

December 8, 2003

**VIA E-MAIL AND COURIER**

Alberta Energy and Utilities Board  
5<sup>th</sup> Floor, 640 – 5<sup>th</sup> Avenue S.W.  
Calgary, Alberta  
T5P 3G4

**Attention: Bob Heggie**  
**Executive Manager**  
**Utilities Branch**

Dear Mr. Heggie:

**Re: Extension of the Pool Price Flow Through Regulated Rate Tariff under the Regulated Default Supply Amendment Regulation (No. 2)**

On November 4, 2003, the government issued the Regulated Default Supply Amendment Regulation (RDSAR) which requires all owners to now assume the procurement risk of acquisition and provide only a transition rate after January 1, 2004.

On November 26, 2003, the government issued the Regulated Default Supply Amendment Regulation (No. 2) (RDSAR(2)) which allows the Board to extend the date for the implementation of a transition rate to not later than July 1, 2004. During the extension period, an owner may continue to provide a pool price flow rate.

The Board is currently considering Direct Energy Regulated Services' (DERS') Application for approval of a Gas Default Rate Tariff and Electricity Regulated Rate Tariff ("RRT"). The DERS RRT Application was designed based on a pool price flow through electric energy charge being provided to all eligible customers. This design is consistent with the RRT energy supply model presently employed by ATCO Electric and is also consistent with the Regulated Default Supply Regulation that came into force in June 2003.

As a result of the RDSAR, DERS will be required to develop a new energy supply pricing methodology reflecting a transition rate. This new methodology will replace the DERS RRT pool price flow through energy pricing methodology that is presently before the Board. Board approval of this new RRT energy pricing methodology will be required. DERS has had an opportunity to assess some of the implications of the RDSAR, and more particularly the requirement that an owner must assume the

procurement risk of acquisition associated with providing a transition rate to all eligible customers from January 1, 2004 to June 30, 2006. After careful consideration of the implications of these new requirements, DERS has concluded that there is no reasonable prospect of DERS being able to develop, obtain approval of, and procure the fixed price energy contemplated in the RDSAR prior to July 1, 2004. This conclusion is based on consideration of a number of factors, including:

**1) DERS Must Establish Contracts and Credit Arrangements with Electricity Supply Counterparties**

The pool price flow through energy price setting methodology does not require DERS to acquire energy or enter into financial hedge transactions with any commercial market participants as all the energy acquired by DERS under the pool price flow through model would be purchased from the AESO. While Direct Energy Marketing Limited does have a limited number of existing agreements in place with Alberta electricity supply counterparties, these agreements were entered into to support the requirements of its unregulated retail business. Transactions that could be completed under these agreements are simply not large enough to support the RRT volume requirements of all eligible customers in the ATCO Electric service territory. Further, Direct Energy Marketing Limited has simply not yet contracted with a sufficient number of counterparties to allow DERS to prudently manage the financial risk associated with the electric energy supply requirements of the full RRT portfolio.

**2) DERS Does Not Have Customer Information or an Understanding of the Load Characteristics of Eligible Customers in the ATCO Electric Service Territory**

The pool price flow through energy price setting methodology does not involve the RRT provider assuming volume risk or price risk. As a result, a thorough understanding of the load characteristics of eligible customers is not required. In contrast, the RDSAR requires the RRT provider to manage the procurement risk of acquisition associated with the electric energy supply. DERS understands this language could be interpreted to limit the usage of deferral accounts. This view is consistent with the contents of a letter to ENMAX dated November 18, 2003 in which the Board indicated that “a deferral account that transfers the procurement risk of acquisition to customers may not comply with the RDS Amendment”. Therefore, to prudently manage a fixed price RRT that imposes procurement risk on DERS, DERS must receive the consumption history of eligible customers. It must then develop models to review and analyze this data in order to understand and prudently manage the financial risks related to the procurement of fixed priced energy contemplated by the RDSAR.

DERS acknowledges that both the EUB and the MSA have approved the release of customer information from ATCO Gas and ATCO Electric to DERS subject to certain conditions and restrictions concerning confidentiality. As of this date the data has not yet been transferred to DERS. It must be noted that the original purpose of

DERS receiving this data was for system and data integrity testing. The acquisition of fixed price electricity as mandated by the RDSAR will require thorough and accurate forecasts that are sufficiently robust to satisfy customers, the Board, and DERS. Customer data must be thoroughly analyzed and understood in order to prepare forecasts with the required level of confidence. DERS is committed to such analysis and understanding, and to the preparation of comprehensive and accurate forecasts. This will, however, take considerable time and effort. The pool price flow through extension requested by DERS will provide the time frame in which to develop an understanding of the characteristics of the customer load requirements and to prepare correspondingly comprehensive forecasts.

**3) DERS Has Not Acquired the Appropriate Level of Internal Resources to Manage These New Requirements**

The pool price flow through energy price setting methodology is considerably less complex to manage than the transition rate. Although Direct Energy Marketing Limited possesses the skills and expertise necessary to manage a large hedged portfolio, these human resources are deployed and committed elsewhere within the organization such that additional resources in the areas of Forecasting, Trading, Supply Acquisition, Settlement, Credit, Risk Management, and Legal will be required to be added to the DERS team in Calgary. These individuals will have to be recruited and hired in advance of DERS proceeding to provide a transition rate as contemplated in the RDSAR.

Given the added complexity of providing a transition rate relative to a pool price flow through energy rate, certain enhancements and modifications to DERS risk and forecasting systems and processes are required for DERS to prudently manage these new requirements.

These incremental human resources and systems requirements will result in DERS incurring new non-energy costs not contemplated in the RRT Application presently being considered by the Board. DERS will require an adjustment to its RRT Non-Energy Revenue Requirement such that a negotiated settlement with consumers or another Board application will be necessary.

**4) DERS Requires Time to Consult with Consumers and/or Bring Forward an Updated RRT Energy Price Application to the Board**

It is clearly the preference of DERS to engage representatives of consumer groups in the process of developing an appropriate RRT Energy Price Setting Plan. This requires DERS to achieve an understanding of the existing plans utilized by EPCOR Energy Services Inc., EPCOR Energy Services Alberta Inc., and ENMAX Power Corporation. DERS must also consider other possible rate design options. Once an appropriate design is developed, it will then be incumbent upon DERS to seek agreement of consumer representatives. Failing this DERS will have to proceed with a contested application to the Board on its new DERS RRT Energy Price

Setting Plan, presumably through a written process. In either scenario, and given this will be the first time the DERS has engaged in either process, it is anticipated that this stage alone could not be completed in less than 2 - 3 months.

**5) DERS Will Require a Reasonable Window of Time to Undertake the Actual Procurement of Energy in Order to Avoid Unnecessarily High RRT Energy Pricing in the ATCO Electric Service Territory**

Given the limited liquidity in the Alberta electricity market and the large volume of energy required to supply the RRT in the ATCO Electric service territory, it is unlikely that DERS would implement a methodology to acquire the necessary energy supply to support the transition rate by way of a transparent RFP process. With an RFP process, market participants would have full knowledge of the date that DERS is in the market to acquire supply. This could have the impact of increasing the prices that constitute the forward curve to the detriment of RRT customers. DERS envisions it will employ a less transparent approach that contemplates the acquisition of its supply portfolio over the course of a minimum of 1-2 months. This process can only commence after the necessary approvals are in place. Further, DERS is concerned that winter gas price volatility typically flows through to the power market during the winter gas months of December, January, February, and March and therefore these are not optimal pricing months to be acquiring longer term hedges. This concern is consistent with the submission of EESAI to the Board in August 2003 in which it requested the Board expedite its approval process to permit EESAI to capitalize on existing favorable forward market pricing for the benefit of RRT customers.

DERS wishes to avoid a circumstance where its RRT energy rate is considerably higher than the fixed RRT prices charged by ENMAX Power Corporation, EPCOR Energy Services Inc. and EPCOR Energy Services (Alberta) Inc. DERS observes that when EPCOR Energy Services (Alberta) Inc. procured hedges on behalf of RRO customers in the Aquila service territory in late 2000 and early 2001 in a very compressed time frame under less than ideal conditions the resulting price levels proved to be less than satisfactory to consumers. DERS sincerely wishes to avoid the possibility of a similar outcome.

We trust these factors provide an appreciation of the implications of the RDSAR on the current DERS RRT Application and the business planning to date based solely on a pool price flow through model that has been undertaken by DERS since January 2003. These implications are clearly different for DERS than they are for ENMAX Power Corporation, EPCOR Energy Services Inc. and EPCOR Energy Service (Alberta) Inc.

With respect to the appropriate time period for DERS to develop the required transition rate design, we note from our examination of Decision 2003-074 rendered by the Board on October 7, 2003 that the EESAI 2004 and 2005 Regulated Rate Tariff Negotiated Settlement process commenced in January 2003 and was concluded on October 7, 2003 with the Board approval of the Negotiated Settlement. This process took in

excess of nine months notwithstanding the Negotiated Settlement was heavily based on previous negotiated settlements that the parties had entered into since 2001.

In view of the above, DERS requests that the Board grant an extension of the date for the implementation of a transition rate in the ATCO Electric service territory, as contemplated in the RDSAR(2), to July 1, 2004. This period is essential and necessary for DERS to implement a reasonable and prudent RRT transition rate in an orderly manner. During the extension period, DERS would provide the applied-for pool price flow through rate.

As illustrated throughout this letter, even a 6 month extension of the pool price flow through will provide only the minimum essential time required for the conversion to a transition rate, therefore the Board's earliest attention in this matter is appreciated. Should the Board grant the requested extension, DERS will immediately file for approval to enter into negotiated settlement discussions with interested parties. DERS anticipates that settlement discussions would be able to start in earnest in late January 2004 with a view to filing a settlement application or a contested application with the Board near the end of the first quarter of 2004. Following Board approval of that application, DERS would then be in a position to execute an approved fixed price acquisition strategy for implementation July 1, 2004.

Should you require additional information I can be reached at 403-290-7745.

Yours truly,



Gary Newcombe  
Director, Regulatory Affairs, Western Region  
Direct Energy Marketing Limited  
*Direct Energy Regulated Services  
is a business unit of Direct Energy Marketing Limited*

cc: Registered Interveners – DERS RRT Application