

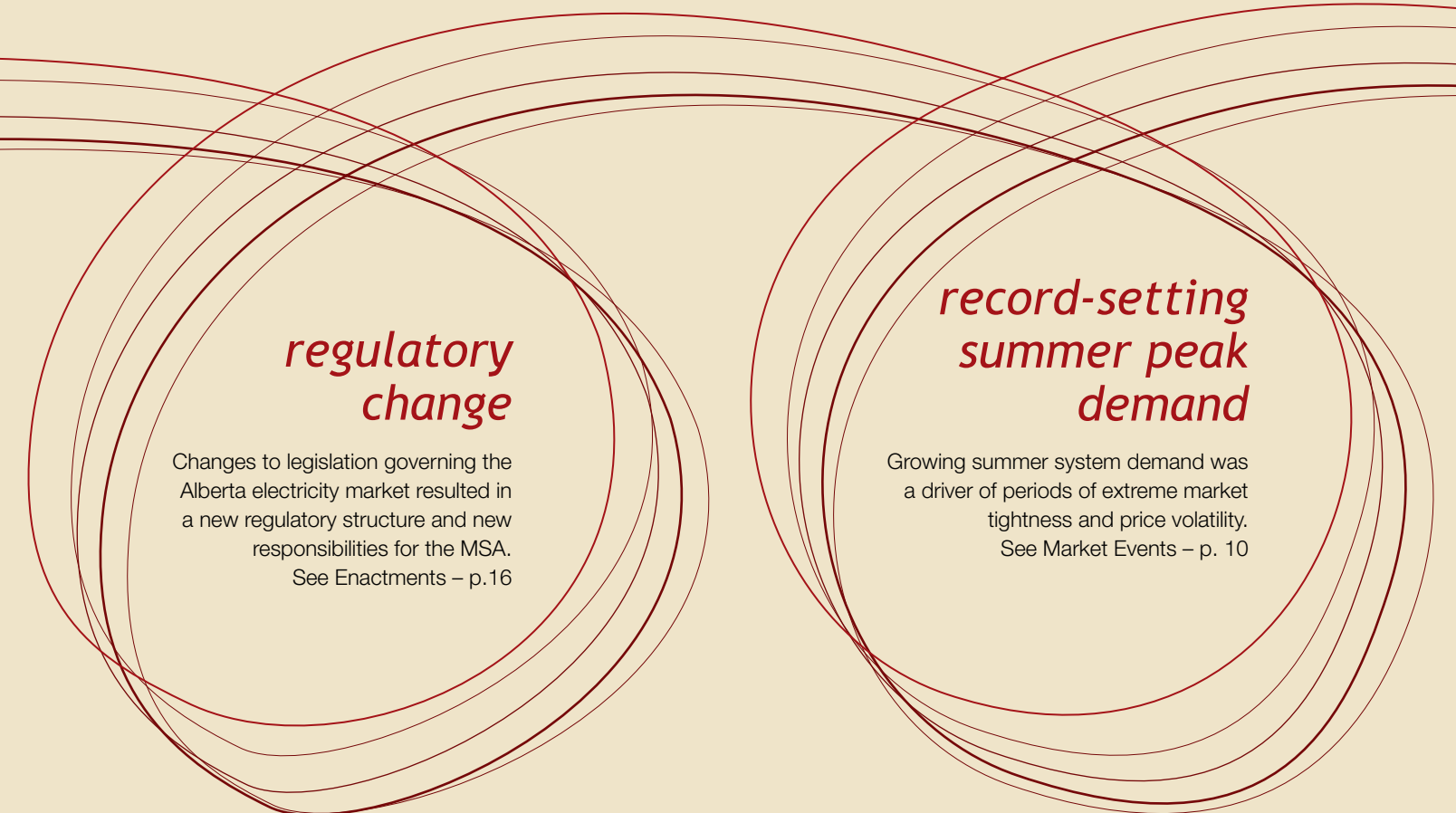
Power of *Adaptability*

Alberta's Electricity Market.



MARKET SURVEILLANCE
ADMINISTRATOR

2007 Annual Report



regulatory change

Changes to legislation governing the Alberta electricity market resulted in a new regulatory structure and new responsibilities for the MSA.
See Enactments – p.16

record-setting summer peak demand

Growing summer system demand was a driver of periods of extreme market tightness and price volatility.
See Market Events – p. 10

Alberta's Market Surveillance Administrator (MSA) is in place to conduct monitoring and surveillance of Alberta's electricity market. The MSA keeps a close watch on the overall performance of Alberta's electricity market – checking that it operates fairly and in an openly competitive manner.



integration of wind power

The integration of a growing proportion of wind generation presents a number of operational and market challenges.
See Wind Generation – p. 13

a year of adapting to change

Alberta's electricity market adapted to wide-ranging change in 2007 while continuing to produce fair, efficient, and openly competitive outcomes.

PRESIDENT'S MESSAGE

The year saw the MSA in court twice – both times seeking and obtaining clarity about its powers to investigate.



MARTIN MERRITT
President and Chief Executive Officer

The year was filled with technological, regulatory, legal, political, market rule, investment and operational events, not one of which turned out to be bigger than the market itself, though every one of them shaped it.

There is a wonderful milestone in the evolution of a market where it becomes larger than any single element or issue that makes it up. If there were any doubts about Alberta's electricity market having crossed this bridge then 2007 should have put them to rest. The year was filled with technological, regulatory, legal, political, market rule, investment and operational events, not one of which turned out to be bigger than the market itself though every one of them shaped it. The year has been about adaptation – consumers and participants adapting to the signals of the market and the market adapting to changes in societal expectations reflected by legislative and regulatory amendments. The surveillance function too has had to adapt to changes in both the legislative environment and in participant strategies.

In the first half of 2007 the Department of Energy led an extensive process of stakeholder consultation focused on the conduct standard set out in Section 6 of the *Electric Utilities Act*. Changes to key pieces of legislation and regulation, including passage of the new *Alberta Utilities Commission Act*, were made late in the year. In the same period the Alberta Electric System Operator (AESO) proposed and implemented a comprehensive package of new rules known as "Quick Hits".

The year saw the MSA in court twice – both times seeking and obtaining clarity about its powers to investigate. There clearly must be a balance between the interests of parties under investigation and those of the market at large.

The two judgements that resulted from this issue supported both the MSA's authority and the reasonable approach that we have taken in exercising it.

This balance must be struck in a way that does not deprive Albertans of their right to an effective surveillance and investigation function. In both decisions the court has been very supportive of the mandate and approach of the MSA.

The great triumph of 2007 has been the market's ability to continue to produce fair, efficient and openly competitive

outcomes through such a dynamic period. While the average Pool price for the year was \$66.95/MWh, down 17% from 2006, the number, size and technology choice of generating capacity additions announced in 2007 suggest that

investors remain confident in Alberta's electricity market.

The growing participation and trade volumes, particularly by financial institutions, in the forward markets have also been very encouraging.

The great triumph of 2007 has been the market's ability to continue to produce fair, efficient, and openly competitive outcomes through such a dynamic period.

LEGISLATION AND REGULATORY CHANGES

The Alberta Utilities Commission Act became law on January 1, 2008. The Act clarifies the roles and mandates of our industry's implementing agencies, including the MSA, in a way that is responsive to the input of market participants and other stakeholders.

The MSA will have to adapt to a broader investigation and prosecution role, on behalf of both the AESO and the Alberta Utilities Commission (AUC). The MSA also takes on some responsibilities regarding the retail natural gas market. The AUC is now the hearing body for matters brought by the MSA, replacing the tribunal established under previous legislation. New legislation and recent case law also provide clarification regarding the ability of the MSA to obtain information and regarding the publishing of records by the MSA.

One thing that seems certain is that the level of interaction between the MSA and other bodies will grow. Under the new legislation the MSA and the AESO will collaborate on investigation and, if required, prosecution of AESO rule breaches. In addition to previous responsibilities for prosecution of behaviour contrary to the Act or Regulations, the MSA will appear before the AUC on matters relating to negotiated settlements, breaches of rules or standards that fall outside the approved penalty matrix, and for consideration of reference questions.

THE MEANING OF 'FAIR, EFFICIENT AND OPEN COMPETITION'

Market participants must abide by legislation, regulation, and market rules set out by the AESO. The overriding requirement of participants is that their conduct must support 'fair, efficient

In addition to previous responsibilities...the MSA will appear before the AUC on matters relating to negotiated settlements, breaches of rules or standards that fall outside the approved penalty matrix, and for consideration of reference questions.

and open competition'. This subject has been the topic of numerous MSA notices, reports and guidelines since the agency's formation in 2003. From January through June 2007, the Section 6 Committee including representatives of industry, consumers, government, and implementing agencies (the AESO, MSA and Balancing Pool) held several workshops. The Committee's final report to Energy Minister Mel Knight was issued mid-year 2007. The government responded with a white paper released early in 2008 that adopts large parts of the Committee's recommendations

and sets out a path all stakeholders hope will lead to a clearer understanding of the "fair, efficient and openly competitive" standard set out in the legislation.

INVESTIGATIONS AND MSA POWERS

The Act establishing the MSA gives the agency the power to obtain records and investigate matters relevant to its mandate. Without such powers the MSA would be unable to provide effective surveillance of the market or identify potential breaches of the legislation or rules. In 2007 we saw an increase in market participants seeking to test the limit of these powers by denying the MSA access to certain information or avenues of investigation. While the MSA believes that the wording of the Act (old and new) is clear, we accept that some market participants may

take an opposing view. During 2007, I directed the MSA staff to take an issue to court to secure cooperation from a market participant in the form of responding to questions posed during an investigation. The two judgements that resulted from this issue supported both the MSA's authority and the reasonable approach that we have taken in

exercising it. We now expect that participants that find themselves under investigation will adapt to this important case law. Should the MSA find itself similarly frustrated in the future we will not hesitate to seek further assistance from the courts.

THE POWER OF THE MARKET

A robust market design and a level playing field breed market confidence, a necessary precondition for investment. In 2007 we saw a series of investment announcements and the removal of the



900 MW cap on wind generation. Better still, we observed market-driven investment decisions – in response to those same market signals that were the theme of last year’s annual report. I am encouraged to see diversity in

new proposals and no shortage of innovation in new technologies – whether coal gasification, clean coal, nuclear or renewables. Recent regulatory changes have also paved the way for micro-generation (small scale distributed power generation projects) to participate in the market.

CHALLENGES AHEAD

The quest for certainty seems inexorable. While considerable effort was spent on better defining “fair, efficient and openly competitive” in 2007, I have no sense that the market’s desire for certainty has been satisfied. Further guidance in the form of regulation or MSA promulgated guidelines, with appropriate consultation and/or further litigation before either the court or the AUC seems likely in 2008.

One great challenge remains for our deregulated market and ironically it relates to a part of the system that is and always has been regulated – how best to build transmission. The insufficiency of this regulated infrastructure in some parts of Alberta taxes the competitiveness of the market and results in higher power prices. In many hours of the year, transmission constraints force more expensive generation to run while cheaper resources lay idle. Further, in some areas generation projects face considerable delays in being able to connect to the system. Experience in other jurisdictions clearly demonstrates that a congested system multiplies the opportunities for market power abuse and yields overall weaker competitive outcomes. Although vigilance on the part of the MSA can discourage market power exercise,

Although vigilance on the part of the MSA can discourage market power exercise, it can never replace the benefits created by unconstrained competition on the broadest possible scale.

it can never replace the benefits created by unconstrained competition on the broadest possible scale. Continued delays in reinforcing the province’s transmission system threaten the benefits of a competitive market. Putting this into context, annually the wholesale energy market sees about \$5 billion in energy transactions, whereas the annual cost for transmission wires is less than 10% of that total. Albertans will not be well served by allowing the tail to wag the dog.

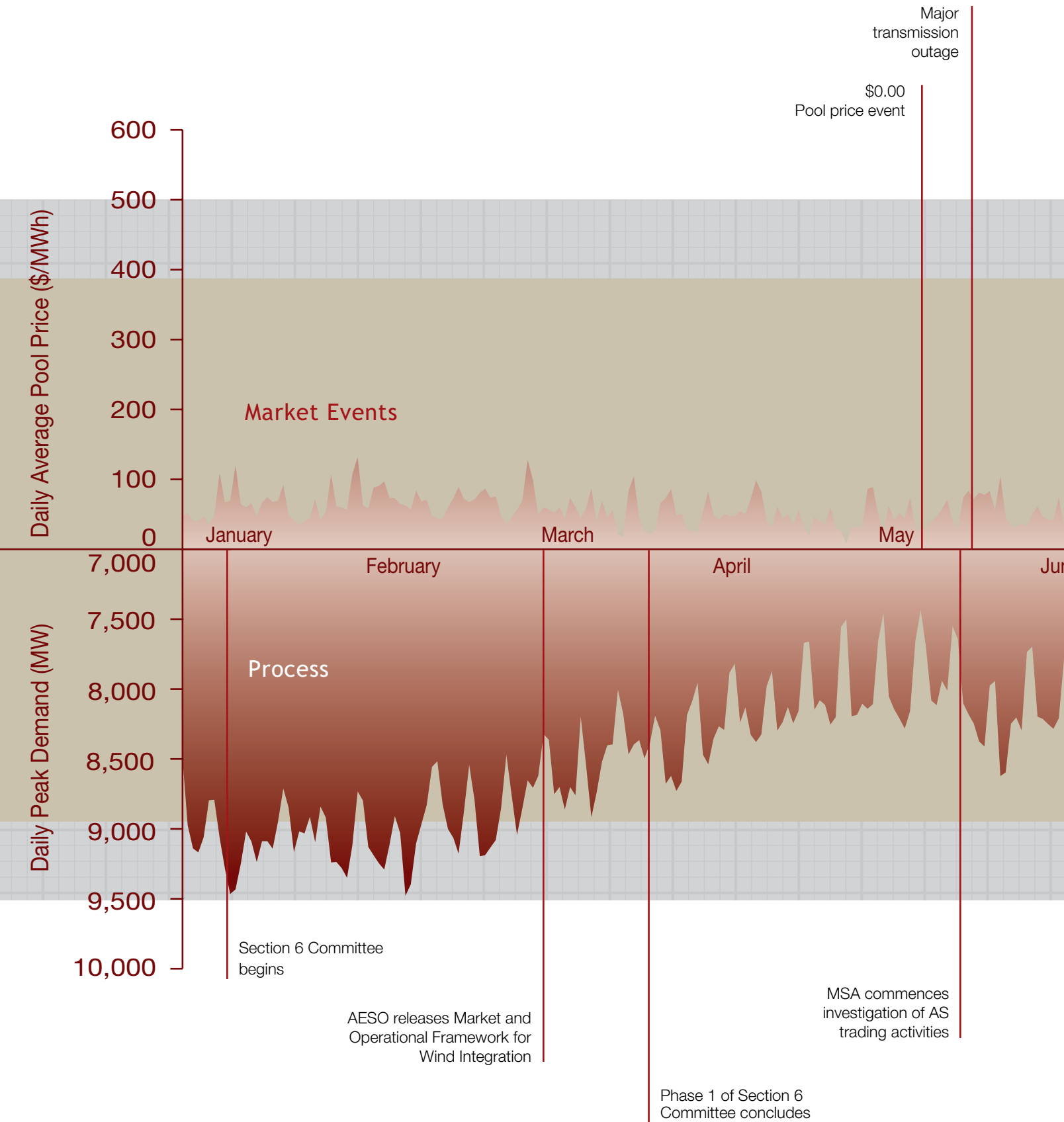
Wind development is already having an impact on market outcomes and may also be changing incentives for new investment and existing participant behaviour. Increasing levels of wind generation on the system result in increased frequency of sudden changes in supply levels. So far the market has been able to adapt physically and commercially to increasing supply volatility. Though with substantial wind generation still in the pipeline, this issue will continue to attract the analytical attention of both investors and the MSA.

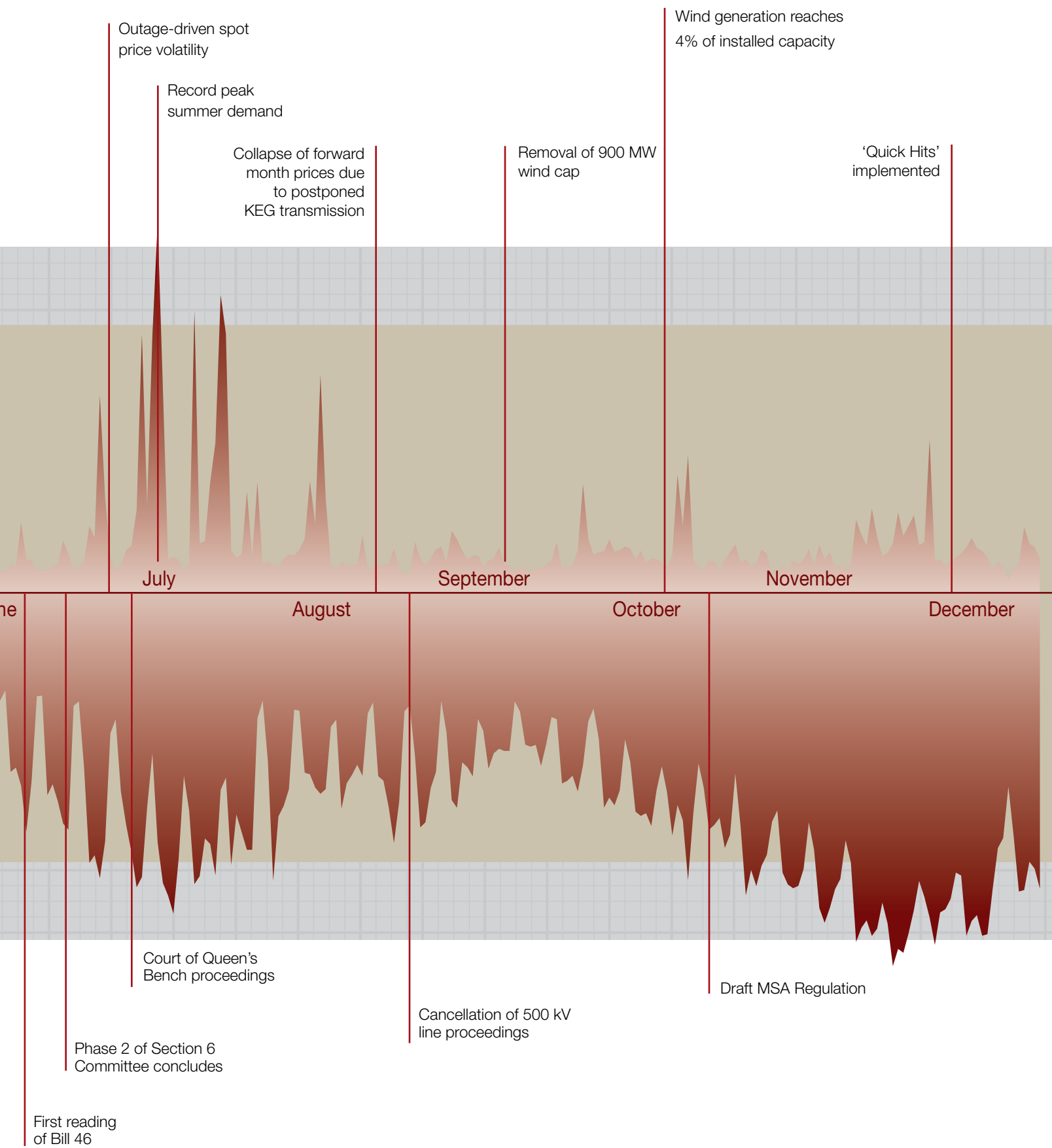
Two-thousand-eight is shaping up to be a very interesting year.

[Signed "Martin Merritt"]

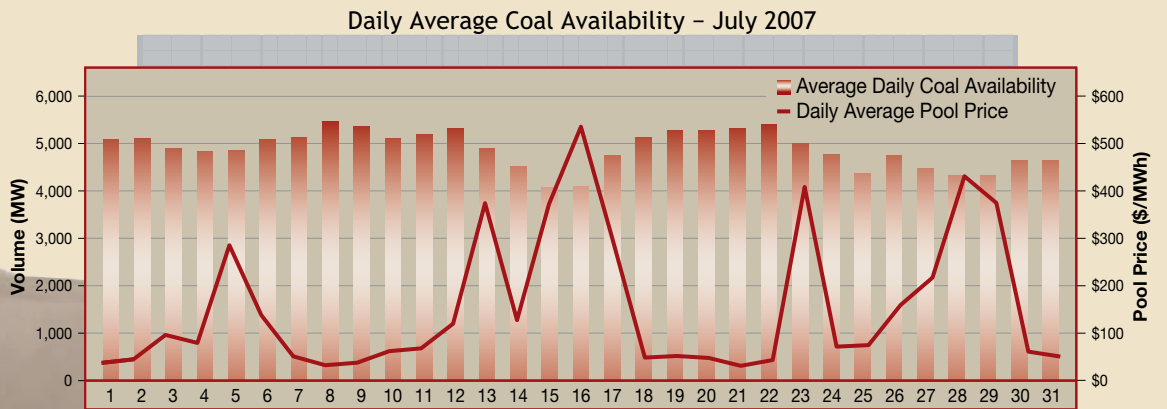
Martin Merritt
Market Surveillance Administrator
February 29, 2008

2007: A YEAR OF TRANSITION AND STABLE GROWTH





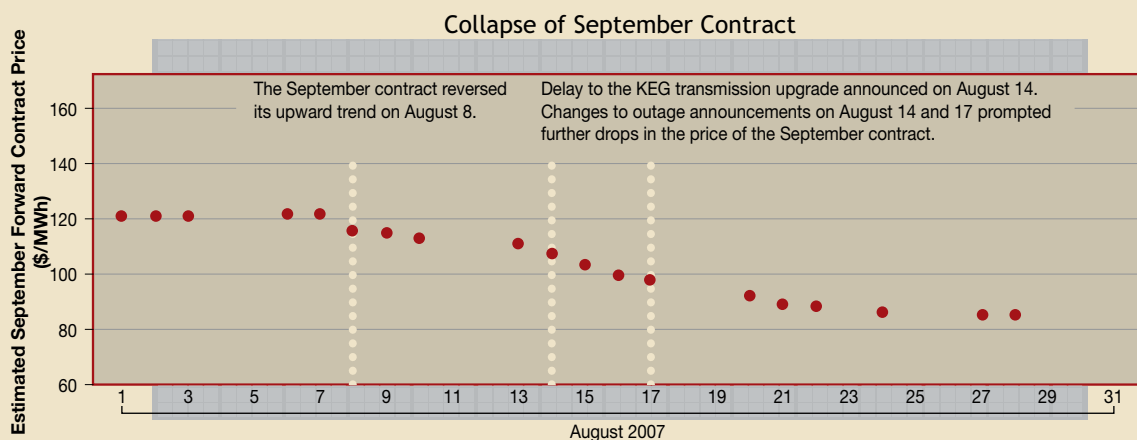
2007 Market Events



In 2007 the Alberta wholesale electricity pool price averaged \$66.95/MWh. This was down 17% from an average pool price of \$80.79/MWh in 2006 and 5% from an average pool price of \$70.36/MWh in 2005. Average monthly prices trended similarly to 2006 for the first eight months of the year after which 2007 prices from September through November were significantly softer than in 2006. For purposes of comparison, natural gas prices at AECO-C declined from an average in 2006 of \$6.17/GJ to \$6.10/GJ in 2007 (a fall of about 1%). Understanding the other drivers of pool price requires us to dig a little deeper.

Both July 2006 and 2007 saw instances of extreme market tightness and price volatility. Both years saw record-setting summer peak demand, combined with susceptibility of thermal generators to derates and forced outages under high ambient temperatures. The July 2006 monthly average pool price was

is higher still in the cold of winter, at that time most units are fully available having finished their annual maintenance activities in the milder weather. In addition, cold air improves the ability of thermal generators to operate to their rated capacity while in warmer temperatures they are subject to derates.



Left.

Coal outages and derates in July led to market tightness and periods of extreme price volatility.

Right.

The impact of delayed transmission work saw forward prices for September collapse.

\$128.23/MWh which was exceeded in July 2007 when the average monthly pool price reached \$155.73/MWh. Summer 2007 was not a story of all high prices. Despite continued low availability of coal, the lower temperatures and system demand in August (on average 287 MW lower than July), resulted in much more modest prices (\$70.92 / MWh).

In general, high summer prices are becoming a notable feature of the Alberta market. Market expectations, as evidenced by the forward price curve, suggest that summer 2008 will also see high prices. These expectations are underpinned by the upward trend in summer system peak demand growth, compounded by the advancing age of the existing coal fleet⁽¹⁾. Although demand

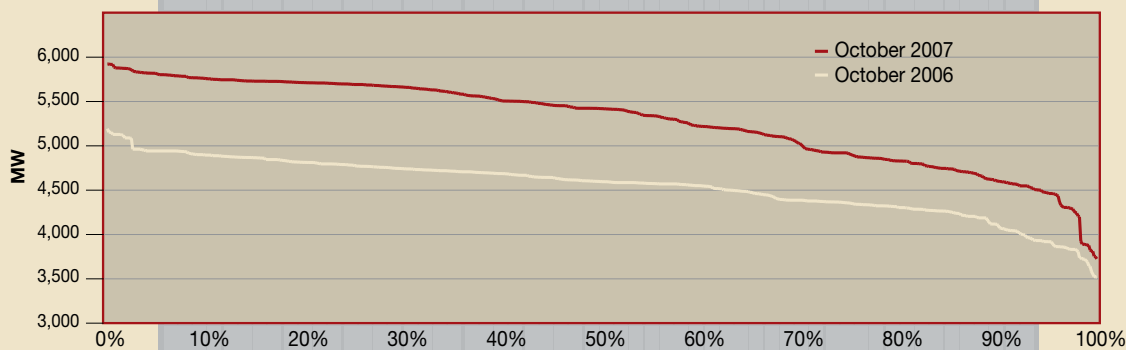
Prices in late fall and early winter 2007 were softer than expected. October of the previous year had seen an unusually high level of coincident outages across the coal generators. It is important to recognize that maintenance at one or two coal generators has a modest impact on price. With more than two generators offline prices are often disproportionately higher. Availability levels for coal generators during Q4/07 were substantially above Q4/06 levels. The additional generation from wind resources is also likely to have been a factor in moderating prices. Comparing supply availability from coal and wind year-over-year for the month of October indicated system supply was, on average, approximately 865 MW better in October 2007 relative to October 2006.

(1) 24.3 years as calculated on a capacity weighted basis

The changing pattern of prices in the Alberta market is already sending signals to investors and operators. Light summer conditions prompt generation owners to seek other times of the year to conduct maintenance – in 2007 we saw some maintenance delayed until winter when market prices were modest.

forward electricity contract prices collapsed from \$110/MWh to \$80/MWh within a matter of days. The MSA conducted a review of this event and concluded that the price collapse could reasonably be explained by market fundamentals. Further, the MSA found no evidence of contravention of the Trading Practices Guideline⁽²⁾.

Coal Generation Availability Duration Curve



Availability levels for coal generators during Q4/07 were substantially above Q4/06 levels. This was especially true for October.

The variability of output from wind generation is also creating opportunities for new investment in new fast-response generators (typically peaking gas generation).

Transmission upgrades are another potential source of price volatility. Two-thousand-seven presented an example of the link between transmission work and price volatility in forward markets. In August the Alberta Electric System Operator (AESO) announced a delay of the South Keephills-Ellerslie-Generation (S-KEG) transmission project due the failure of a major piece of equipment. During the upgrade work planned for September and October some generators would have seen their output restricted. With the delay of the project these restrictions were lifted and high September

Other notable events in 2007 included a period of \$0 prices on May 6th attributable to low demand early on a Sunday morning. Zero-dollar price events remain very infrequent but during such times the system controller may be forced to curtail imports or generation in order to keep the system in balance. The MSA closely monitors such situations and notes that with growing development of less flexible generation (for example: cogeneration and wind) the frequency of pool prices at both extremes may increase.

May 15th also saw a major forced outage caused by the collapse of a transmission tower between the Benalto and Red Deer substations. The outage on this line limited the ability to supply power from northern generators to southern loads. In response,

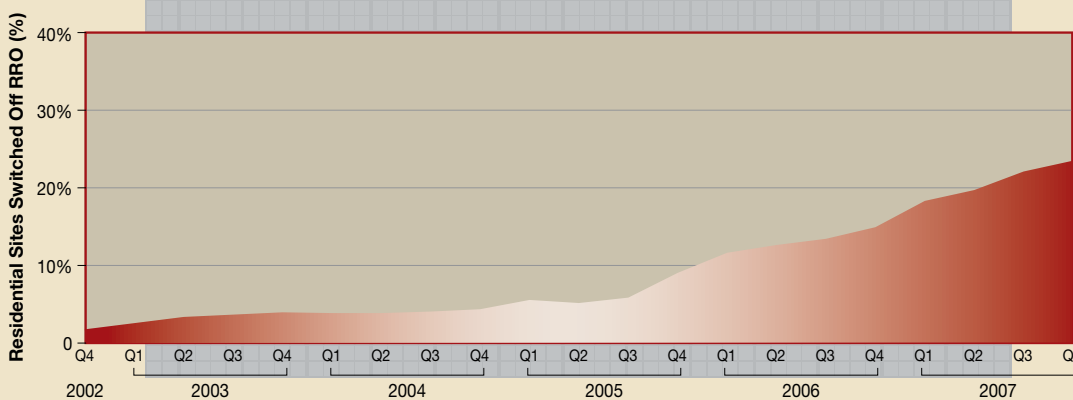
(2) For further details on the MSA's Trading Practices Guideline, we refer the reader to <http://www.albertamsa.ca/142.html>



the system controller follows procedures that include out-of-market directives to southern generators (transmission must run or TMR directives). The transmission line was back in service on May 17th by which time all directives to southern generation had been cancelled. Congestion events such as this have not been

fluctuating rates. These rates are based on a mix of short-term (month ahead) and longer-term purchases. Over time the RRO rate is increasingly based on shorter-term purchases. July 2007 saw the short-term (month ahead) proportion increase from 20% to 40% as prescribed by the RRO Regulation.

Retail Switching Statistics



Residential customers continue to switch away from regulated to competitive rates.

common in the Alberta market but it is important that they do not unduly disrupt normal market activities. With this in mind we are encouraged that the AESO reviewed the event to identify some upgrades to its rules and operating procedures.

In the retail market, 2007 saw continued growth across all customer categories in switching from regulated retail rates to competitive providers. By the end of 2007 it is estimated that approximately 24% of residential retail customers had made the switch to competitive rates. Most of these are switching to fixed rate options. Some switching also occurs within the same company (from the regulated rate option to competitive contract). Customers still on the Regulated Rate Option (RRO) face monthly

The Regulation directs that the month-ahead proportion of RRO rates increases by 20% per year until the RRO rate basis becomes 100% forward month based in July 2010. RRO rates vary somewhat depending on location but the rates among the principle RRO providers converged significantly in mid to late 2007. Wider ranges had been observed in Q4/06 and Q1/07. Continued convergence of RRO rates indicates that the different price-setting plans used by each RRO provider are broadly equivalent.

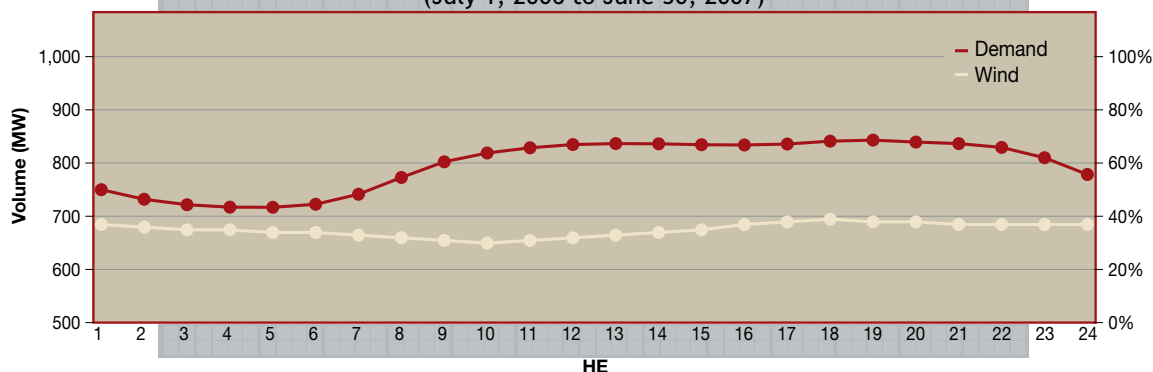
Process Events

SECTION 6 COMMITTEE

The Section 6 Committee was established by the Government in late 2006 to provide further clarification around Section 6 of the Electric Utilities Act (EUA). This section of the EUA requires that market participants are to conduct themselves in a manner that supports the 'fair, efficient and openly competitive operation of

The Committee's final report was made to the Minister of Energy at the end of June, 2007. The MSA abstained from supporting any of the proposals in the final report. As a regulator, we have typically refrained from publicly expressing our views on the content of legislation/regulation or guidance to the government in order to be

Average Hourly Wind Generation (% of MCR) and System Demand
(July 1, 2006 to June 30, 2007)



The MSA conducted a wind generation study during 2007 which suggested that generally, wind output is uncorrelated with system demand.

the market'. As market monitor the MSA is called upon to assess whether participants' conduct meets this standard.

The Section 6 Committee consisted of senior staff from 24 agencies and organizations representing government, generators, suppliers, load, and implementing agencies. As one of the participants on the Committee the MSA took an active role – preparing materials for discussion, participating in the main Committee meetings and on various sub-committees. The Section 6 Committee reached broad consensus in some areas, including a set of 'principles of participant conduct' and agreement that there should be a framework for addressing market power. In other areas a divergence of views remained.

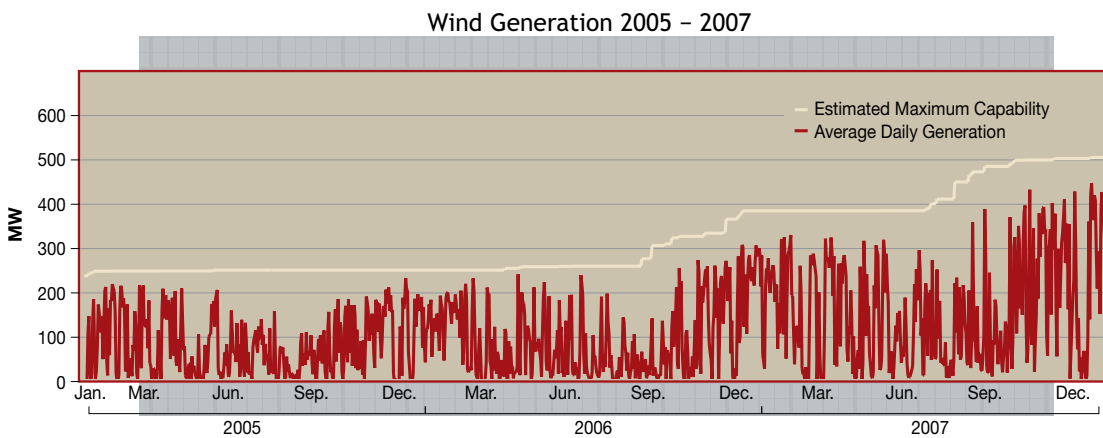
objective in implementing the final outcome.

The Section 6 Committee activities also overlapped those related to the Alberta Utilities Commission Act, with some issues related to mandates being clarified in the latter. As we enter 2008, the Minister and his staff have set forth direction on providing further clarity around Section 6 with recommendations on implementing some of the ideas suggested at the Committee. It is anticipated that at least a portion of those recommendations may be codified in regulation in 2008. From the perspective of the MSA, the Committee was useful in further understanding participants' concerns and identifying areas in which additional guidance may be necessary.

WIND GENERATION

Two-thousand-seven has clearly been a year of adaptation for the market in terms of the integration of wind generation. Not only has the physical operation of the market adapted to allow and encourage the participation of wind, participants have had to adapt to the effect of wind generation on the market and on the price signal.

An element of increasing wind generation that is of particular interest to the MSA is wind's influence on the attractiveness of investment in other generation types going forward. In 2007, the MSA conducted an analysis to explore this question and found that due to a lack of correlation between system demand and



Approximately 500 MW of wind generation are now connected to the Alberta grid.

In September 2007, the AESO removed the 900 MW threshold on total wind generation established in April 2006, opening the door to substantial future investment in wind while providing time to address operational challenges associated with the integration of wind. Foremost among these challenges is the inherent variability of wind output from hour-to-hour along with its dramatic ramping characteristics. The ability to forecast wind generation is a key factor in allowing the AESO to accommodate growing levels of wind while ensuring system stability and reliability. During Q2/07 the AESO initiated a wind power forecasting pilot project to assess the effectiveness of various forecasting methodologies – the final results of which are expected in Q2/08.

wind generation, a steeper residual demand function is likely to result. This is assuming the existing lack of geographic diversity in wind generation. Presumably, incremental wind development will bring with it some improvement in geographic diversity which will moderate further increases in residual demand. A steeper residual demand function suggests enhanced opportunities for peaking generation relative to other generation types as faster ramping dispatchable units are required to keep pace with steeper load ramps.

During 2007 approximately 135 MW of additional wind generation was brought on-line, bringing the total of installed wind generation to approximately 500 MW or approximately 4% of installed capacity.

INVESTIGATIONS AND COURT PROCEEDINGS

During 2007, the MSA actively worked on four major investigation files concerning issues affecting the Alberta electricity markets. The investigations focused on possible breaches of Section 6 of the EUA concerning activity related to uneconomic importing, trading in the forward market, locking restatements, and trading in the ancillary services market.

The investigation into certain imports of energy by ENMAX Energy Corporation and ENMAX Energy Marketing Inc. (ENMAX) was initiated in October 2005 and pertains to the MSA's concerns about the uneconomic importation of energy into Alberta and the potential undesirable impact this may have on Alberta electricity prices. As part of the investigation the MSA interviewed employees of ENMAX wherein they were advised by ENMAX's legal counsel not to answer specific questions. The MSA responded to ENMAX's refusal by applying to the Court of Queen's Bench on February 15, 2007 for an order compelling the ENMAX employees to answer questions.

In response to the MSA's court application, ENMAX brought a cross application to contest the ability of the MSA to seek the assistance of the court to hear the MSA's application and to insist the application be held in-camera. On July 5, 2007 Mr. Justice A.D. Macleod ruled that the MSA was in fact entitled to seek a court order to compel answers to reasonable questions

("2007 ABQB 309"). On January 24, 2008 Mr. Justice Macleod filed his second decision in this matter and dealt with the questions that had been objected to by ENMAX ("2008 ABQB 54").

This latest decision is significant for the MSA as the court ruled that all of the objected to questions are appropriate and the MSA is allowed to re-interview the witnesses who will answer the questions previously objected to. Moreover, the MSA is entitled to ask further questions following upon the answers given to the objected questions. The decision also deals with the matter of public interest. In this regard, Mr. Justice Macleod noted that the public interest is not served by an order which would shield any further proceedings in this matter from public scrutiny. Mr. Justice Macleod determined that the public is entitled to scrutinize the debates between the MSA and ENMAX as to whether or not the extent of the investigation is in the public interest as to whether ENMAX has had the benefit of due process. Further, Mr. Justice Macleod indicated that when parties disagree over important issues which relate to the right of those being investigated to due process, the public interest trumps any confidentiality consideration.

The court decisions in this matter will help the MSA to carry out its mandate, and should also help guide the actions of market participants, such that investigations will generally be able to



proceed in a more direct and efficient fashion. In this regard, the MSA anticipates completing the investigation this year.

In October 2006, the MSA commenced an investigation into certain forward market trading activity which occurred during the summer of 2006; the investigation specifically focused on a generating plant outage and the disclosure of related outage information during that period. The MSA was concerned that a market participant may have breached the Trading Practices Guideline (TPG). The TPG was established in 2004 and states:

Market participants must not trade on the basis of known but not public information about the status of supply, load or transmission assets that can reasonably be expected to have a material impact on market price. Trading shall be understood to include any type of financial or physical transaction or operational strategy designed to extract value from known but not public information about the status of supply, load or transmission assets.

The MSA determined that the market participant did not breach the TPG and accordingly closed the file in May 2007.

In October 2006, the MSA also commenced an investigation into a market participant's use of a locking restatement. The investigation considered the impact of the activity as to whether the price signal

was adversely affected, whether it was possible for other market participants to respond to the conduct and whether the activity represented an appropriate balance between risk and reward. The MSA concluded its investigation in the later part of 2007 and decided not to pursue enforcement action. Although the file is closed, the MSA remains interested in the bounds of acceptable offer behaviour, particularly during periods of scarcity. It is reasonable to anticipate that the new ISO rules relating to market offers, and the continuing discussions being led by the Department of Energy in respect of the recent white paper, may have a significant impact on market participant conduct in this area.

On May 14, 2007, the MSA announced that it had initiated an investigation into certain trading activity in the ancillary services market. The investigation is concerned with the sale and purchase of ancillary service products which were negotiated in the Over-the-Counter market and then posted to the Watt Exchange. Among other things, the MSA is concerned the trading activity may have a negative impact on the price signal, may not represent a level playing field for market participants and may restrict market participants' ability to compete. The MSA expects to complete this investigation during 2008.

2007 ENACTMENTS

On June 14, 2007, Bill 46, the Alberta Utilities Commission Act, was given First Reading in the Alberta legislature. The draft legislation set out changes which would impact the Alberta Energy and Utilities Board (EUB) as well as various implementing agencies, including the AESO, the Utilities Consumer Advocate (UCA) and the MSA.

Bill 46 went through Second and Third Reading in the fall of 2007 and in its amended form received royal assent on December 7, 2007. During the legislative process, there were several amendments made to the initial version of the legislation, including changes regarding the hearing process for the new Alberta Utilities Commission (AUC), the removal of the provisions relating to the UCA, and changes to the liability provisions. The new Act was proclaimed into force on January 1, 2008, thus creating the Energy Resources Conservation Board (ERCB) and the AUC as successors to the EUB. The ERCB will generally focus on oil and gas matters; the AUC will generally focus on utilities, including electricity, natural gas and water, as well as the transmission and distribution of those commodities.

The AUC will also have a role in relation to the AESO and the MSA beyond what the EUB previously had. For example, the AUC will have the power to approve the ISO rules, and will adjudicate enforcement matters brought by the MSA.

From the perspective of the MSA, the new legislation is a significant step forward. An important consideration of the new legislation was to clarify the roles and mandates of the various agencies and minimize the overlap of responsibilities. The new legislation makes it clear that the AESO is the party responsible for the development of the pool rules, albeit that they must be approved by the AUC. The AESO is left with the power to monitor for compliance with their rules, but no longer has the authority to investigate, prosecute or issue fines and sanctions for breaches

of rules. The new legislation makes it clear that the MSA is the body responsible for investigations and prosecutions; accordingly, suspected rule breaches identified by the AESO will be referred to the MSA. Sanctions for rule breaches are issued by the AUC. In addition, the legislation makes it clear that if the AUC suspects any breach of their own rules or orders, the AUC will refer those files to the MSA for investigation and, as applicable, prosecution (before the AUC). Given the new legislative scheme, the various agencies will be expected to work closely together to help ensure an efficient regulatory regime.

The legislation is definitive that the MSA does not have the power to be the judge of any issue; it is only the AUC that has the power to issue sanctions and penalties. The legislation does clarify the MSA's right to enter into negotiated settlements with parties, including ones which may contemplate the agreement to a financial penalty but also makes it clear that even those settlements must be approved by the AUC. The legislation provides the MSA with a new responsibility in relation to oversight of the retail natural gas business in the province. It has clarified the MSA's rights of access to information and improved the language with respect to the MSA's access to the court when the assistance of the court is required in its acquisition of information. Consequential amendments made to the EUA also increased the ability of the MSA to get relevant market information.

Along with the new legislation came various new or amended regulations, including the Market Surveillance Regulation. That regulation brings clarity and process regarding various matters, including the publishing of information and the making of guidelines by the MSA.

Copies of these enactments can be found on the Alberta Queen's Printer website www.qp.gov.ab.ca.

TRANSMISSION

On September 30, 2007, the EUB published Decision 2007-075 in which the EUB cancelled proceedings and closed applications to construct and operate a 500kV transmission line between Edmonton and Calgary. The EUB also indicated its intention to set aside previous decisions approving the need for the transmission line.

Decision 2007-075 noted that a reasonable apprehension of bias had compromised the proceedings and therefore there had been a denial of a right to a fair hearing.

The needs identification application for this highly anticipated project was originally approved in April 2005 in EUB Decision 2005-031 and if the 500kV project were re-launched, it must begin again from the point of needs applications. Although the failure of the project to proceed was an event of great significance, resilience of the market was demonstrated by the lack of movement of the forward price curve, indicating a pricing-in effect of project risk including the protracted regulatory and consultation processes involved in significant transmission projects even before they ever reach the construction phase.

While the MSA is encouraged by the tempered market response to this event, the MSA remains concerned with the potential for growing congestion and the resultant impact this may have on market efficiency.

'QUICK HITS'

In June of 2005 the Department of Energy released a policy document reaffirming the basic wholesale market design in Alberta. In a few areas it also recommended some refinements. Based on these recommendations the AESO identified a sub-set of refinements that could be introduced relatively quickly, subsequently known as 'Quick Hits' (or alternatively as Phase 1 Market Policy Implementation). This included:

- Merit order stabilizers
- Payment to suppliers on the margin
- Treatment of imports/exports
- Reconstitution of pool price for Transmission Must Run⁽³⁾

Together, the 'Quick Hits' package represents the most significant rule changes in years. They also proved far more challenging to implement than originally anticipated and did not include some refinements contemplated with respect to the treatment of imports and exports. Part of the delay was attributed to the need to upgrade two of the AESO's primary IT systems, the Energy Trading System (ETS) and Dispatch Tool (DT).

Implementation occurred on December 3, 2007. No major operational problems were experienced following the implementation. However, some market reports were impacted and some isolated difficulties have been experienced. The MSA is monitoring the impact on the overall health of the market as well as for unanticipated changes in participant behavior. On a go-forward basis the MSA supports the AESO's efforts to improve the IT systems that are critical to market performance.

⁽³⁾ For further details on 'Quick Hits' we refer the reader to <http://www.aeso.ca/market/8836.html>

FINANCIAL STATEMENTS

Auditors' Report

TO THE MARKET SURVEILLANCE ADMINISTRATOR

We have audited the balance sheet of Market Surveillance Administrator as at December 31, 2007 and the statements of operations and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements.

An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2007 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

[Signed "Pricewaterhouse Coopers LLP"]

Chartered Accountants

February 2, 2008

BALANCE SHEET

As at December 31,	2007	2006
	\$	\$
ASSETS		
Current Assets		
Cash	384,913	379,179
Accounts receivable	-	-
Prepaid expenses and deposits	48,850	50,621
	433,763	429,800
Capital Assets (note 3)	32,014	48,458
	465,777	478,258
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	425,231	423,339
Deferred revenue (note 4)	40,546	54,919
	465,777	478,258
EQUITY (note 1)	-	-
	465,777	478,258

On behalf of the corporation:

[Signed "Martin Merritt"]

Martin Merritt
MARKET SURVEILLANCE ADMINISTRATOR

[Signed "Wayne Silk"]

Wayne Silk
VICE PRESIDENT & CHIEF OPERATING OFFICER

Statement of Operations

YEAR ENDED DECEMBER 31, 2007	2007	2006
	\$	\$
Revenue		
Alberta Electric System Operator (note 4)	3,006,484	2,619,362
Interest Income	9,953	14,525
Total Revenue	3,016,437	2,633,887
Expenses		
Salaries and benefits	2,009,191	1,730,279
Consultants, legal and audit	610,398	500,279
Operating, office and administrative	373,503	373,427
Amortization	23,345	29,901
Total Expenses	3,016,437	2,633,887
Net Earnings (note 1)	-	-

Statement of Cash Flows

YEAR ENDED DECEMBER 31, 2007	2007	2006
	\$	\$
Cash provided by (used for):		
Operations		
Net earnings	-	-
Items not involving cash:		
Amortization	23,345	29,901
Change in non-cash operating items:		
(Increase) decrease in accounts receivable	-	-
Increase in prepaid expenses and deposits	1,771	(3,386)
Increase in accounts payable and accrued liabilities	1,893	135,988
Increase (decrease) in deferred revenue	(14,373)	(468,006)
	12,635	(305,502)
Investing		
Expenditures on capital assets	(6,901)	(18,821)
Increase in cash	5,734	(324,323)
Cash, beginning of the period	379,179	703,503
Cash, end of the period	384,913	379,179

Notes to the Financial Statements

YEAR ENDED DECEMBER 31, 2007

1. Nature of Operations

The Market Surveillance Administrator was incorporated as an independent, standalone entity on June 1, 2003 under the Electric Utilities Act of the Province of Alberta. Prior to June 1, 2003, the Market Surveillance Administrator function was carried out under the Power Pool Council.

The business and affairs of the Market Surveillance Administrator corporation are overseen by an individual appointed as Market Surveillance Administrator by the Minister of Energy for the Province of Alberta.

The mandate of the Market Surveillance Administrator, as set out in the Electric Utilities Act, is to carry out surveillance and investigation in respect of activities in the electric industry in the Province of Alberta. Those activities include the supply, generation, transmission, distribution, trade, exchange, purchase or sale of electricity, electric energy, electricity services or ancillary services. The objective of carrying out surveillance and investigations are to assess whether or not:

- The conduct of market participants is consistent with the fair, efficient and openly competitive operation of the electricity related markets in Alberta;
- Legislation and market rules are being complied with;
- The market rules are sufficient to discourage anti-competitive practices in the electric industry; and
- The market rules facilitate fair, efficient and openly competitive electricity related markets.

The Market Surveillance Administrator has no share capital. The Electric Utilities Act requires that the Market Surveillance Administrator prepare a budget for each fiscal year, for approval by the chair of the Alberta Energy and Utilities Board. Once approved, the Alberta Electric System Operator is required to pay the Market Surveillance Administrator the budgeted costs and expenses, net of any other revenues. The Market Surveillance Administrator is to be managed so that no profit or loss results on an annual basis from its operation.

2. Significant Accounting Policies

Capital Assets

Capital assets are stated at cost. Amortization is provided using the following methods and annual rates:

Computer Hardware	Straight-line	3 Years
Computer Software	Straight-line	3 Years
Furniture & Equipment	Straight-line	5 Years

Income Taxes

No provision has been made for income taxes as the Market Surveillance Administrator is a not-for-profit organization as set out in the Electric Utilities Act of the Province of Alberta.

Financial Instruments

The Company's financial instruments consist of cash, accounts receivable and accounts payable and accrued liabilities.

Revenue Recognition

Consistent with the requirements of the Electric Utilities Act that the Market Surveillance Administrator operate with no annual profit or loss, collections from the Alberta Electric System Operator are recognized as revenue to the extent of annual operating costs including amortization of capital costs. In circumstances where annual collections are in excess of annual costs, the excess is deferred and recognized in future periods. In the event of a shortfall between collections and costs, the shortfall in revenue will be accrued and be collected in a subsequent period from the Alberta Electric System Operator.

3. CAPITAL ASSETS

	2007			2006
	COST	ACCUMULATED AMORTIZATION	NET BOOK VALUE	NET BOOK VALUE
	\$	\$	\$	\$
Computer Hardware	62,626	50,641	11,985	9,606
Computer Software	26,498	26,317	181	912
Furniture & Equipment	90,461	70,613	19,848	37,940
	179,585	147,571	32,014	48,458

4. DEFERRED REVENUE

The collections from the Alberta Electric System Operator are set to recover the operating and capital costs of the Market Surveillance Administrator. Any excess or shortfall in collections is deferred to or accrued for future years.

	2007	2006
	\$	\$
Alberta Electric System Operator		
Opening balance, January 1	54,919	522,924
Collection for February to December 2007	2,992,111	2,151,357
Less: 2007 Revenue	(3,006,484)	(2,619,362)
	40,546	54,919
Collection for January 2008	-	-
CLOSING BALANCE, DECEMBER 31	40,546	54,919

5. COMMITMENTS

The Market Surveillance Administrator is committed under a lease agreement for its current premises until October, 2009. Total lease costs including estimated operating costs are approximately as follows:

	\$
2008	150,000
2009	125,000

The Market Surveillance Administrator has entered into a service agreement with the Alberta Electric System Operator, under which the Market Surveillance Administrator receives certain information technology and office services. These services are provided for a monthly fee of \$2,900, plus an hourly fee for special projects.

6. CREDIT FACILITY

The Market Surveillance Administrator has a demand operating facility. Under the terms and conditions of this facility, the Corporation can borrow up to \$300,000 at the prime rate of interest. No pledges of security are required from the Corporation for the facility and no amount was drawn on this facility at year-end

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