Candela Comment
Revised Import Proposal
Quick Hits Package
November 30, 2005

The revised proposal is a clever solution to the problems associated with the original bilateral dec-down proposal. Now that importers will not be required to contract for dec-down service with an eligible intra-Alberta generator, issues associated with credit and cost are diminished.

While we are supportive of the revised proposal within the parameters of the Quick Hits package, we continue to be sceptical that the package as a whole will achieve the goals outlined in the policy paper. Pool price fidelity, as defined by the AESO/DOE, will only ever come about when generators comply with their offers and an efficient way is found to mitigate the impact of zero-priced import offers. We submit that compliance remains a significant issue, in spite of increased vigilance by the MSA. We also submit that allowing importers to set price under the proposed framework could increase pool price fidelity, but probably will not. Any potential positive impact realized from these quick hits will rely heavily on the rules through which they are implemented. The major threads of the quick hits are at a high level and cannot be properly dissected without their associated rule framework. Recognizing that this is a process, Candela is eager to see the draft rules that will underpin the proposed changes. In the meantime, we would like to register the following specific concerns.

1. Revised Import proposal

    a. The revised proposal is an improvement, but details of implementation and associated rules will be at least as important in determining its efficacy as the high level discussions.
    b. There still appears to be little incentive for importers to offer a non-zero price. Importers may test the new system and offer non-zero prices for a time, but as soon as one of the higher-volume players misses out on a stellar hour, there will be competition to ensure dispatch, resulting in offer prices that may approach $0.
    c. Smaller volume importers will see even less incentive to offer price, as the only scenario in which they are better off in the new system, is if they hold price at their offer (assuming their offer is Mid-C landed price plus some premium). A smaller volume has little chance of holding SMP. They might as well offer in as a price taker and hope for a spike, as that is essentially what they will be doing anyway.
    d. It is unlikely that participants will rely on the AESO to dictate the value of their import. Unless the AESO forecasting improves dramatically, participants will always assume their forecast is better than the AESO's. Even if the AESO forecast improves, it still may be the case that participants don't believe it will construct an accurate enough merit order to risk offering higher.

2. T-2 for Imports and Treating Imports like Intra-Alberta Generators

The more we contemplate this proposal, the less sense it makes. We recognize that it is DOE policy as enshrined in the policy paper, but it is antithetical to the usability of the tie line. Like wind and other intermittent resources, imports cannot and should not be cast into the same pot as thermal or conventional hydro generation.

a. Currently, imports from Mid-C through BC exist in a T-1 hour to T-20 minute world. While it is understood that other markets within WECC adhere to different timelines, the current T-1 timeline works for imports into Alberta. In realistic terms, due to the timing involved in entering offers into the ETS, trading decisions will now have to be made close to 2.5 hours prior to the beginning of the settlement period. Considering all that can happen within a 2-hour timeframe in the Alberta market, importing will be even more of a shot in the dark than it is now. The only beneficiaries of such a proposal will be those with large volumes of transmission and access to low-cost power.
b. Importers have a fundamentally different cost structure when compared to Intra-Alberta generators. Intra-Alberta generators produce MW from various fuels types and are keenly aware of the variable cost associated with those fuels. They offer their power to the pool accordingly and should only be unsatisfied if pool price remains stubbornly below their breakeven point. However, if pool price does remain below their breakeven point, they are able to scale back their production as far as their Minimum Stable mark, or go completely offline if they so desire. If and when pool price returns to an economic level, generators can participate again. Importers have no such luxury. Once the deal is made with a Mid-C counterparty, there is no scaling back, ramping down, or removing oneself from the market completely. For that hour, importers are in the market for better, or worse. If importers choose not to enter an offer at T-2, they cannot participate in any upside in the market. Generators simply ramp up to the next offer block if so dispatched. While the argument can be made that the investment in plant and equipment is a far greater risk overall for a generator, on an hour-by-hour basis, the importer faces a loss of real money, as compared to the opportunity loss borne by an intra-Alberta generator.
c. The issue of zero-priced imports causing inter-hour volatility is valid. What isn't valid is the assumption that it is a timing issue. It is a volume issue. When a participant chooses to import 400 Mw one hour, then 50 MW the next hour, the impact on pool price will be significant. We think the DOE would agree that more consistent import volumes in a T-1 world would result in the desired reduction in volatility envisioned in the T-2 world.

We appreciate that all of these rules are being proposed in an effort to repopulate the merit order with a variety of economic offers, thus resolving the current perceived disconnect between demand and price. However, our perception is that there will be insufficient incentive for import participants to consistently offer non-zero prices. Each participant has different reasons and costs associated with bringing power into Alberta. Along with the vastly different means for procuring power and transmission among the participants, the end result has to be offers that are so close to $0 as to be virtually identical in impact on pool price as they are now. There are two incentives under the proposed rules to encourage offering non-zero prices. Neither of them is inspiring. First, a participant has the possibility to set price, rather than add to the pile of zero offers and become a price taker. Assuming the offer price exceeds landed Mid-C price, this could be beneficial. However, unless the volume of the block is significant, the chances of setting price for a full hour are slim. Second, an offer that is not considered in merit and is not dispatched could save the importer some money if the hour settles below his offer price. Assuming a conservative forecast, the settled price may consistently exceed the importers un-dispatched offer price, encouraging him to offer lower in order to get dispatched.

If our assessment is incorrect and the high-volume importers choose to offer economically viable, non-zero prices on a consistent basis, the market may be on the way to reducing inter-hour volatility. Ultimately, however, the push to have importers offer non-zero prices and repopulate the merit order may require more incentive than is offered under the current proposals.