Alberta Election 2019: The UCP has Concluded that Alberta's Renewable Electricity Program (REP) is a Costly Subsidy

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What is REP?

REP is the series of competitive procurements run by the Alberta Electric System Operator ("AESO") in 2017 and 2018. Through REP the AESO, as instructed by the Province, encouraged the development of new renewable electricity generation in Alberta by entering into long term contracts to acquire the renewable attributes from the successful bidders in those procurements.

A REP contract, called a Renewable Electricity Support Agreement ("RESA"), is a 20-year contract with the AESO. The RESA essentially locks in or fixes the price that the successful proponent will receive for all of the electricity generated by its new renewable project over that 20-year period. That fixed price is called the "strike price", and the winners in the REP procurements bid the lowest strike price. It is important to note that under the RESA the AESO only purchases the renewable attributes of the electricity generated by the project, and not the actual electricity. Accordingly, the successful proponent will, like all generators in Alberta, sell their generated electricity in Alberta's power market over the term of the RESA. However, the RESA provides that if the power price received for that electricity from time to time is less than the strike price bid in the procurement, then the proponent will receive a top-up payment from the AESO equal to that difference (strike price minus power pool price). On the flip side, the RESA also provides that if the power price received by the successful proponent for that electricity from time to time is more than the strike price bid in the procurement, then the proponent will pay the AESO the difference (power pool price minus strike price). This arrangement is also referred to as a contract for differences, or an "Indexed-REC", in the marketplace.

The key thing to note about the RESA for our purposes is that a payment is only made by the AESO to the generator if power prices are less than the strike price. If power prices are more than the strike price then the generator actually pays the AESO. Essentially, to mitigate power price risk and achieve power price certainty over the term of its RESA, the generator trades its potential up side from higher power prices for down side protection from lower power prices.

What have been the REP results?

Round 1 of REP was held in 2017, and resulted in four proposed renewable electricity projects, with an aggregate generating capacity of 595.6 MW, signing RESAs with the AESO. The strike prices (fixed power price for the generators) under the Round 1 RESAs averaged $37.35/MWh. Those projects will be built and come in service by December 1, 2019.

Rounds 2 and 3 of REP were held in 2018 for projects that will be built and come in service by June 30, 2021:

- Round 2 had a 25% Indigenous project ownership requirement, and resulted in five proposed renewable electricity projects, with an aggregate generating capacity of 363 MW, signing RESAs with the AESO. The strike prices (fixed power price for generators) under the Round 2 RESAs averaged $38.97/MWh.
- Round 3 resulted in three proposed renewable electricity projects, with an aggregate generating capacity of 400 MW, signing RESAs with the AESO. The strike prices (fixed power price for generators) under the Round 3 RESAs averaged $40.14/MWh.

Taken together, the REP results mean that 1,358.6 MW of new renewable generation will be built in Alberta by June 30, 2021 and the average strike price (fixed power price for the generators) for those projects will be $38.59/MWh for 20 years.

Are those REP prices low?

Yes, even those who may be opposed to REP admit that the REP prices achieved by the AESO in the procurements were low – even lower than expected by the most ardent proponents of wind generation. By comparison, Ontario's last procurement of large renewable generation in 2016 achieved a price of $85.94/MWh for new wind generation, or more than twice the price achieved in Alberta's REP.

Proponents of REP also highlight that the REP prices are even lower than current Alberta power prices, which averaged $50.35/MWh in 2018. Proponents often assert that this means that the RESAs are profitable for the Province because, as described above, generators pay the AESO if the power prices they receive in the power market are higher than the REP prices. However, this position distorts reality to some degree because, for various reasons (e.g. wind patterns and concentration of wind generation facilities in Southern Alberta), wind projects generate their electricity at times when power prices, which fluctuate hourly in the Alberta market, are lower than the average. For example, in 2018 wind projects earned on average $38.90/MWh (77% of the $50.35/MWh market average) for their electricity. Still that $38.90 is greater that the $38.59/MWh average REP price, and would have resulted in the Province earning money from the RESAs had all of the renewable projects been constructed and operated in 2018 and achieved the average power prices that other wind projects in Alberta earned in 2018.

Is REP a costly subsidy?

The election platform of the United Conservative Party ("UCP") titled "Getting Alberta Back to Work" (the "UCP Platform") was recently released and states that:
"A United Conservative government will end costly subsidies after the Renewable Energy Program's round 3"

The release of the platform removed any uncertainty about whether or not the UCP (i) considered REP a subsidy, or (ii) would continue with REP if it were elected, including Round 4 of REP that the current government announced for 2019.

The UCP position on REP has raised a debate about whether or not REP is a subsidy, let alone a costly one.

REP proponents point out, as we did above, that the REP prices achieved to date are extremely low, even lower they say than what it would cost for new gas-fired power plants to be constructed to generate that electricity. Proponents also claim, as we highlighted for 2018 above, that the RESAs will likely result in cash payments from the generators to the Province because power prices will be higher than the REP prices over the 20 term of the RESAs.

Those people on the other side of the argument point out that REP is a subsidy because it is an incentive arrangement that is not offered to other generators, whether they be owners of existing thermal or renewable projects or proponents of new thermal projects. Whether or not the RESAs result in payments to or by the Province, opponents of REP argue that REP distorts what is supposed to be a competitive electricity market in Alberta. They claim it is an "out-of-the-market" contract scheme that subsidies (by eliminating power market price risk) those generators who want to construct new renewable generation but not those who want to build other forms of generation.

The UCP Platform concludes, rightly or wrongly, that REP is a subsidy, a costly one at that, and that a competitive electricity market should incent renewable generation without any need for REP. A few quotes from the UCP Platform help to illustrate the UCP position:

"Before the NDP [current government], a market-friendly electricity system brought $20 billion in investment dollars to Alberta to build 10,000 megawatts of new power since 1996, including 1,727 megawatts of market-based green energy without subsidies. In the future, EDC Associates estimates that a market-driven approach to renewables will add 1,566 megawatts of renewable power through 2030, without the need for any new taxpayer or consumer subsidies."

"A United Conservative government will ensure Alberta has a market-based electricity system that welcomes green power, providing affordable electricity for job-creators that gets Alberta back to work."

What is the bottom line?

The UCP has concluded that REP is a costly subsidy that will end with Round 3. If elected, the UCP will not proceed with Round 4 of REP that the current Alberta government announced earlier this year. Under a UCP government, new renewable

electricity projects will have to be financed and built in Alberta based on a market-based electricity system. They are unlikely to receive any “out-of-the-market” payments that other generation projects do not receive.

The good news is that REP, and we would add the Alberta Infrastructure solar procurement that also occurred in 2018 under the current government, demonstrate that new renewable electricity projects can compete in the Alberta market. The wind and solar resource is first class making for attractive renewable power pricing. This has resulted in the corporate power purchase agreement market heating up as aggregators and commercial and industrial (“C&I”) users in Alberta and elsewhere identify Alberta as a true power market – the only one in Canada – where renewable power contracts between C&I users and generators can be implemented at attractive prices. We should also note that we were hearing before the release of the UCP Platform that, because of the low renewable pricing coming out of REP, some generators were already considering taking some merchant price risk in order to earn higher returns on their invested dollars than could be earned through REP given the low REP prices.

Thus, even if the UCP is elected on April 16th and REP is canceled, in our view REP will have a positive lasting legacy for renewable generation development in Alberta – one that extends beyond the 1,358.6 MW of new renewable generation that has been contracted to be built under the program.

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