THE POWER OF POSSIBILITY

May 25, 2005

Dear Market Participants:

Re: LOSS FACTOR RULES ISSUES

Pursuant to Part 5 of the ***Transmission Regulation*** the AESO is required to make rules with respect to loss factors. The AESO began, in May 2004, consulting with stakeholder about the proposed treatment of loss factors for 2006 and beyond to be addressed in new ISO Rules. Since autumn 2004, AESO has hosted approximately 10 stakeholder sessions plus two industry-wide forums for the new loss factor process. In February 2005, the AESO issued a Loss Factors discussion paper and initiated the formal ISO Rules development, consultation and approval process.

Through this process the AESO received considerable feedback and comments from stakeholders. Issues identified by stakeholders were discussed in an effort to achieve consensus. There are some issues where consensus could not be reached ("Issues"). The AESO outlines these outstanding issues below.

The AESO's Executive Rules Committee ("ERC") is delegated by the AESO Board with considering and approving ISO Rules. On May 16, the ERC reviewed and considered proposed new Loss Factor Rules, including an assessment of the Issues. The result was the approval by the ERC of new Loss Factor Rules in the form attached, effective May 25, 2005.

The ERC has asked this issue document be shared with stakeholders in an effort to enhance their understanding of the considerations used to address these issues and approve the loss factor rules. The Issues described are not inclusive, but rather reflect major decisions where consensus was not immediately obtained. The Issues included are described, along with a brief discussion outlining the AESO rational for addressing these Issues in the manner it has.

1. **Methodology Selection**

   Issue:
   The AESO has included in the new Loss Factor Rules the Corrected R-Matrix 50% Area Load Adjustment Methodology as the approved methodology ("Approved Methodology"). Some stakeholders objected to the muting of the locational signals with the use of average losses produced by this methodology.

   Discussion:
   Stakeholders requested AESO to review and assess an Incremental Loss Factor Methodology and a Flow Tracking Loss Factor Methodology in addition to the 18 methodologies it initially assessed. All methodologies were ranked in an evaluation matrix with five measurements. The result is that the Approved Methodology is the most suitable method based on the criteria. Many stakeholders agree with the assessment and as a result AESO selected the Approved Methodology.

2. Inter-tie Loss Factors

Issue:
Inter-tie loss factors have long been an issue for many stakeholders who believe that losses are being over-charged for export transactions.

Discussion:
The Approved Methodology uses incremental calculations on the inter-ties only, to comply with the requirements of s 22 (2) of the Transmission Regulation. The AESO has proposed an analytical methodology to calculate a single weighted average loss factor which can be used as an annual loss factor. The AESO provided analytical analysis demonstrating that losses for export transactions are not being over-charged through the use of this loss factor. The AESO also analyzed a couple of bilateral transactions for exports to demonstrate the same result. Most stakeholders have accepted the analysis.

3. Transition of the Implementation of the New Loss Factor Methodology

Issue:
Three stakeholders requested a phase in period to the new Loss Factor Rules as they will be paying more than with the existing loss factor process.

Discussion:
The AESO met with stakeholders to consider if there was a basis for an acceptable and reasonable phase in period. What is clear is that this is not the case. As with many new rules, market participants will be negatively or positively impacted, while some may be neutral. The majority of stakeholders did not support a phase in proposal. The ERC noted that there is limited support and significant stakeholder objection to the consideration of the use of a transition period.

4. Transmission Regulation Issues

Some stakeholders raised issues regarding the interpretation of certain sections in the Transmission Regulation and the implementation of the new loss factor methodology. These issues have been discussed with the Department of Energy. The issues are:

Issue A Loss Charges/Credits for Imports and Exports

Issue:
Some stakeholders have indicated that s. 22(2) of the Transmission Regulation does not permit the AESO to provide a credit to "a person receiving transmission service under an interruptible service arrangement for load, import or export…" The argument is based on a principle of statutory interpretation that says if credits were permitted, the Transmission Regulation would have specified so, particularly since specific reference was made to "charges or credits in s 22 (1).

Discussion:
Although other sections of the Transmission Regulation refer to “charges and credits”, s. 22(2) only refer to “charges”. While the wording is not as precise as one would hope, a

reading of the whole of Part 5 does permit an interpretation consistent with permitting payment for “charges”. This is also consistent with the AESO’s technical assessment, which is that imports and DOS loads may in fact provide a net benefit to reduce losses. Therefore providing a credit where this is the case, seems fair and reasonable.

Stakeholders agree that importers or exporters should receive a credit where a transaction reduces system losses. The AESO in its rule will provide a credit to importers and DOS loads where these services reduce system losses.

Issue B Compression of Opportunity Transmission Services

Issue:
The AESO has proposed the use of compression for opportunity load, import and export transactions. Some loads stakeholders have expressed opposition to the use of compression on opportunity exports citing s 22 (2) of the Transmission Regulation.

Discussion:
The AESO currently defines import and export as opportunity services. Both the current ISO Tariff and the proposed ISO 2006 General Terms and Conditions for import and export services, indicate the service is recallable with one hour notice. The AESO does not link definitions for opportunity service to others defined by WECC, NWPP or FERC (i.e. FERC pro forma tariff). The long standing Alberta practice has been to consider imports and exports as firm for the hour with respect to provision of operating reserves. Under these circumstances it would be unfair to provide importers a larger credit than Alberta generators. The AESO considers that loss factors for firm imports, opportunity service imports and DOS loads should be compressed as per s. 19(2) (f) of the Transmission Regulation to create a level playing field between importers and intra-provincial generators. This will also simplify the administration and reduce the overhead associated with loss calculations and is therefore a practical and appropriate approach.

Losses for opportunity imports and exports are charged based on schedules and not on dispatch. Charges for losses will be billed based on inter-tie schedules, even though offsetting schedules could zero out flows on the inter-ties. The Approved Methodology may produce loss factors for exports to Saskatchewan that require compression. However, the other opportunity import and export loss factors calculated for 2006 do not require compression.

Therefore, the AESO believes that load customers will be essentially neutral to losses resulting from opportunity transactions over the inter-ties and is implementing compression requirements for all opportunity services.

Issue C: Inclusion of Transmission Must Run in loss factor calculations

Issue:

Some stakeholders have requested that the new loss factors be calculated excluding TMR. They consider that the inclusion of TMR in loss calculations results in the inappropriate muting of locational signals.

Discussion:

Section 19(2) (c) of the Transmission Regulation states that "...loss factors must be determined ... as if no abnormal operating condition exists…" The term "abnormal operating conditions" is defined in the Transmission Regulation. The AESO considers provision of TMR to be part of "normal system operation" and therefore will include it in the loss factor calculation.

Issue D: Compression Technique

Issue:

S.19 (2) (f) of the Regulation states that "...every loss factor must be multiplied by a common number in order to limit the loss factors..." This provision has proven to be a major challenge to implement.

Discussion:

The AESO has developed a compression methodology that adjusts loss factors to within the specified envelope using a simple technique. The proposed compression methodology involves clipping of loss factors that are outside of the loss factor envelope, applying a shift factor and then applying linear compression to all other loss factors. This methodology is not exactly as prescribed by the Regulation (i.e. all loss factors be multiplied by a "common number") as that approach has proven to be impractical to implement. The new methodology developed is generally supported by the stakeholders and provides a transparent method which produces results that are reasonably representative of generator losses.

The AESO will develop rules in accordance with this methodology. This will result in the AESO not being in compliance with the letter of s. 19(2) (f). The AESO has suggested that an amendment be made to the Regulation to provide that all loss factors will be "adjusted by a common method".

Please contact Rob Baker (**rob.baker@aeso.ca**) at 403 539 2614 if you have any questions or comments.

Original Signed By

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