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MSA Report

Review of Electricity Procurement for Regulated Rate Tariff Customers in Alberta

14 March, 2006

MARKET SURVEILLANCE ADMINISTRATOR

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1 INTRODUCTION

Under the *Electric Utilities Act* ("Act") and related regulations, each owner of an electric distribution system has a duty to act as a provider of the regulated rate tariff to eligible customers in its service area. The owner may itself be the regulated rate provider, or may authorize another party to act as the regulated rate provider on its behalf

For the larger owners, the regulated rate tariff is subject to the approval of the Alberta Energy and Utilities Board ("Board"). Other owners - municipalities and rural electrification associations ("REAs") - utilize different regulatory approval mechanisms.

Currently, the regulated rate tariff is provided under the terms of the *Regulated Default Supply Regulation* ("RDS Regulation"). However, as of July 1, 2006, the regulated rate tariff will be provided under the terms of the new *Regulated Rate Option Regulation* ("RRO Regulation"). [For convenience, we refer to both the RDS Regulation and the RRO Regulation as "RRO" unless otherwise noted.]

In the summer of 2005, a number of parties raised concerns with the Market Surveillance Administrator ("MSA") about the competitiveness of the RRO procurement process. In particular, parties were concerned about how energy procurement would be undertaken when the new regulation becomes effective in mid-2006. The concerns were brought pursuant to the mandate of the MSA under the Act. Among other things, s. 49 of the Act requires the MSA to assess the conduct of market participants to determine whether the conduct complies with relevant enactments and also whether the conduct is consistent with the *fair, efficient and openly competitive* operation of the market.

Clearly, the Board and the other regulators with responsibility for regulated rate tariff approval are the first line of review around RRO obligations. That said, given its mandate and the concerns raised, the MSA concluded that it would be appropriate to review how regulated rate providers procure energy, both toward increasing our understanding of this complex area and to offer, where useful, any higher level guidance on conduct relevant to the MSA mandate. That is, guidance as to what *fair, efficient and openly competitive* means in the regulated rate tariff procurement context.

Between September 2005 and February 2006, the MSA undertook a review of the various procurement methodologies used by larger regulated rate providers, as well as the procurement practices of certain municipalities and REAs, (collectively, the "Owners"). In that regard, the MSA would like to take this opportunity to express appreciation to those parties and to other stakeholders for their cooperation and assistance in relation to the review.

Now that the MSA has concluded the review, we are publishing the results with the intent of providing useful feedback to all parties currently engaged in the RRO process to develop the regulated rate tariff for the 2006/07 time period and for those parties who may have an interest in the RRO but who are not directly involved.

Given the fundamental change to the procurement process that is contemplated in the new RRO Regulation and the fact that this is the MSA's first review of the topic, we expect to have on-going dialogue with market participants to refine competitive principles proposed later in the report.

We anticipate that this report will help parties to assess for themselves the manner of conduct which will tend to support the *fair, efficient and openly competitive* operation of the market. Market participants are advised that the report is not a formal guideline and is intended only as guidance for market participants to use in developing price setting plans pursuant to the RRO Regulation.

This report includes the following sections: Introduction, Background, Review Findings, Provision of Regulated Rate Services, and Closing Comments.

2 BACKGROUND

2.1 Overview

On August 23, 2005 Alberta Energy ("the DOE") issued a draft discussion document entitled *Regulated Rate Option Regulation*, as a follow-up to the DOE's policy paper – *Alberta's Electricity Policy Framework: Competitive – Reliable – Sustainable*, dated June 6, 2005. The objective of the discussion document was to create a foundation for replacing the current RDS Regulation. Following a review and comment period by stakeholders, the DOE issued a revised draft of the RRO Regulation on October 18, 2005. Additional comment was requested from stakeholders on the revised draft. The DOE issued a final draft of the proposed RRO Regulation on November 25, 2005. The final RRO Regulation was approved by the Minister of Energy on December 20, 2005.

2.2 Objective of Review

The objective of the review is to develop a set of principles that can be used by market participants to meet the requirements of the new RRO Regulation which in part requires the use of a "competitive acquisition process" that will encourage and support the concept of a *fair, efficient and openly competitive* market.

2.3 Methodology

The MSA undertook the following key steps in the completing the review:

1. Review of the legislative and regulatory structure including the Act, the RDS Regulation and various drafts of the RRO Regulation. For this section of the methodology we were primarily concerned with identifying the legislative and regulatory principles that guide the development of the regulated rate tariff and, in particular, how the procurement process will change starting July 1, 2006.
2. Review of the policy framework for the retail market in Alberta. This consisted of a review of recent policy papers by the DOE to ensure an understanding of the future direction of retail policy in the province.
3. Review of previous Board decisions pertaining to the larger regulated rate providers. This part of the methodology involved identifying the general framework for the procurement process used by the various Owners.
4. Review of confidential appendices that form part of the Energy Price Setting Plans for certain regulated rate tariffs approved by the Board, which dealt with certain aspects of the procurement process.
5. Discussions with Owners, Consultation Parties ("CPs")[1], Independent Advisors ("IAs") and other parties to increase our overall understanding of the procurement processes.

The review is not intended as an analysis or critique of the individual procurement plans used by the various Owners.

[1] Consultation Parties are representatives of various consumer groups involved in negotiating Energy Price Setting Plans.

In this regard, the goal of the methodology is to identify common characteristics of the various procurement processes that exist amongst the various Owners and assess them against criteria for a *fair, efficient and openly competitive* market. In the report, we do not attempt to attribute any one characteristic to a particular Owner.

2.4 Legislative and Regulatory Structure

This section outlines the various sections of legislation and regulation which pertain to the procurement of the RRO.

2.4.1 History

The mechanisms currently in use to procure energy for the regulated rate tariff have been under development since 2000. This occurred in conjunction with major changes to the Alberta electricity market that went into effect on January 1, 2001. Owners developed energy supply portfolios based on principles of fair market value.[2] The resulting tariff rates were approved by the EUB based on established regulatory criteria such as “just and reasonable rates of return”, whether supply costs were “prudent” and whether the resulting rates were in the “public interest”. In the case of municipalities and REAs, approval is by city councils and each REA board of directors, respectively.

Owners and CPs who fall within the Board’s purview use the Board’s negotiated settlement process to develop EPSPs, which are then used as a framework for energy procurement, pricing and subsequent development of regulated rates. This process has been very successful and incorporates a number of competitive processes for the procurement of energy supplies.

2.4.2 Electric Utilities Act, 2003

MSA Mandate

There are a variety of provisions within the Act that facilitate the MSA’s involvement in the RRO, particularly as it relates to the procurement process.

The MSA has a broad mandate to undertake surveillance and investigation in respect of the Alberta electricity market. As part of this mandate the MSA is required to assess the conduct of participants.

Section 6 of the Act sets out the expectations of market participants and places a requirement on their conduct:

> *Market participants are to conduct themselves in a manner that supports the fair, efficient and openly competitive operation of the market.*

The *fair, efficient and openly competitive* operation of the market is not precisely defined in the Act, nor do we believe the dynamics of the market lead to a completely comprehensive definition. However, the MSA considers that s. 6 requires a high level of conduct from market participants.

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[2] Simply stated, fair market value is the price at which a willing seller and a willing buyer are prepared to enter into a commercial transaction.

The MSA's mandate to carry out surveillance and investigation on a variety of market activities is defined in s. 49(1) of the Act[3]:

> *The Market Surveillance Administrator has the mandate to carry out surveillance and investigation in respect of 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 (emphasis added).*

Section 49(2) provides a further elaboration of the MSA's mandate in respect of surveillance and investigation, including but not limited to:

> *(a) the conduct of market participants;*
>
> *(f) arrangements, information sharing and decisions relating to market participants exchanging or wishing to exchange electric energy and ancillary services or any aspect of those activities;*
>
> *(h) the relationship between the owner of an electric distribution system and its affiliated retailers or other retailers, or any aspect of the parties in the relationship;*
>
> *(i) the relationship between the owner of an electric distribution system and a regulated rate provider or between the regulated rate provider and an affiliated retailer, or any aspect of the parties in the relationship;*

Based on the provisions of the Act, the MSA is of the view that it has the necessary jurisdiction and mandate to carry out surveillance and investigation of the procurement process for the regulated rate option as it relates to the conduct of market participants and in the *fair, efficient and openly competitive* operation of the market, including arrangements and relationships amongst market participants such as owners of electric distribution systems, affiliated retailers, and other retailers.

The Act also requires the MSA to assess whether conduct complies with the Act and related regulations.

Regulated Rate Tariff

Section 103 of the Act requires that each owner of an electric distribution system must prepare and obtain approval for a regulated rate tariff for the purpose of recovering the prudent costs of providing electricity services to eligible customers.

Eligible customers are defined to include small commercial customers whose annual consumption is under 250 MWh and all residential, farm, and irrigation customers.

Section 103 goes on to state that an owner must apply to the Board for approval of the regulated rate tariff, unless the owner is a municipality or an REA which does not have an affiliated retailer providing retail electricity services outside the service area of the owner.

[3] Electric Utilities Act, Statutes of Alberta, 2003,Chapter E-5.1

In those cases the municipality would apply to its own municipal council for approval of the regulated rate tariff, and the REA would apply to its own board of directors.

Effectively, this means that the Board regulates the RRO for the bigger players. Other owners, municipalities and REAs, are not regulated by the Board and instead are regulated by their respective city council or board of directors.

Regulated Default Supply Regulation

Currently all Owners are subject to the existing RDS Regulation. The RDS Regulation contemplates that the RRO would be based upon 'flow through' pricing after July 1, 2006, but could be based upon other (hedged, fixed rate) pricing until that point. Thus, most existing RRO rates are fixed in price. The RDS Regulation makes no explicit provision about the process or mechanisms for how or when energy supplies are to be procured for the regulated rate tariff.

Regulated Rate Option Regulation

The RRO Regulation contemplates that the RRO will be based upon a mix of 'month ahead' forward pricing and other pricing for other procurement arrangements such as RFPs. Subject to recalibration, the mix goes from 20% month ahead and 80% fixed on July 1, 2006 to a full 100% month ahead at July 1, 2010. The portion of the RRO which is based upon monthly forward pricing is referred to as the 'new RRO rate'. The mix of monthly forward pricing (new RRO rate) and pricing for other procurement arrangements is referred to as the 'transition rate'.

The RRO Regulation requires that the RRO tariff must include price setting plans for both the new RRO rate and other procurement arrangements.

The pricing approach prescribed in the RRO Regulation marks a significant departure from the approach prescribed under the existing RDS Regulation. In particular, the regulated rate provider will be required to incorporate monthly forward pricing into the transition rate in increasing amounts year over year until 2010. The transition to 100% monthly forward pricing heightens the importance of identifying and dealing with any potential process and conduct issues.

Further, and also of particular importance for this discussion, the RRO Regulation stipulates how the price setting plans must operate:

> *4(1) [The price setting plans] must, with a reasonable degree of transparency, use a fair, efficient and openly competitive acquisition process to ensure that the resulting prices for the supply of electric energy are just, reasonable and electricity market based.*

Insofar as Owners and RRO tariffs are regulated by the Board, this provision crystallizes a degree of overlap in jurisdiction and interest between the Board and the MSA. In particular:

- The Board must review and approve each tariff in accordance with the Act and the RRO Regulation – ultimately to ensure that the

RRO rates are just and reasonable and electricity market based; and

- The MSA will be interested to see whether the procurement process used by the Owner meets the standard of conduct set by the Act and by the RRO Regulation – *fair, efficient and openly competitive*.

At a practical level, the oversight and approval of the regulated rate tariffs will continue in the same manner as exists now. The Board will carry out is tariff review and approval obligations in the normal course, as will the other regulatory authorities (e.g., municipal councils and REA boards). The MSA will not be part of those proceedings, except to the extent that our views on *fair, efficient and openly competitive* might provide some guidance to the parties.

Where specific complaints or issues of conduct arise, s. 54 of the Act clearly contemplates that the MSA will refer relevant matters which are outside the MSA's jurisdiction to the Board, and the MSA will be available to work with the Board toward resolution of the issues, if appropriate.

<u>Alberta Energy and Utilities Board – Directive 018 Negotiated Settlement Rules</u>[4]

This Directive renames, updates, and replaces the Board's *Information Letter (IL) 98-04 Revised: Negotiated Settlement Guidelines,* dated February 4, 2003. The Directive provides the framework that Owners and CPs use to develop negotiated settlements ("NP"). The negotiated settlement process provides an alternative mechanism to the traditional hearing process for dealing with utility related issues such as the regulated rate tariff.

Directive 018 does not provides specific guidance to the parties in terms of how energy supplies should be procured. Rather, the parties are provided with a considerable amount of latitude and may develop an Energy Price Setting Plan in the manner most appropriate for the specific circumstances.

The Board's expectations with respect to the negotiated settlement process are based on the following key principles:

- Parties involved in the process will participate in good faith; and
- The negotiated settlement must be
  - open and fair to all interested parties,
  - conducted on a confidential, without –prejudice basis, and
  - sufficiently flexible to accommodate unique circumstances and requirements.

In determining the acceptability of a settlement agreement, the Board will address any deviation from existing law and policies of the Board and will consider, inter alia, whether the agreement:

[4] The MSA understands that Directive 018 Negotiated Settlement Rules are to be revised in the near future.

- Is in the public interest;
- Is reasonable and fair to all parties;
- Is rationally substantiated; and
- Is supported by a complete and adequate application.

If the Board is satisfied that a unanimous settlement meets the above-noted criteria, it will then assess whether the settlement results in rates and terms and conditions that are just and reasonable.

3 REVIEW FINDINGS

Since its creation the MSA has been active in establishing principles against which to the judge the *fair, efficient and openly competitive* operation of the markets under its purview. In 2005 we published two papers discussing these principles in more detail and in the context of a number of issues the MSA has considered.[5] In the view of the MSA the principles that constitute *fair, efficient and openly competitive* are:

- *High fidelity price signal;*
- *Competitive response;*
- *Information rich environment;*
- *Balance between risk and reward;*
- *Level playing field; and*
- *Opportunity to compete.*

The review conducted by the MSA found that the predominant procurement method is the request for proposal ("RFP") model. Using this model, relevant Owners have been able to acquire a significant component of the energy supply requirements on a full load and/or block load basis. To a lesser extent, energy is also procured using exchange models such as NGX and Watt-ex. Both of these methods of procuring energy may be supported by processes that procure energy on a discretionary or intersession basis. The MSA considers that these and other similar types of procurement models are consistent with the *fair, efficient and openly competitive* criteria specified in the Act. Moreover, the MSA considers that the current methods of procuring energy are consistent (subject to comments below) with a "competitive acquisition process" required by the new RRO Regulation and we expect these approaches will continue to be utilized in the future, in particular, for the "other procurement arrangements" component of the transition rate.

From our review we highlight several issues that relate to the competitiveness of the current procurement process. In each case we provide some context as to how these issues relate to the six principles that constitute a *fair, efficient and openly competitive* market. The MSA is of the view that the six principles as discussed in the context below can also be applied to future energy procurement for both the other procurement arrangements and the new RRO rate. In terms of applying the principles, sections 3.1 to 3.5 relate generally to the "other procurement arrangements" contemplated by the RRO Regulation whereas section 3.6 applies mainly to the new RRO rate.

[5] MSA Report; *Undesirable Conduct and Market Power*, July 26, 2005 and MSA Report; *A Common Understanding: Fair, Efficient and Openly Competitive*, November 4, 2005.

3.1 Procurement Process Design

In the past the method used by utilities for procuring RRO supply has been determined via a negotiated settlement between the Owner, CPs and an IA. In general this process has worked well. However, the process may provide some benefit to an Owner's retail affiliate. It is the MSA's view that Owners who are negotiating the terms of an electricity procurement plan should not seek terms and conditions which favour it or its affiliates at the expense of third party suppliers. This is an important part of a establishing a fair and *level playing field*.

In our review we found that market participants were, in general, concerned about an affiliate's access to information that arises from the design of the procurement process, pricing information from an RFP, and in the 'right' to supply volumes not always available to all suppliers (discussed in more detail under supply optionality below). One CP interviewed expressed that he had only "certain confidence" about the effectiveness of corporate policies that were put in place by an Owner to prevent the inappropriate sharing of information with its affiliate.. Another CP suggested that because retail affiliates are afforded the benefit of participating in the negotiated settlement process, they have knowledge of approved processes and calculations that are not disclosed to non-retail affiliates; third party suppliers must therefore trust that the related party does not make use of the information gained solely as a result of affiliation.

It is the MSA's view that a procurement process should feature safeguards which prevent inappropriate sharing of information between an Owner and its retail affiliate gained from participating in the design and/or operation of the procurement process. In addition, to minimize the perception of advantage, the details of the negotiated settlement must be reasonably transparent. (See section 3.4.)

3.2 Review of Offers or Proposals

A competitive process should be one that results in a *high fidelity price signal.* In its review of current procurement methods, the MSA noted the practice of reviewing offers relative to market price indicators before accepting supplier offers in any round of a procurement process. Reviewing offers relative to pre-established market benchmarks may be one way of ensuring a competitive process is not susceptible to gaming and/or lack of liquidity (few offers) during a procurement round. Methods of reviewing offers could include comparison with market fundamentals (for example, changes in implied market heat rates) or require that the number of offers received is sufficiently in excess of the target volume for that procurement round.

While the MSA believes some review of offers is prudent, it should be exercised infrequently or it may in itself damage liquidity. Frequent recourse to rejecting offers in a procurement round should signal consideration of whether the procurement process design is appropriate. At a minimum, the criteria that are used to review and accept or reject offers should be visible to market participants.

3.3 Owner's Supply Optionality

The essence of a competitive market is that there should be an element of uncertainty as to whether or not an offer will be accepted. In choosing to make an offer each competitor independently balances risk (offers may not be accepted) and reward (higher offers have greater reward but are less likely to accepted). A procurement process where there is an inappropriate *balance between risk and reward* is inconsistent with a *fair, efficient and openly competitive* market. One example of where risk and reward may be inappropriately balanced is where Owners retain supply optionality. Where supply optionality is limited to one party it may also be inconsistent with achieving a *level playing field.*

Supply optionality has in the past taken a number of forms including matching rights[6] and rights of first refusal ("ROFR")[7] whereby the Owner is able to purchase from a retail affiliate at a price no more than that offered by third party suppliers or at a price which effectively provides a discount to consumers for the equivalent volume of energy.[8] One argument for Owners to retain supply optionality has been as appropriate compensation for the risks associated with the requirement for an owner to supply a regulated rate option. We note that under the new RRO regulation compensation for the risks faced by Owners is included in the risk margin.

Consequently, it is the view of the MSA that an Owner retaining the ability to purchase from an unregulated affiliate on a preferential basis is not consistent with a *fair, efficient and openly competitive* market. Owners should purchase from an affiliate only if that affiliate has followed the same procurement process and met the same hurdles as all other suppliers. Only if all other competitive supply options have failed or are not available should the Owner have a right to unilaterally offer a deal to their affiliate.

3.4 Transparency

It is the MSA's view that competition and confidence will be enhanced in an *information rich* environment. This requires that information about the electricity procurement process be available to market participants and retail consumers.

The design of the procurement process should address what information is to be provided and how to inform market participants of the various procurement methodologies used by Owners and the conditions under which they apply. For example, descriptive information might include:

- Triggers that indicate an unsuccessful procurement round;

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[6] An example of a matching right is where an affiliate would have the right to match the price and volume of a third party offer. In this case the third party supplier would not be displaced by the affiliate.

[7] An example of a ROFR is where an affiliate has a right to substitute its energy volume at the price and volume offered by a third party supplier. In this case the energy of the third party supplier is displaced by the affiliate.

[8] The MSA acknowledges that matching rights or ROFRs may have appeared in the short term to have benefited consumers. However, in the longer term the imbalance created by supply optionality may have reduced competition by discouraging the participation of third party suppliers.

- Conditions that trigger any rights for an Owner to purchase in a manner that varies from price and/or volume targets that have been established for any given procurement round; and
- Performance indicators that should be published following the completion of a procurement round that may be useful in improving the competitive acquisition process for future procurement rounds. This should include some form of price revelation.

The use of confidentiality provisions should be restricted to protecting the terms and conditions that define the actual commercial arrangements between buyers and sellers. Confidentiality should not be used to restrict the availability of information that may have the benefit of improving the competitive acquisition process. The MSA notes that the Board has also commented on the appropriate extent of confidentiality in relation to certain RRO tariff decisions.

An Owner should take reasonable steps to ensure that market participants and residential customers have a reasonable opportunity to obtain information about how the procurement process operates is available and/or accessible to retail customers.

3.5 Credit

The competitiveness of a procurement process will be enhanced if there are potentially a large number of suppliers available to participate in the process. One particular area that may limit the opportunity to compete relates to issues around credit. The purpose of this section is to encourage market participants to develop and implement new approaches to help facilitate market liquidity. It is not the intent of the MSA to dictate how a market participant should make business decisions pertaining to credit.

During the normal course of business, Owners assess creditworthiness and establish credit limits for third party suppliers. While this is a necessary and proper feature of the market, credit limits have been seen to result in a reduction of market liquidity. An Owner may be able to reduce the impact of credit limits through the design of the acquisition process. Possibilities include:

- The use of an exchange to procure RRO supply, such as NGX or Watt-ex;
- A process for ‘netting’ or ‘rights of offset’; or
- A “clearinghouse” concept that could be used to cross counter party credit obligations.

During the MSA’s review at least one party expressed concern that the credit approval process is largely conducted “behind curtains”. Where possible the MSA encourages Owners to make the process of determining creditworthiness and credit limits as transparent as possible.

The possibilities mentioned above in addition to minimizing the impact of credit issues and enhancing liquidity may have other benefits in enhancing information and transparency for potential participants.

3.6 Determination of the New RRO Rate

The RRO regulation indicates that for the period July 1, 2006 to June 30, 2007 a minimum of 20% of the calendar month volumes must reflect the new RRO rate. In subsequent years the minimum requirement is set to increase by an additional 20% until it reaches 100%. According to s. 11 of the regulation, in each calendar month the new RRO rate must be based on load forecasts and monthly forward market prices established in the price setting period (from the 45th day preceding the month and ending on the 5th business day preceding the month).

A number of approaches are being suggested for determining the price associated with the minimum 20% requirement. The MSA is aware of one particular approach that determines price using an index of standard products based on a trading platform that is facilitated by a 'market-maker' and using the risk margin to allow for differences between standard products and load shape. If the forward market price is competitively determined in a manner that is transparent to the market, the actual method used to procure energy supplies may be less of a concern to the MSA.

The MSA is of the opinion that a competitively determined index would ensure that price determination, to the greatest extent possible, meets the principles of a *fair, efficient and openly competitive* market. The MSA expects that market participants maybe able to develop other forward pricing methodologies that will also meet the aforementioned criteria.

In order to assist participants we provide the following commentary relating to the principles underlying a *fair, efficient and openly competitive* market in relation to determination of the new RRO rate.

High fidelity price signal: The method of price determination should result in a good representation of the expected price for the calendar month in question. The MSA is concerned that approaches should be auditable, provide protection for consumers against possible price manipulation and reflective of price expectations throughout the price setting period (rather than subject to market views on a single day). Where procurement and pricing are not closely related, the MSA believes that prices included in the index must meet a test of 'transactability' (e.g. there was a reasonable opportunity for a transaction, a transaction took place or a narrow bid-ask spread was placed on a trading platform). From the perspective of building market confidence and fostering liquidity, Owners should be seen to be actively supporting forward pricing methodologies.

Competitive response: The MSA encourages an approach where price is revealed to the market during the price setting period in order to facilitate a competitive response. Where price is determined only by a few transactions or are transactions that are not visible, the MSA is concerned that competitive pricing will not emerge.

Information rich environment: The MSA's view is that to the greatest extent possible the method determining the new RRO rate should be made available both to other participants and customers. The MSA considers it acceptable that some parts of the price setting plan remain confidential where there are grounds for believing release of this information may harm a *fair, efficient and openly competitive* outcome. The determination of pricing in a given price setting period should also be available to consumers.

Balance between risk and reward: According to the RRO regulation, recovery for all risk faced by the RRO provider is allowed for through the 'risk margin'. Under the new regulation, the risk margin may be negotiated by the Owners and CPs and approved as part of the price setting plan. The balance between risk and reward also takes into consideration the degree to which Owners and other market participants support pricing methodologies such as a possible index. For example, entering into transactions on an exchange using a price index is a stronger level of support than merely using the price index as a point of reference. In any case, the MSA considers that market participants must consider the efficiency of the price mechanism, that is, the benefit/cost and practicality associated with a particular methodology. With respect to the procurement of energy, the MSA is of the view that matching rights and ROFRs distort the balance between risk and reward in a way that favours an Owner and is not consistent with a *fair, efficient and openly competitive* market.

Opportunity to compete: The MSA believes an appropriate test is that participants have adequate opportunity to participate in an RFP or to supply volume at the prices used to determine an index. Approaches that result in unreasonable credit limits excluding some participation may be unlikely to reveal a competitive price.

Level playing field: In addition to the concerns raised in other areas the MSA will consider whether the method of determining price and the method each RRO provider selects for procurement do not have adverse implications for ensuring a level playing field. For example, the MSA may wish to examine the implications for a level playing field where large RRO providers choose to rely upon a price index in their price setting plans but persistently choose not to transact on that index (instead relying upon other sources such as OTC transactions or their own generation assets to self-supply). Moreover, the MSA is of the view that energy procurement methods which allow an affiliate to supply while not having to offer all the same terms and conditions or while not following the exact same process as all other potential suppliers are not consistent with a level playing field unless those opportunities are also offered to those other potential suppliers.

Notwithstanding the above the MSA supports approaches to determine the new RRO rate that are practical, not administratively expensive or burdensome and likely to support both the minimum 20% requirement for the year from July 1 2006 and increased requirements in later years.

For small REAs one practical option may be to competitively procure over a long period and use as the basis for its new RRO rate the pricing determined by one of the larger RRO providers.[9]

[9] Where pricing is based on standard products fitted to the RRO providers load shape it is expected that differences in load shape between RRO providers may mean that using the same methodology may result in different, although consistent rates.

4 PROVISION OF REGULATED RATE SERVICES

4.1 Utilities, Rural Electrification Associations and Municipalities

The new RRO Regulation will impact the larger utilities, municipalities and REAs in different ways. This is primarily due to the size of the different organizations and their ability to benefit from economies of scale, expertise and available resources. Given the difference in how the new RRO regulation may impact the various entities, the MSA wishes to articulate its views on the requirements that are placed on utilities, municipalities and REAs. We address these views in answer to a number questions received from participants.

How should the larger utilities ensure that their procurement process is competitive?

The MSA considers that the larger utilities have the necessary scale and experience to develop competitive acquisition processes that will be consistent with the principles of a *fair, efficient, and openly competitive* market. Subject to points discussed in the review, current approaches to acquisition should serve as a suitable template for developing future process.

For a small REA frequent competitive procurement rounds may not be practical / possible when the total requirements are very small. How should Owners ensure their procurement process is competitive?

The MSA is of the view that in the cases of smaller REAs it may not be efficient, that is, practical or cost effective, to conduct a competitive procurement process for very small volumes. In this case, total energy requirements might be procured using a competitive process over a longer period (i.e. less frequently). Monthly prices charged to retail customers will need to reflect market prices in accordance with the RRO Regulation. Given the fact that REAs act as 'non-profit' entities, this would require any difference between the costs of procuring energy and monthly rates to be distributed to or recovered from the REAs members.

Can an REA or municipality purchase the required volumes from a sole source supplier?

The MSA's view is that this should be acceptable if the REA or municipality meets the requirements of the RRO Regulation by conducting a competitive process to select a supplier and the supplier uses a monthly forward pricing mechanism for the new RRO rate component of the transition rate. In some cases, REAs and municipalities may already have established business relationships with suppliers who effectively act as agents or supply managers. The MSA encourages REAs and municipalities to continue with these historical relationships, if appropriate. The MSA notes that in this case, it is the responsibility of the municipal council or REA board to ensure that the sole supplier procures energy in a manner that is consistent with the RRO Regulation.

5 CLOSING COMMENTS

In summary, the mandate of the MSA is to ensure that the conduct of market participants is consistent with the *fair, efficient and openly competitive* operation of the market. The MSA further believes that the transition to the new RRO Regulation provides an opportunity to further enhance competition in the Alberta electricity market. With the utilization of the procurement principles described in this report, it is expected that this may help to increase the number of market participants in the competitive process. In this regard, Albertans would benefit by being assured that their electricity was provided within the parameters of an openly competitive market.