

## The End of Economic Withholding in Alberta's Electricity Market?

By: Nigel Bankes

**Matter Commented On:** Market Surveillance Administrator, Notice to Participants and Stakeholders Re: [Consultation re Revocation of Offer Behaviour Enforcement Guidelines](#), March 17, 2017

On March 17, 2017 Alberta's Market Surveillance Administrator (MSA) issued a Notice to market participants in Alberta's electricity market triggering a consultation with respect to the possible revocation of an important set of guidelines known as the Offer Behaviour Enforcement Guidelines (the [OBEG Guidelines](#)). These Guidelines provide guidance to market participants as to, *inter alia*, how they offer generation into Alberta's wholesale power market (the power pool) with a view to ensuring a fair, efficient and openly competitive market (the FEOC principle). The OBEG Guidelines do not currently prohibit economic withholding. This Notice indicates that the MSA is reconsidering its position on this in light of a number of developments including the competition jurisprudence of the Alberta Utilities Commission (AUC) and proposals to supplement Alberta's energy-only market with a capacity market. For an earlier post on the capacity market proposals see [here](#).

Some background is in order to understand what this all about. Alberta's power pool is provided for by s.17 of the *Electric Utilities Act*, [SA 2003, c. E-5.1](#) (*EUA*). The purposes of the *EUA* (s.5(b)) include providing for a "a competitive power pool so that an efficient market for electricity based on fair and open competition can develop, where all persons wishing to exchange electric energy through the power pool may do so on non-discriminatory terms and may make financial arrangements to manage financial risk associated with the pool price;" The Alberta Electric System Operator (AESO) is responsible for administering the pool and dispatching generation. The FEOC principle is further elaborated by the Fair, Efficient and Open Competition Regulation, [Alta Reg 159/2009](#) (the FEOC Regulation). The MSA is continued by Part 5 of the *Alberta Utilities Commission Act*, [SA 2007, A-37.2](#) (*AUCA*). The MSA is a sector-specific provincial competition authority. The responsibilities of the MSA include

- (a) to carry out surveillance in respect of
  - (i) the supply, generation, transmission, distribution, trade, exchange, purchase or sale of electricity, electric energy, electricity services or ancillary services or any aspect of those activities, ....
- (b) to investigate matters, on its own initiative or on receiving a complaint or referral ... and to undertake activities to address
  - (i) contraventions of the [Electric Utilities Act](#), the regulations under that Act, the ISO rules, reliability standards, Part 2.1 of the [Gas Utilities Act](#) or the regulations under that Act or of decisions, orders or rules of the Commission,

- (ii) conduct that does not support the fair, efficient and openly competitive operation of the electricity market or the natural gas market, and
- (iii) any other matters that relate to or affect the structure and performance of the electricity market or the natural gas market, including negotiating and entering into settlement agreements and bringing matters before the Commission.

The MSA is entitled to issue guidelines for the information and guidance of market participants under s.39(4) of the *AUCA*.

Alberta's energy market is currently an energy-only market. Generation bids into the market (the pool) in price\quantity pairs (e.g. 40 MW at \$30 MWh) for each hour of generation. The AESO, dispatches units in merit order until generation matches load. The last unit of power dispatched sets the system marginal price (SMP) which is paid to all generation that is dispatched. Section 2(f) of the FEOC Regulation prohibits physical withholding of generation. Absent scheduled shut downs or an unanticipated outage, all generation must offer. The MSA however has previously taken the view in a number of documents, including the OBEG Guidelines, that economic withholding of generation is tolerated and is not inconsistent with the FEOC principle.

The MSA defines economic withholding (see OBEG Guidelines at 9 – 10) as “offering available supply at a sufficiently high price in excess of the supplier's marginal costs and opportunity costs so that it is not called on to run ...”. The most obvious example is a bid of \$999/MWh. The result of economic withholding is that a unit which ordinarily would have been dispatched is not dispatched. This forces the AESO to move up the merit order. As a result the SMP is set higher than it otherwise would have been. As the MSA notes, “Such a strategy is only profitable for a firm that benefits from the higher price in the market”. This means that the party (X) engaging in economic withholding must have sufficient additional generation that is dispatched that its overall portfolio position will benefit more from the increased SMP than X will suffer from revenue losses in relation to the withheld capacity. It bears emphasising that all other generation owned by X's competitors that is dispatched gets a free ride on the uplift that X has caused. See MSA, [\*State of the Market Report 2012, An Assessment of Structure Conduct and Performance of Alberta's wholesale electricity market\*](#), at 43).

The MSA recognizes that economic withholding results in inefficiency in the sense that as a consequence the least cost resources are not being dispatched in order to meet demand. Instead, X exercises market power and causes consumers to pay more than they otherwise would. The MSA justifies its tolerance of economic withholding and the resulting static inefficiency on the grounds that the prospect of being able to earn such rents is essential to stimulate new investment over time *in the context of an energy-only market*. This is consistent with the MSA's idea of “dynamic efficiency” i.e. an assessment of efficiency over time rather than at any given point in time. Such an incentive should not be necessary in a jurisdiction that operates a capacity market since that market should serve (OBEG Guidelines at 9) “to ensure adequate new investment in generation.”

Given that Alberta has now announced that it is moving to introduce a capacity market the MSA is surely correct to state that behaviour such as economic withholding which results in static

efficiency losses “will now not result in dynamic efficiency gains from innovation and investment (MSA letter, emphasis is the MSA’s). The fact that the capacity market will not actually be put into effect for a number of years is not relevant since it is clear that the expectations of potential investors of new generation are already operating on a new set of assumptions. Consequently there is no reason to tolerate the exercise of market power at the expense of consumers since there will be no corresponding benefit.

A second consideration for the MSA in revisiting the OBEG Guidelines draws upon the decision of the Alberta Utilities Commission (AUC) on the allegations brought by the MSA against TransAlta Corporation, Nathan Kaiser and Scott Connelly in 2015, [AUC Decision 3110-D01-2015](#). In that decision the Commission offered interpretive guidance with respect to several important provisions of the Fair, Efficient and Open Competition Regulation, [Alta. Reg. 159/2009](#) particularly with respect to the behaviour of owners of generation encumbered by power purchase arrangements (PPAs). The AUC concluded that the MSA had established that TransAlta was in breach of ss.2(h) and 2(j) of the FEOC Regulation and s.4 of the *EUA* when it timed discretionary outages at PPA-encumbered facilities in order to benefit TransAlta’s overall trading position in the market rather than to safeguard life property or the environment. Paragraph 2(h) provides that it is inconsistent with FEOC to restrict or prevent competition, a competitive response or market entry by another person, and paragraph 2(j) provides that it is similarly inconsistent to manipulate market prices, including any price index, away from a competitive market outcome. The implementation of TransAlta’s “portfolio bidding strategy” breached both provisions.

In light of the above the MSA has invited stakeholders to comment on the following issues by April 7, 2017:

- Provide reasons for agreement or disagreement with the perspectives that are set out above, including but not limited to alternative rationales for the exercise of market power.
- Explain whether sections of the existing OBEG remain relevant.
- Explain whether a stakeholder meeting, following the submission of comments, would be desirable and, if so, what topics market participants wish to focus on and why.

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