



22 July 2009

Mr. Kris Aksomitis
Market Services
Alberta Electric System Operator
2500, 333 4th Ave SW
Calgary, AB T5K 2B6

RE: IPPSA Response to Alberta Wholesale Market Price Cap Discussion Paper

Dear Mr. Aksomitis;

The Independent Power Producers Society of Alberta (IPPSA) provides its comments on the Alberta Electric System Operator's (AESO) Wholesale Market Price Cap Discussion Paper. At the outset, we appreciate the iterative approach employed by the AESO in developing this paper, which was undertaken through a host of discussions with a subcommittee of the Market Advisory Committee. This approach contributed greatly to the substance of the paper and to the understanding of the issues among the parties involved. We would encourage a similar approach in the development of future AESO discussion papers.

Our response begins with our comments on the content of the paper by key section, and then addresses the chief question posed, which is whether the level of the price cap creates a barrier to the operation of the Alberta electricity market. We conclude by urging the AESO to proceed with the next steps of the analysis, which is to examine new options for the price cap in Alberta's market.

1.0 IPPSA's Comments on the Content of the Paper

1.1 "FEOC Market and the Price Signal"

IPPSA finds a number of the opinions put forth by the AESO in this section to differ from our expectations of the AESO's role and mandate.

To the point, we do not support the AESO's view that "*a FEOC market as articulated by Alberta's policy and legislation does not require that price is set at a completely unfettered level in all circumstances.*"¹ Quite the contrary, legislation and policy are silent on the price cap. In fact, we see the policies quoted in the report to be entirely consistent with an unconstrained price cap. The policies quoted include: "*The market framework must be guided and founded on fair and sustainable market and competitive forces*" and "*the market framework must provide market signals to build new supply in a timely manner to meet growing demand while recognizing the lead-time required in (sic) building new generation*", and that "*the market framework must continue to preclude the exercise of market power and unwarranted transfer of wealth.*"² We see nothing in policy or in legislation that precludes a higher price cap, or that even suggests that there should be a cap. The last quote implies a market framework for protecting against abuse. We take this 'framework' to include a surveillance agency, an adjudicator and a legislative and regulatory rules regime. This framework exists apart from the AESO's mandate, which is to operate a successful spot market that acts as the principal means to achieve electricity reliability in Alberta.

¹ "Alberta Wholesale Market Price Cap Discussion Paper," AESO, June 23, 2009, pg 4

² "Alberta's Electricity Policy Framework: Competitive – Reliable – Sustainable", Department of Energy, June 6, 2005, pg 8

In addition, we disagree with AESO's report where it states, "*small changes in the number of scarcity hours are unpredictable, largely based on the timing of forced outages. If these basically random hours have too much influence, the market signals are neither predictable nor understandable.*" And, "*for the market to be sustainable, transient instances of scarcity that will occur from time to time should not artificially impact annual price levels.*" These views do not reflect how pricing works in a market of relatively inelastic supply and demand. When we consider the global crude oil market as an example, a host of 'transient instances' impact pricing, such as hurricanes in the gulf coast or war in the Middle East. Crude oil prices can be impacted by a host of unpredictable events, even for the most liquid commodity on the planet and, moreover, one that can be stored. Rational governments, including Alberta's, recognize that price signals set by 'transient instances' are part and parcel of energy commodity markets. We urge the AESO to fully recognize this market dynamic.

Furthermore, we disagree with the AESO when it states, "*Sustainability requires both sufficient generation and reasonable prices reflecting market economics. If prices rise too quickly in response to relatively limited instances of scarcity, the market structure will come under public pressure.*" IPPSA sees nowhere in legislation where a concern over the rapidity of price excursions, or the responsibility for public pressure to such excursions, is in the AESO's mandate. Quite the opposite, the AESO has a mandate to operate a FEOC market. It should not at all be concerned with price outcomes emanating from the legitimate intersection of supply and demand in that market. No matter how high the price. To a rational observer, a forced outage of one or a number of coal plants in Alberta, for example, represents a justifiable loss of supply and from there can come a legitimate scarcity price. Should a price be perceived as 'illegitimate', this is the mandate of the province's surveillance and adjudication functions to resolve.

Let our expectations be clear. The AESO is to meet its mandate for reliability by facilitating a FEOC market, where supply and demand intersects to set price, and where consumers determine their own level of reliability. The AESO should not be concerned with price outcomes derived from forced outages. Instead, the AESO should be concerned with price outcomes if the price cap acts to impede the investment signal and the demand response signal and therefore impedes reliability.

1.2 "Frequency of Price Cap Events and Out of Market Actions"

We believe the use of OPP 801, particularly those steps beyond #5 of the OPP, represent out-of-market actions. These steps preclude the market from clearing to where supply and demand should intersect. This barrier represents a perversity in our market. While the use of OPP 801 steps has not been significant in the past, we are concerned about the potential reliance on this tool and other tools, such as outage coordination and long lead time dispatches, should the cap remain where it is and the cost of new generation rises.

1.3 "Generation Investment in Alberta"

We do not believe that the AESO's historic analysis of generation cost is the most appropriate way to assess the functioning of the price cap going forward. Instead, the AESO should have compared market prices to where future generation costs are going. To this end, we have enclosed in the appendix to this letter a comparison of climate change compliant generation costs prepared for IPPSA by Hatch Energy.

We note the AESO has made one attempt to assess the cost of a carbon compliant source, that being coal with sequestration. However, the AESO's assessment does not appear to reflect the 20-40%³ parasitic load required in sequestration. As such, this technology's projected returns would be dramatically lower, and arguably unfeasible under the historic review of market prices.

³ "Technology Challenges for Alberta's Power Industry", Alberta Research Council presentation, May 11, 2009

In addition, the paper suggests that the issue of insufficient recovery of returns for a base load unit may not be the lack of high on-peak prices, but rather the preponderance of low off-peak prices. We submit that this issue may be easier to resolve with a change to the price cap, thereby potentially lifting on-peak prices, rather than limiting the volume of Alberta's must run energy in the off-peak period.

Finally, the paper does not address the impact of the price cap on Alberta's forward market.

2.0 The Price Cap and the Barrier to the Operation of the Market

In addressing the key question, of whether the price cap creates a barrier to the operation of the market, we begin by the self-evident notion that any price cap creates a perversity in any open market. By definition, price caps interfere in the functioning of a market and in the unfettered intersection of supply and demand. The question then becomes 'is this impact acceptable now and into the future?'

In terms of the present, we concur with the AESO that the use of OPP 801 tools, or other tools such as outage coordination, long-term adequacy tools or long-lead time energy, has not be excessive to date. However, we are concerned with the use of these tools in the future should price signals be insufficient to incent future supply or prove insufficient to incent additional volumes of price-responsive load. It is this future view where we think the AESO's analysis is lacking.

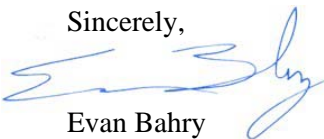
The AESO needs to look forward; that is to the market it is responsible for overseeing for the next ten to twenty years. It is a market where the Power Purchase Arrangements will expire. It is also a market that will be shaped by the Provincial Energy Strategy, which intends on lowering emissions and introducing new metering technology for commercial and residential customers. It is the analysis of future generation costs and future demand side technologies such as micro-generation and automatic load control that should be considered when evaluating the merits of the current price cap.

We can assume that generators, consumers and service/technology providers need to see a higher price signal than they are seeing today in order to make the investments they need to meet reliability and to achieve the Energy Strategy's goals. We urge the AESO to recast its work towards where the market and the province need to be twenty years from now.

With this input in mind, IPPSA encourages the AESO to proceed with the next steps of its analysis, which is to examine new price cap options for Alberta's market. These could include simply tying the price cap to the Consumer Price Index, or examining the ERCOT or Australia models, or examining the models suggested by FERC in docket #RM07-19-000/AD07-7-000, such as unconstrained loads bids with the price being set by the bids.

Thank you for considering our input.

Sincerely,



Evan Bahry
Executive Director

Relative Costs
 (levelized costs, excluding taxes, transmission, escalation and therefore not comparable to pool prices or customer rates)

	Fossil Fuel Without Capture (\$/MWh)	Fossil Fuel With Capture & Other Options (\$/MWh)
Pulverized Coal	60	100 to 140
Nat. Gas CC	90	90 to 120
Nat. Gas Cogen	80	80 to 110
Wind		80 to 90
Large Hydro		70 to 120
Nuclear		100 to 140