report only seems to be concerned with offer behaviour (such as economic withholding) that may cause prices to settle *above* what would be consistent with competitive outcomes (see for example at 16). Given that focus, a key conclusion of the report is that for so long as the BP has significant offer control through the remaining PPAs, we should not be concerned about higher than competitive prices (this is so unless as part of the settlement agreement with the MSA the BP's bidding strategy becomes more aggressive (at 12, n 36)). However, when the PPAs come to an end in the beginning of 2021 there will be a further change in offer control since offer control reverts at that time to the owners of the generation (at 3 and 11 - 12). Given that the first auction under the anticipated capacity market construct will commence in 2019 with the auction taking place in 2020 and deliveries beginning late 2020, there is a relatively short period (at 3) between the post-PPA-period and the new-normal of the capacity market. This "period may be too short to warrant implementation of guidelines" (at 12).

The CRA Report also suggests that even if there were concerns during this period it would be technically very difficult (at 16 - 17) to establish meaningful guidelines, principally because of the difficulty of establishing appropriate benchmarks when the market is in transition from an energy only market to dual energy and capacity markets. Furthermore, the transition is already imposing huge transaction costs with large regulatory and consultation burdens on market participants. The CRA Report rightly questions whether it is worth imposing additional regulatory development costs for such a short period: "the benefit [of guidelines] would likely be fleeting" and potentially outweighed by the regulatory burden considerations (at 18). In the view of the CRA Report it might be better to invest in the creation of an ad hoc Advisory Opinion Program rather than new guidelines which would need to be revisited with the introduction of the capacity market. And on that point, the MSA released [the advice that it had received](#) on the development of such a program on December 14, 2018.

One concluding note. I have a question for both the AESO and the MSA and it's this: is there no capacity to prepare this sort of report in Alberta? So far as I can see from the many reports prepared at the instance of the MSA, but even more so at the request of the AESO, one group that is clearly a significant major beneficiary of moving to a capacity market is the elite group of economic, regulatory and financial consultants providing this advice. Those retained largely seem to be out of province and even out of the country. I am sure that the legal profession has also done well out of the transition, but so far as I can tell it is principally Alberta-based counsel providing that advice. Does the picture need to be so different in these other areas? And if so, what are we doing to build this competence and this capacity within the province?

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