



KNOWLEDGE = POWER

Annual Report 2004

MARKET SURVEILLANCE
ADMINISTRATOR

Information-rich marketplace

PG 9

Competition does the heavy lifting

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Level playing field

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High fidelity price signal

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PRESIDENT'S MESSAGE

Two thousand four was certainly interesting. Current in-province generation capability is generous with yet more capacity pending; pool prices are down from 2003 in both absolute terms and relative to fuel costs and demand is up by 4 percent. Current wholesale prices are at levels well below what is profitable for many generators. As of early January 2005, forward prices are lower yet for the next two calendar years.

If 2004 was the perfect storm for generators then it doesn't get a lot better for wholesale purchasers of electrical energy from the pool. For the retail customer, billing accuracy was improved; a number of deferral account charges came to an end removing some of the "extra" charges related to 2001, and the retail market gained some new players. Direct Energy commenced operations, Energy Savings Income Fund announced their arrival for 2005 and various REAs reorganized in anticipation of offering competitive contracts for energy. In spite of the current legislation, there is still uncertainty by some about whether the regulated pricing will go to a pool price flow-through methodology in mid-2006; a retail market review underway in early 2005 should reduce this uncertainty.

If 2004 was the perfect storm for generators then it doesn't get a lot better for wholesale purchasers of electrical energy from the pool.

It was entirely expected that prices in 2004 would continue to decline as large amounts of new, efficient capacity were brought on-line. While directionally the market is working as it should, the magnitude and persistence of the price decline raises concerns of



Martin Merritt, President & CEO

sustainability. More than 5,000 MW of supply – over one-half of the 9,000 MW demand – is regularly offered at \$0 for part of the day simply to ensure that the units continue to operate. On one December day, the pool price remained at \$0 for five hours straight even as Alberta exported power. Quite appropriately the question of sustainability has been raised and was the subject of a series of consultations hosted by the Department of Energy and the AESO during the second half of the year. In theory, prices will rebound in due course, returning generators to profitability and ultimately signalling the need for additional capacity as demand growth shrinks the oversupply. We've seen significant new capacity added at no risk to ratepayers over the past three years with attendant price effects; over the next two years we shall have to assure ourselves that the pendulum can swing both ways and do so within reasonable bounds.

HIGH-LEVERAGE MARKET ISSUES

In 2004 the MSA focused on a small number of high-leverage issues that are squarely within its mandate and expertise. These included:

Fostering an information-rich environment

With few exceptions information is the grease that allows markets to work efficiently. Proprietary information gleaned through the expenditure of capital or intellectual resources are legitimate munitions of competition. Unearned or unintended information asymmetries however, detract from market competitiveness.

Information availability contributes to efficient decision-making and naturally co-opts participants into the role of surveillance.

Notwithstanding this, such advantages tend to be clung to jealously by those to whom fate has granted them. Championing an information-rich environment will always be a high leverage point for the MSA because it contributes to efficient decision-making and naturally co-opts participants into the role of surveillance.

ARE CURRENT MARKET ECONOMICS SUSTAINABLE FOR GENERATORS?


ECONOMICS WERE LESS FAVORABLE IN 2004 DUE TO A SUPPLY OVERHANG; AS DEMAND GROWS PRICES WILL BECOME MORE ATTRACTIVE TO GENERATORS.

Keeping the playing field level

Few things could be more central to fair competition than a level playing field. The challenge of creating a competitive environment from a regulated one is to provide the legacy firms with every opportunity to contest the competitive market while restricting unearned legacy advantages that act as barriers to the entry of new competitors. Primary sources of “tilt” such as taxation advantages (for municipally-owned entities) and legacy information advantages have been addressed by statute, regulation or MSA guideline. The importance of competitors to competition is hard to overstate so this aspect of the market will continue to figure prominently in the way the MSA discharges its mandate.

Ensuring a high fidelity price signal

A price signal is the essence of a competitive market. Price should faithfully reflect market circumstance in order to signal the need for construction, retirement, alternative fuel sources, efficiency improvement, consumption curtailment and much more. To the extent that the price signal is noisy, creates perverse incentives, or otherwise does not faithfully reflect the market circumstance, we say it lacks fidelity. Increasingly, the MSA finds itself being asked to investigate the conduct of individual participants which is within the rules and rational (for the participant) but which produces a result that is collectively inefficient. We should not expect or force participants to act irrationally to serve the common good. We must instead

 The importance of competitors to competition is hard to overstate, so this aspect of the market will continue to figure prominently in the way the MSA discharges its mandate.

find and fix infidelities in the price signal that cause participants to pursue strategies that do not serve the common good. The MSA pursues its role in a way that ensures self-regulating mechanisms are in place and are working; no principle could be more important than a high fidelity price signal.

**IS THE MARKET MORE
EFFICIENT SINCE THE
INDUSTRY WAS
RESTRUCTURED?**

*EFFICIENCY GAINS SINCE
RESTRUCTURING HAVE
ABSORBED A LARGE PORTION
OF THE PRICE INCREASES
CONSUMERS WOULD HAVE
OTHERWISE SEEN.*

Letting competition do the heavy lifting

The MSA has a suite of statutory prerogatives and regulatory tools with which to pursue its mandate. None of these tools, however, will make the MSA as insightful, swift, or capable of efficient regulation as a keen participant on a level playing field, guided by a high fidelity price signal. The MSA will not be shy about availing itself of the regulatory tools at its disposal to ensure that the market is fair, efficient and openly competitive. However, we shall make every effort to foster an environment in which market forces are given the first opportunity to regulate.

By focusing on these simple yet high leverage themes, we hope to engender the confidence of participants, policy makers and the public at large. Each of the initiatives we undertook in 2004 speaks to one or more of these themes. We discuss several of the key initiatives later in this report.

STAKEHOLDER SURVEY

In May 2004, the MSA commissioned a survey of market stakeholders to solicit views and feedback on how effectively we fulfill our mandate. The complete results were published on our website in June. While people saw the MSA as being visible, approachable and proactive, some felt we could do more to enhance confidence and promote transparency. We have taken steps to act on some of the concerns raised, including making incremental enhancements to our website, improving the weekly Market Monitor report and adding a new, daily market report entitled the Daily Snapshot.

The MSA pursues its role in a way that ensures self-regulating mechanisms are in place and are working; no principle could be more important than a high fidelity price signal.

We anticipate conducting this survey on an annual basis going forward to gather the views and concerns of a broad cross-section of market participants and stakeholders.

**WHAT IF RATIONAL,
INDIVIDUAL MARKET
BEHAVIOUR PRODUCES
COLLECTIVELY IRRATIONAL
OR INEFFICIENT OUTCOMES?**

*RATIONAL BEHAVIOUR THAT
PRODUCES PERSISTENTLY
INEFFICIENT OUTCOMES
POINTS TO MARKET
DESIGN ISSUES.*

MARKET CHALLENGES

The market challenges for 2005 are already shaping up. They include:

- Finding remedies for several noise generators in our price signal. Key among them are imports which are forced to offer power at \$0 by ISO rule and the mismatch between the price at which generators are dispatched and the hourly price that they receive. This mismatch is unfair and causes generators to ask for a price premium, which reduces the fidelity of our price signal.
- Satisfying ourselves that our market design will signal and allow the retirement of older, uneconomic units in an orderly fashion and that the market will respond to reductions in the supply overhang with rising prices and timely generation development.
- Giving the retail market every chance to prosper by keeping the playing field level and by doing so in a manner that does not add excessive regulatory burden. We must in fact continue to take steps to reduce regulation wherever possible.
- As previously committed to the generation and trading sector, showing that the Trading Practices Guideline is contributing to fair, efficient and open competition or amending or withdrawing it.

We look forward to working with industry, policy makers and the other implementing agencies to ensure that Alberta's restructured electricity market is fair, efficient and openly competitive.



Martin Merritt

Martin Merritt | Market Surveillance Administrator | March 7, 2005

WHEN SHOULD OVERSIGHT AGENCIES INTERVENE IN THE MARKET?

WHEN AGENCIES INTERVENE IT SHOULD BE TO ENSURE INTEGRITY. MARKETS WILL TAKE CARE OF PRICES AS LONG AS AGENCIES TAKE CARE OF THE MARKETS.

ALBERTA'S ELECTRICITY MARKET

The average wholesale market price of electricity declined in 2004 to \$54.59/MWh from \$62.99/MWh in 2003. Lower prices, while beneficial to consumers, provided a challenging environment for generators as the trend in market heat rate continued downward to an all-hours average of 8.8 GJ/MWh in 2004. This compares to 10.1 GJ/MWh in 2003 and 11.6 GJ/MWh in 2002.

Averages show an overall perspective but distributions can show another. The heat-rate duration curve for 2004 shows that a new gas generator would have at a minimum, met its variable cost of fuel 65 percent of the time – a level similar to 2003. However, the Pool price duration curve shows that prices above \$100/MWh, which peaking gas generators are

built to capture, were less frequent. In fact, prices reached or exceeded \$100/MWh 7.8 percent of the time in 2004 compared to 12.5 percent of the time in 2003. This means that there were 411 less hours of \$100/MWh or higher prices in the market in 2004 relative to the previous year.

Although the Alberta market continues to be coal dominated, gas-fired generation is a close second. As such, natural gas prices have an influence on the electricity market since gas generators set the system's marginal price on average about half the time on a 24-hour basis and about 65 percent of the time during on-peak hours. In 2004, Alberta gas prices remained relatively stable, averaging \$6.19/GJ which contributed to lower volatility in Pool prices compared to 2003.

Price setting continued to be well contested in 2004. The most frequent price setter did so 23 percent of the time at a weighted average price of \$71.58/MWh. Coal units were the leading price setters in 2004 as they set price 46 percent of the time at a weighted average price of \$24.78/MWh. At the same time, co-generation and gas units together set price 53 percent of the time at an average price of \$77.11/MWh. We tend to view co-generation separately from other gas generators due to their quite different operating parameters and constraints.

Net capacity additions in 2004 were approximately equal to additions in 2003, including the commissioning of Genesee 3 – a 450 MW coal-plant joint venture between Epcor and TransAlta. As a result, growth in installed



THE MSA'S MARKET MONITOR IS YOUR WEEKLY FACT SOURCE ON ALBERTA'S ELECTRICITY MARKET. REVIEW THE MARKET MONITOR AT: WWW.ALBERTAMSA.CA

“Net capacity additions in 2004 were approximately equal to additions in 2003, including the commissioning of Genesee 3 – a 450 MW coal-plant joint venture between Epcor and TransAlta. As a result, growth in installed generation capacity kept pace with the growth in peak system demand year-over-year.”

generation capacity kept pace with the growth in peak system demand year-over-year.

The use of the interconnections (primarily the Alberta-B.C. interconnection) and their influence on the Alberta market continued to be a contentious issue in 2004. With the sale of a package of firm transmission rights to an Alberta participant, BC Hydro's wholly-owned marketing affiliate, Powerex, is no longer the exclusive holder of firm rights on that interconnection. Another development affecting the interconnections in 2004 was the status of the 21S capacitor bank in Calgary. This outage created a technical impediment to export capability on the Alberta-B.C. interconnection. Under current AESO operating policies and procedures, available transfer capacity (ATC) for exports is set to zero when Alberta load exceeds 8,100 MW. However, with the capacitor bank out

of service, ATC is set to zero when Alberta load exceeds 7,700 MW. With winter load normally exceeding 8,100 MW, this outage would have only been a consideration during the summer months under present system operating policies.

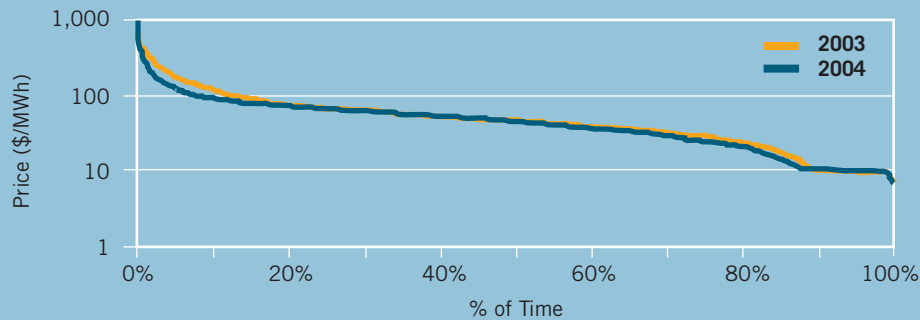
The retail market continued to have challenges in 2004 as we saw only one new entrant into the market. Although a reasonable percentage of commercial/industrial customers have switched off regulated default power supply, less than five percent of residential owners have selected an alternative. Most residential customers continue choosing not to choose, in part due to the extension of regulated default supply to July 2006.

In the ancillary services market, a significant event was the renegotiation of the agreement between the Hydro PPA counterparties TransAlta

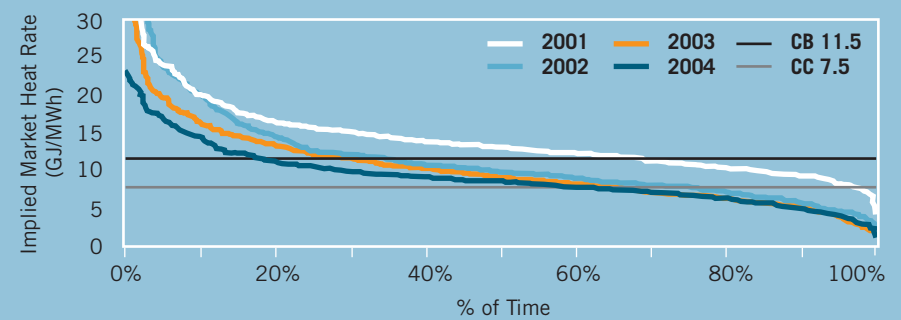
and the Balancing Pool. The agreement sets out how the obligation of the hydro assets to supply reserves to the market will be satisfied across the various ancillary service products. Transparency of the OTC segment of ancillary services

- *Price Duration Curve – Duration curves simply show a frequency distribution of a variable – in this case, Pool price. The graph shows that in 2004 there were fewer price spikes and more frequent high discount hours relative to 2003.*
- *Heat-Rate Duration Curve – The heat-rate duration curves in the graph show the increasing market efficiency trend as the curve has steadily moved downward over the last four years. The graph compares how a Cloverbar unit and a newer combined cycle gas generator would have fared relative to their break-even heat rates.*

PRICE DURATION CURVE



HEAT-RATE DURATION CURVE



procurement remained a contentious issue due to the increased use of this market in the overall procurement practices of the AESO. This concern prompted the MSA to advocate for improved disclosure, which was followed by regular publication of a set of aggregate OTC price statistics by the AESO.

The MSA believes the path to building confidence in the Alberta electricity market is to advocate for and to facilitate an information-rich marketplace, to ensure a level playing field, and to promote a high-fidelity market-price signal. Progress in these areas allows us to let competitive forces do the “heavy lifting” of keeping market practices and behaviour of participants in check. Such an environment builds and perpetuates confidence in the market mechanism. The MSA is working with

stakeholders to build an efficient market in which sufficient and functioning mechanisms are in place for the market to regulate itself.

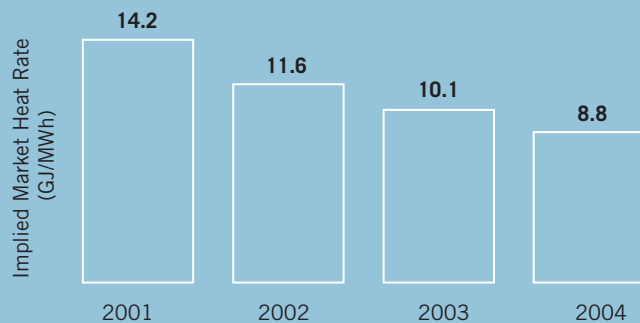
In the following sections, each of the four pillars which underpin the MSA's view of a rationally functioning fair, efficient, and openly competitive market are better defined. As well, the MSA has identified a representative sample of the issues we addressed in 2004; these are ascribed to the various elements of our four pillars framework, where the resolution of that issue had most direct influence.

Within this framework, the resolution of a market issue tends to have a ripple effect. An improvement in the richness of the information available to the market, for example, promotes more educated decisions and actions which in

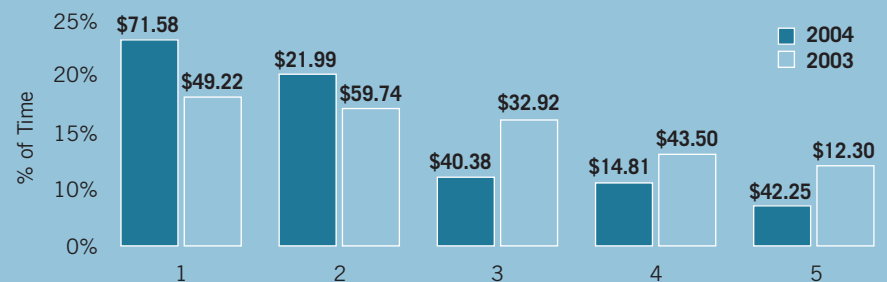
turn improves the rationality of the pricing outcome – hence, greater price fidelity. Similarly, an event that levels the playing field, allows competitors to better police each other's behaviour thus allowing competition to do the “heavy lifting”.

- *Average Heat Rate – This graph clearly shows the dramatic downward trend in heat rate over the last four years.*
- *Pool Price Setters – The graph shows that marginal price setting activity was not unduly weighted to any one or two participants in 2004 but was reasonably contested.*

AVERAGE HEAT RATE



POOL PRICE SETTERS



INFORMATION-RICH MARKETPLACE

In facilitating a competitive market, more information is generally better than less, provided it is available to all. An information-rich marketplace promotes efficient decision-making and thus builds confidence since competitors are able to satisfy themselves that outcomes are closely tied to fundamentals.

An information-rich marketplace has at least two dimensions. One is disclosure of the machinery of market workings – for example, policies and issues of an operational nature that may not be widely understood, yet have a material impact on market outcomes. The second is disclosure of market data including price, volume, and outages (generation and/or transmission) which allows market participants to make more informed decisions.

In building an information-rich marketplace, the MSA addresses both dimensions as an advocate for appropriate levels of disclosure among market participants and agencies, and through publication of a broad range of market analyses and reviews. Making the marketplace machinery and outcomes more transparent was a priority for the MSA in 2004 and in the future.

Our study and publication on residential load profiles in 2004 sought to determine the effect of load profiling and location on a customer's bills, and to assess the effect of Pool price volatility on monthly electricity bills based on an assumed monthly consumption level.

The increased level of reserve procurement via the OTC market by the AESO reduced that market segment's transparency. Publication of aggregated pricing data for this market allows participants to better assess the pricing of Watt-Ex volumes vs. OTC volumes. The MSA worked with the AESO to improve the level of disclosure which now includes a separate OTC pricing report available on the AESO website.

The outcome of this initiative is an example of one which crosses over more than one of our four pillars. With the additional pricing information, participants can make better decisions regarding their offer levels or the method of offering Watt-Ex vs. OTC. There is also a leveling of the playing field as everyone now sees all the options and outcomes for participating; hence, there is an improvement in the fidelity of the price.

The MSA's inclination is toward disclosure. A high level of information disclosure in a market enhances market transparency – a precursor to building a level playing field, which in turn improves the prospects for a higher fidelity price.



L to R: Donna Ehrhardt; Doug Doll; Wayne Silk

THE MSA'S YEAR IN REVIEW
REPORT IS THE "TECHNICAL"
VERSION OF OUR ANNUAL REPORT.
SEE THE YEAR IN REVIEW REPORT AT:
WWW.ALBERTAMSA.CA

LEVEL PLAYING FIELD

A fundamental requirement for a competitive market is a level playing field. There are several lenses through which we can look at a market to assess whether the field is level. These lenses show us the relative competitiveness of large players vs. small players; incumbents vs. new

entrants; taxable entities vs. non-taxable; and suppliers vs. consumers. Some competitive advantages are hard-earned and deserve to be rewarded and not leveled. But others may be unearned, unintended, or unfair. These are the tilts in the playing field where the MSA has focused its efforts.

Unintended information asymmetries in a market are one example of this. Last year we said that a key priority in 2004 would be addressing some of these information asymmetries in order to create a more level playing field. As a result of the MSA implementing the trading practices guideline (TPG), we began publishing a scheduled generation outage report intended to level the

playing field with respect to knowledge of scale and timing of planned generation outages. The trading practices guideline sets out that parties must not trade based on knowledge of their own planned outages unless they have disclosed this information to the broader market in advance.

Other work of the MSA in 2004 involved a review of spinning reserve contracts sold to the AESO by Powerex. These contracts were being administered in an inconsistent manner relative to other sellers of spinning reserves since contracts were receiving payment when the reserve service could not have been provided due to Powerex' concurrent import activities. The MSA published a report on this issue in August recommending that the contract



L to R: Mike Nozdryn-Plotnicki; Alex Qu; Rob Spragins

A level playing field is fundamental to building a competitive market – a level playing field means the absence of competitive advantages that are unearned, unintended, or unfair.

SEE THE MSA'S REVIEW OF
POWEREX SPINNING RESERVES AT:
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terms for the purchase of spinning reserves across the Alberta/B.C. interconnection be enforced uniformly to all other spinning reserve purchases.

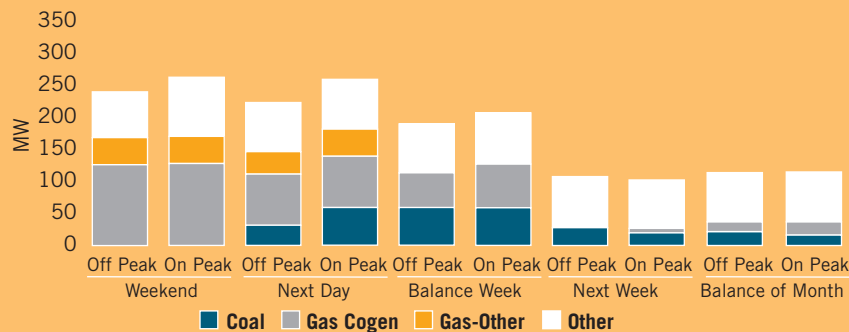
The Code of Conduct Regulation sets out the “rules of the road” for retail competition in the Alberta market. It ensures that retail affiliates of incumbent utilities are not at a material advantage to new retailers by virtue of being associated with the incumbent provider of those wire services. Pursuant to the Code, incumbent wire owners and their affiliated retailers are required to undergo compliance audits. The MSA is given authority to approve both the proposed auditor, as well as the audit work plan. In 2004, the MSA approved customer data handling procedures for the regulated distribution companies that removed any real or perceived

advantage that incumbents might have had as a result of historical control of this customer information.

The improvement to the level playing field through the work on each of these issues translates to improvements in some or all of the other three pillars.

The MSA will continue to promote a level playing field in all markets within its mandate. A market that is information-rich and has a level playing field enhances competition and best facilitates a clear and robust price signal.

PUBLISHED TPG OUTAGE DATA



- Published TPG Outage Data – The graph shows a representation of outage data that is published by the MSA three times each day as a result of the Trading Practices Guideline (TPG) which was implemented in 2004.

HIGH FIDELITY PRICE SIGNAL

By the term high fidelity price signal, we mean that the price signal is a rational and true reflection of market conditions and fundamentals that can be relied upon consistently across both short and longer-term timeframes. A high fidelity price provides a signal for appropriate short and

long-term market responses by both supply and demand. The MSA introduced a number of initiatives in 2004 to improve price signal fidelity.

For some time, generation participants have been concerned that system controllers have a tendency to “lean” on regulating reserves for incremental energy requirements rather than dispatching up the merit order. In 2004, the MSA undertook a comprehensive study that encompassed the 17-month period ended May 2004. The study concluded that there was no evidence to support this allegation. The report indicated that the actions of system controllers were consistent with managing system reliability in order to prevent the imposition of penalties by WECC. The report pointed to a lack of dispatch fidelity, producing

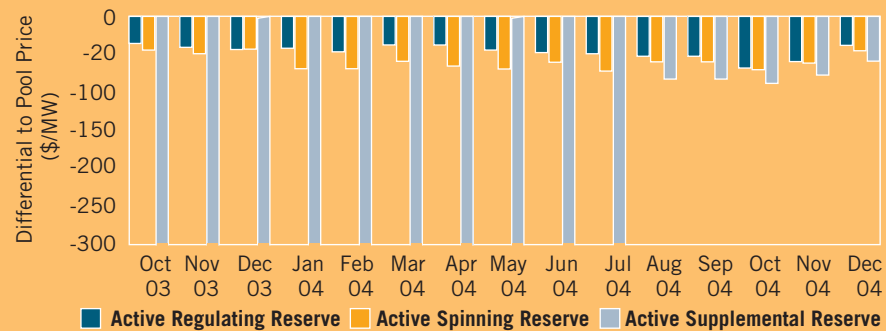
substantial swings in area control error (ACE) when the next dispatch produced a significant increase in SMP. The full report and analysis is available for review on the MSA website.

The MSA addressed the issue of aberrant pricing in the supplemental reserves market, as a result of the Hydro Power Purchase Arrangement (PPA), in several publications over the last 12 months. These efforts prompted the counter-parties of the Hydro PPA to recast an addendum to the PPA giving rise to more rational outcomes. The result has been a pricing index which participants can better relate to market fundamentals as they know and see them. The improved fidelity of the index in turn makes the playing field more level.



L to R: Douglas Wilson; Chris Joy

ACTIVE RESERVES PRICE INDICES



READ THE MSA'S REVIEW OF REGULATING RESERVES PERFORMANCE IN ALBERTA AT: WWW.ALBERTAMSA.CA

Certain aspects of the MSA's Ancillary Services Review, which continued into 2004, also addressed price signal fidelity. The MSA developed a more comprehensive set of market metrics for presentation in the MSA quarterly reports beginning in Q1 2004. The enhancements to OTC transparency noted earlier also served to improve price signal fidelity between exchange-traded reserves and OTC-procured reserves.

In the second half of 2004, the MSA reviewed import and export activity on the Alberta-B.C. interconnection to assess allegations that certain parties were importing energy uneconomically in order to manage the Pool price to suit their portfolio position. The economic or uneconomic nature of participants' activities is of concern to the MSA only to the extent that it harms the fidelity of the price signal. A key message in this

review was that the MSA expects reasonable efforts by participants to use the tie-line in a profitable (or least cost) way that demonstrates an effort to avoid manipulating Pool price.

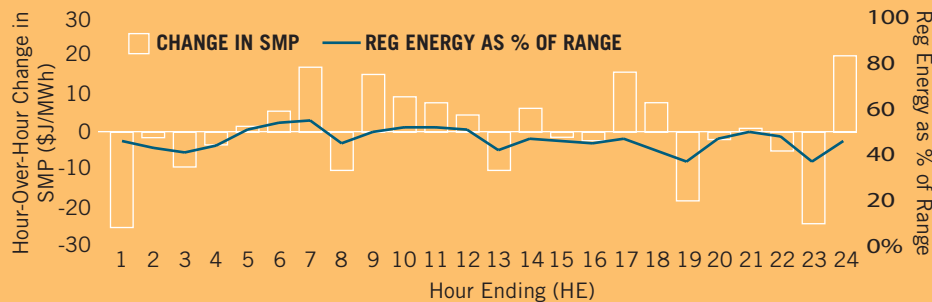
The MSA offered a number of recommendations to address this issue and will be following up on these in 2005.

A market that is information-rich and facilitates a level playing field in turn promotes a high fidelity price signal. A true and robust price signal is the evidence needed to prompt oversight agencies to take a step back and allow competition to work.

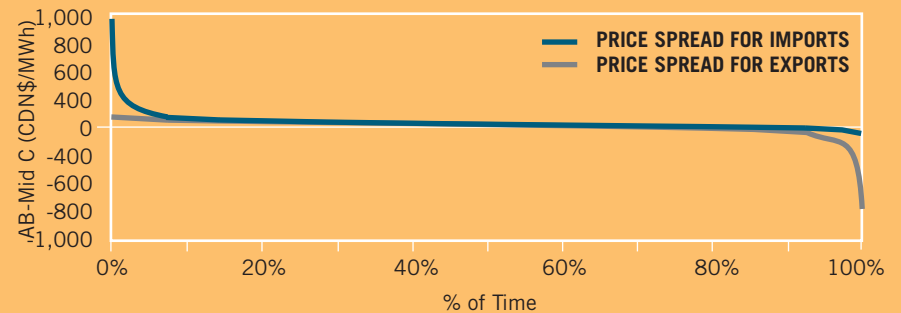


- *Active Reserve Price Indices – The graph shows the dramatic change in trade differentials for active supplemental reserves beginning in August, as a result of recasting an addendum to the Hydro PPA by counter-parties to the PPA.*
- *Regulating Energy and SMP – The graph is taken from the MSA review of regulating reserves performance in Alberta and shows that hours in which load ramps most steeply require the most balancing energy from regulating range.*
- *Import/Export – The graph is taken from the MSA review of imports, exports, and economic use of the Alberta/BC interconnection. The duration curves illustrate the price spreads that importers faced through the first seven months of 2004 compared to those faced by exporters. The difference is a function of much higher variability in Alberta prices relative to prices in the Mid-C market and whether you are a buyer from or a seller to the Alberta Pool.*

REGULATING ENERGY AND SMP



IMPORT/EXPORT



LET COMPETITION DO THE HEAVY LIFTING

Sometimes, the best investments are the ones you don't make. Allowing competition to do the "heavy lifting" means recognizing that the market is capable of regulating itself when the appropriate and functioning mechanisms are in place.

Such an approach, while "light handed," should not be construed as passive or asleep at the switch. It is an active choice that our agency makes wherever possible in discharging our mandate, in order to build confidence in the market mechanism. Undue intervention by market oversight agencies does not engender confidence that competitive forces are being provided reasonable tolerances within which to work.

Examples of where the MSA is trying to let competition do the "heavy lifting" can be found in our efforts to provide better transparency between the buying and selling of ancillary services OTC vs. through the exchange. With added transparency, it is hoped that participants will discipline the monopsony buyer by moving from one method of selling to the other if the buyer

allows the price difference between venues to shift. In addition, the MSA has advocated for imports and exports to no longer be confined as price takers, and for the level of export ATC to be improved. All of these recommendations were made to allow participants to more easily find ways to take their own actions to counter the actions of their competitors.

Going forward, the MSA will endeavour to not fix those things that will fix themselves in due course.



L to R: Martin Merritt; Mark McGillivray; Wes Green



THE MSA REGULARLY PRESENTS TO VARIOUS INDUSTRY CONFERENCES AND FORUMS. VIEW THE MSA'S PUBLIC PRESENTATIONS AT:
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Allowing competition to do the "heavy lifting" means recognizing that the market is capable of regulating itself when the appropriate and functioning mechanisms are in place.

2005 OUTLOOK

In 2005, the MSA will continue to focus on the four high-leverage “pillars” outlined in this report as the foundation for building confidence in a well functioning, competitive market.

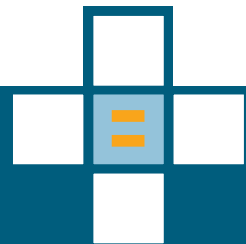
Undertakings for 2005 include Code of Conduct audits for all owners and affiliated retailers for the period July 2004 to June 2005. Also on the retail side, the MSA will continue to work with other agencies to determine how best to release all non-contracted industrial and commercial customer information so as to facilitate equal access to this information by all parties. Retail market metrics will also be the focus of enhancements for presentation in upcoming MSA quarterly and annual reports.

With respect to the wholesale market, the MSA is moving forward with an initiative to streamline procedures for generators to report their outages as per the trading practices guideline (TPG) through the energy trading system (ETS) of the AESO. Also with respect to the TPG, the MSA expects to provide industry with a review of the effectiveness of this guideline, and to take appropriate steps based on the outcome of the review. We will also move forward with procedures for participants to follow internally with respect to appropriate use of the tie-line; alternatively, we will develop and publish an MSA guideline if the industry proves unable to discipline its own behaviour.

Industry and government will be advancing their deliberations around market design and the MSA will provide whatever co-operation we can to facilitate this process.

The MSA looks forward to working with participants, stakeholders, and fellow agencies in ensuring that competition continues to benefit Alberta’s electricity market.

In 2005, the MSA will continue to focus on the four high-leverage “pillars” outlined in this report as the foundation for building confidence in a well functioning competitive market.



**BUILDING
CONFIDENCE**

AUDITOR'S REPORT

We have audited the balance sheet of the Market Surveillance Administrator as at December 31, 2004 and the statements of operations and cash flows for the year then ended. These financial statements are the responsibility of the company'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 company as at December 31, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

February 3, 2005

BALANCE SHEET

As at December 31, 2004	\$ 2004	\$ 2003
ASSETS		
Current Assets		
Cash	604,157	473,513
Accounts receivable	-	682
Prepaid expenses and deposits	52,168	33,289
	656,325	507,484
CAPITAL ASSETS (note 3)	84,145	110,494
	740,470	617,978
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	573,159	293,620
Deferred revenue (note 4)	167,311	324,358
	740,470	617,978
EQUITY (note 1)	-	-
	740,470	617,978

On behalf of the corporation:



Martin Merritt
 President & Chief Executive Officer,
 Market Surveillance Administrator



Wayne Silk
 Vice President & Chief Operating Officer

STATEMENT OF OPERATIONS

For the twelve months ended December 31, 2004

	Twelve Months Ended December 31, 2004 \$ 2004	Seven Months Ended December 31, 2003 \$ 2003
REVENUE		
Alberta Electric System Operator (note 4)	2,316,110	1,145,407
Interest income	2,754	696
TOTAL REVENUE	2,318,864	1,146,103
EXPENSES		
Salaries and benefits	1,355,327	805,995
Consultants and audit	557,460	149,384
Operating, office and administrative	369,381	171,115
Amortization	36,696	19,609
TOTAL EXPENSES	2,318,864	1,146,103
NET EARNINGS (note 1)	-	-

STATEMENT OF CASH FLOWS

For the twelve months ended December 31, 2004

	Twelve Months Ended December 31, 2004 \$ 2004	Seven Months Ended December 31, 2003 \$ 2003
CASH PROVIDED BY (USED FOR):		
OPERATIONS		
Net earnings	-	-
Item not involving cash:		
Amortization	36,696	19,609
Change in non-cash operating items:		
(Increase) decrease in accounts receivable	682	(682)
Increase in prepaid expenses and deposits	(18,879)	(33,289)
Increase in accounts payable and accrued liabilities	279,539	293,620
Increase (decrease) in deferred revenue	(157,047)	324,358
	140,991	603,616
INVESTING		
Expenditures on capital assets	(10,347)	(130,103)
INCREASE IN CASH	130,644	473,513
CASH, BEGINNING OF THE PERIOD	473,513	-
CASH, END OF THE PERIOD	604,157	473,513

NOTES TO FINANCIAL STATEMENTS

For the Twelve Months Ended December 31, 2004

1. NATURE OF OPERATIONS

The Market Surveillance Administrator was incorporated as an independent, stand-alone 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

	2004			2003
	Cost	Accumulated	Net	Net
	\$	Amortization	Book Value	Book Value
	\$	\$	\$	\$
Computer Hardware	42,694	21,565	21,129	31,154
Computer Software	24,389	12,699	11,690	19,592
Furniture & Equipment	73,366	22,040	51,326	59,748
	140,449	56,304	84,145	110,494

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.

	2004	2003
	\$	\$
Alberta Electric System Operator		
Opening balance, January 1	324,358	–
Collection for February to December 2004	1,935,818	1,293,782
Less: 2004 Revenue	(2,316,110)	(1,145,407)
	(55,934)	148,375
Collection for January 2005	223,245	175,983
Closing balance, December 31	167,311	324,358

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:

	\$
2005	84,000
2006	113,000
2007	117,000
2008	117,000
2009	98,000

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.

ALBERTA'S MARKET SURVEILLANCE TEAM

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