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January 11, 2019

Via email

Market Surveillance Administrator
#500, 400 – 5th Avenue SW
Calgary, AB T2P 0L6

Attention: Mr. Gordon Kaiser, Market Surveillance Administrator

Dear Mr. Kaiser,

Re: Market Surveillance Administrator ("MSA") Consultation on Offer Behaviour Guidelines Prior to Implementation of Capacity Market; TransCanada Energy Ltd. ("TCE") Comments

TCE writes in response to the MSA's December 10, 2018 Notice to Participants and Stakeholders in which the MSA requested written feedback from stakeholders regarding a report prepared by Charles River Associates (the "CRA Report"). TCE has reviewed the CRA Report and provides its comments below.

<u>The CRA Report</u>

The CRA Report addresses three questions posed by the MSA:

- 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 CRA Report generally responds to these questions with the recommendation that the MSA not "implement <u>new</u> offer behavior guidelines at this time" [emphasis added].[1] The basis for this recommendation is that: (i) consultation on a <u>new</u> set of guidelines would be difficult; and (ii) CRA's examination of pool prices indicated that the level of competition, including the moderating effect of the Balancing Pool, in the market is sufficient to discipline pool prices. The

[1] Offer Behaviour Guidelines Prior to the Implementation of a Capacity Market, Charles River Associates, December 10, 2018, p. 4/32.

CRA Report also recommends that the MSA "continue to monitor price evolution, using, for example, LRMC as a benchmark".[2]

TCE Comments

TCE agrees that consultation on a new set of guidelines could be challenging and time consuming. However, TCE suggests that the MSA could reintroduce the original Offer Behaviour Enforcement Guidelines ("OBEGs"), which would be less challenging. TCE also agrees that with the current level of supply and competition in the market it is unlikely that pool prices will trend above competitive market outcomes.

However, TCE is concerned by the recommendation that the MSA "continue to monitor price evolution, using, for example, LRMC as a benchmark".[3] While monitoring price outcomes may assist the MSA to identify conduct that does not support a FEOC market, TCE submits that the primary focus should be on the conduct of market participants rather than the price outcomes.

TCE is also concerned by the use of "for example" in the CRA Report's recommendation that the MSA continue to monitor price evolution. It is unclear what this means. If the use of "for example" refers to an alternate benchmark similar to long-run marginal cost ("LRMC") such as the cost of new entry ("CONE"), then TCE would agree with the recommendation provided that there is recognition that competitive prices naturally fluctuate both above and below the benchmark. However, if the use of "for example" suggests that short-run marginal cost ("SRMC") could be an appropriate benchmark, TCE would have significant concerns with the recommendation.

One of the challenges to dynamic efficiency in Alberta's energy-only market is the existence of a time inconsistency problem. Time inconsistency arises when a policy maker has the incentive to renege on a policy it implemented once the desired behaviour or policy outcome has been achieved. The problem is that market participants will not behave in the desired manner unless the policy maker can credibly commit not to renege. Credible commitments from policy makers are required to overcome the time inconsistency problem.

Consider the development of new pharmaceutical medicines. Policy makers have the incentive to establish policies that allow for the recovery of the research and development costs associated with new and better medications. However, once developed, the policy maker then has the incentive to renege on its prior policy in order to provide the new medicine to the population at the lowest possible cost. This is the time inconsistency. The problem arises because the policy unravels when pharmaceutical companies, upon recognizing the risk that they may be unable to recover their research and development costs due to the time inconsistency, decline to develop new medicines. Patent legislation, which credibly commits to provide pharmaceutical companies the opportunity to recover their fixed costs over a specified period of time, is designed to resolve this time inconsistency problem.

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[2] Offer Behaviour Guidelines Prior to the Implementation of a Capacity Market, Charles River Associates, December 10, 2018, p. 5/32.
[3] *Ibid*.

There is a direct analogue to Alberta's energy-only market, which is similarly characterized by a market structure that requires significant upfront investments. Policy makers have the incentive to implement policies that provide the opportunity for generators to recover their fixed costs (i.e., pricing at LRMC), and then to change the policies (i.e., pricing at SRMC) once the investments are sunk.

In Alberta's electricity market, the credible commitment on behalf of policy makers is multi-faceted. Legislation provides a credible commitment to investors, but lacks specificity, as it links acceptable market participant conduct to competitive market outcomes, the interpretation of which is subjective. Generation investments in Alberta have been made on the basis that competitive market outcomes were understood to be based on LRMC or CONE, which would provide investors a reasonable opportunity to recover their fixed costs.

The introduction of the MSA's OBEGs provided guidance that the MSA's interpretation of a competitive market outcome in the context of an energy-only market did not require offers at SRMC and that static efficiency losses were not inconsistent with such an outcome. The OBEGs became an important element in the credible commitment to investors and helped to resolve the time inconsistency problem. The MSA's abrupt removal of its OBEGs on May 26, 2017, has left a gap in the credible commitment and created investor uncertainty, as the MSA's interpretation of a competitive market outcome is now unclear. TCE submits that investor confidence has waned as a result.

If the CRA Report's recommendation is interpreted that SRMC may be an appropriate benchmark, it will have made matters worse. The MSA must be careful not to adopt a benchmark based on SRMC, as doing so would demonstrate a willingness to renege on its prior policy commitment and could have negative implications on its ability to credibly commit in the future. If this were to occur, the time inconsistency problem could become endemic causing serious repercussions to investor confidence and dynamic efficiency during the interim period and beyond.

TCE Recommendation

The MSA has an opportunity to remove investor uncertainty and demonstrate its willingness to credibly commit to its prior policy initiatives. Consistent with this, TCE recommends that the MSA reintroduce the original OBEGs for the duration of the energy-only market. The OBEGs have already undergone significant consultation and TCE believes that support for these guidelines is widespread among market participants. Reintroducing the OBEGs would also help to resolve the time inconsistency problem and restore investor confidence.

In the alternative, TCE strongly encourages the MSA to adopt LRMC or CONE as its benchmark. Similarly, the MSA should expressly reject the notion that SRMC may be an appropriate benchmark. TCE submits that, in the absence of the OBEGs, such action would be necessary to ensure there is no appearance that the MSA has reneged on its prior policy commitment.

TCE appreciates the opportunity to provide feedback on this matter. If you would like to discuss this further, please feel free to contact me at (403) 920-5005 or via e-mail at markj_thompson@transcanada.com.

Yours truly,

Original Signed by

Mark Thompson
Manager, Market Services