NOTICE TO MARKET PARTICIPANTS AND STAKEHOLDERS

Date: January 14, 2011
Re: Final Offer Behaviour Enforcement Guidelines and stakeholder comments on the draft

Effective today the MSA is releasing its finalized *Offer Behaviour Enforcement Guidelines* (OBEGs). This notice includes stakeholder comments received on the draft guidelines, the MSA responses to those comments and note of where changes have been made to the draft Guidelines. In one area, concerning discretionary outages at units covered by a Power Purchase Arrangement (PPA) the MSA has decided that the issue merits further and detailed consideration outside the guideline making process. Therefore, the Guidelines provide no view from the MSA on the timing of discretionary outages at PPA units. Stakeholders should expect to see a paper outlining the MSA's views in the area of discretionary outages in the next few weeks. An opportunity will be provided for further stakeholder comment at that time.

A final copy has been placed under the Guidelines tab on the MSA's website. The MSA will continue to consider new fact patterns and where possible give guidance to market participants. To the extent these fact patterns relate to offer behaviour the MSA will, from time to time, incorporate additional examples into the Guidelines. Market participants should note that *Intertie Conduct Guideline* (July 14, 2008) is now formally revoked. An amendment has been made to that guideline on the MSA's website to indicate that change but a copy will remain archived.

The MSA's stakeholder consultation on market participant offer behaviour is now complete. The MSA appreciates stakeholder participation in these matters. While the process has not been one designed necessarily to achieve consensus the MSA feels the process has been successful in providing clarification, narrowing areas of disagreement and providing clarity on the MSA's views. No specific evaluation activities are planned for reviewing the guidelines but the MSA expects the principles in the OBEGs to provide the basis for regular and special reports.

Yours truly,

/s/ Matt Ayres

Chief Economist

MSA Response to Stakeholder Comments

Comments were received from seven parties during the comment period.

Capital Power Corporation
Constellation Energy
ENMAX Energy (Comments & Attachment)
IPPSA
Powerex Corp.
TransCanada Energy Ltd.
TransAlta

Most participants welcomed the general approach to offer behaviour. In some areas market participants asked for clarifications and where able we have provided these below. In most cases the requests for clarification have not resulted in changes to the Guidelines themselves.

Interpretation of Subsection 2(h) of the Fair, Efficient, Open Competition Regulation

TransCanada and Capital Power both suggest that 'intent' should be required under subsection 2(h). This subsection reads:

> restricting or preventing competition, a competitive response or market entry by another person, including
>
> (i) a market participant directly or indirectly colluding, conspiring, combining, agreeing or arranging with another market participant to restrict or prevent competition, and
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> (ii) a market participant engaging in predatory pricing or any other form of predatory conduct;

TransCanada suggests the magnitude of available penalties applicable should also require some high burden of proof (i.e. intent). The MSA disagrees. Penalties are not articulated for specific provisions of the Regulation but broadly for contraventions of the legislation and consequently the MSA draws no inference from the maximum penalty levels to the appropriate burden of proof. Further, AUC Rule 013 suggests at subsection 4(l) conduct that is not willful or part of a broader scheme may be considered less serious.

Both market participants suggested that inference for the general provision should be drawn from the specifics in sub-paragraphs (i) and (ii), which do require an element of intent. The MSA agrees that both sub-paragraphs (i) and (ii) appear to involve an element of intent, which may be shown on direct evidence ('subjective' intent) or by reasonable inference ('objective' intent). However, we do not agree that subsection 2(h) requires a finding of intent in all circumstances.

The wording of subsection 2(h) supports an interpretation that sub-paragraphs (i) and (ii) are examples of the conduct described in the general provision but not an exclusive list. The general provision arguably sets out several categories or classes of prohibited conduct: restriction or preventing competition; restricting or preventing a competitive response; restricting or preventing market entry. The examples set out in sub-paragraphs (i) and (ii) do not by their language cover all of those categories or classes.

The legislative scheme is also relevant. Section 2 of the Regulation describes conduct that does not support the *fair, efficient and openly competitive* operation of the market, but is again not an exclusive list of such conduct. Among other things, this interpretation is supported by the language in subsection 3(3)(a) of the Regulation. By its preamble language section 2 of the Regulation links to the general conduct standard in section 6 of the *Electric Utilities Act* (EUA). There is no requirement in section 6 for a showing of intent in all cases.

Notwithstanding our view regarding whether proof of intent is required in all cases, the MSA will take apparent intent (subjective or objective) into account when considering its response to any conduct and related market outcome.

Capital Power suggests that the language in subsection 2(h) is explicit in requiring more than one action, but provides no further justification. The MSA interprets subsection 2(h) to indicate a single instance where a competitive response is restricted or prevented would constitute a breach. The draft guidelines were not explicit as to this view so we have amended the text to state 'The provision suggests a single event as well as a course of action might constitute a breach' (added to the first bullet in subsection 3.2.1.1)

Standard of Proof for Tacit Collusion

Capital Power noted that the Competition Bureau would require proof beyond a reasonable doubt in cases of a collusive agreement. Further, Capital Power asked for the MSA's view on the standard of proof. We note that a collusive agreement may be dealt with on either a civil (balance of probabilities) or criminal track under the *Competition Act*. The MSA believes that in proceedings brought by the MSA pursuant to the *Alberta*

Utilities Commission Act (AUCA) proof would need to be established on a balance of probabilities, as indicated by the AUC in Bulletin 2010-17. Accordingly, we see no need to add additional clarification to this section of the Guidelines.

Interpretation of Subsection 2(k) of the Fair, Efficient, Open Competition Regulation

TransAlta argued that only actual and not attempted circumvention should be viewed as a breach. In support it cited 'extensive deliberation in consultations leading up to the FEOC regulation' but provided no specifics.

The subsection 2(k) reads:

> carrying out actions or transactions to circumvent any enactment, order or decision of the Commission, ISO rule or other rule applicable to a market participant.

The MSA would have been inclined to agree with TransAlta if the wording more obviously supported its point, e.g., 'actions or transactions that circumvent'. In reviewing the other sections of the FEOC regulation we find in subsection (i) language that also suggests that 'purpose' without necessarily achieving effect is contrary to the regulation. Subsection 2(i) reads:

> offering electric energy from a generating unit or operating a generating unit, transmission facility or electric distribution system for the purpose of
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> (i) creating or increasing congestion, and
>
> (ii) being paid to relieve that congestion;

Consequently, the MSA is not persuaded to change the guidelines.

TransCanada argues that NGX rules should not be included in the term 'other rule' under subsection 2(k). In support TransCanada advances a number of arguments to view NGX rules as akin to a set of contractual terms and that 'other rule' should be defined in a more limited context. The MSA agrees that circumventing a provision of an NGX contract, or indeed other contracts, should not be within the scope of subsection 2(k). Section 3.2.1.3, final sentence has been amended to state 'This would include reliability standards but not include contractual terms between market participants'. We note that while the MSA would not pursue a 'circumvention' of contractual terms under section 2(k), such conduct is still potentially subject to action under other sections of the FEOC regulation.

Implementation Process

Capital Power commented on the MSA's process for incorporating examples into the guidelines and recommended a single document be maintained to catalogue this information. The MSA is considering a process for posting guidance on further hypothetical examples both on offer behaviour and in other areas. We accept that these examples should be readily accessible on the MSA's website.

Capital Power also asked the MSA to be clear on effective dates of views and allow the market time to adjust to changing guidelines. The request that the MSA be clear on effective dates is a reasonable one. Allowing time for the market to adjust to changing guidelines is more difficult. Since guidelines are only views and not rules, should the MSA change its view it is in essence effective immediately and that having been convinced to change its view the MSA would not normally seek to enforce a previous view on conduct that had occurred prior to the change in view. In circumstances where the MSA proceeded against a market participant under a revised doctrine and there was credible evidence that a market participant received insufficient notice to modify behaviour, the MSA would take this into consideration in seeking a remedy.

During guideline making, the process for communicating effective dates becomes more complex since the MSA genuinely wants to consult with stakeholders during the process of finalizing a guideline. The MSA believes the correct approach is to provide no view on a subject until it has had sufficient time to formulate an opinion and provide notice should that opinion change. The MSA is prepared to consider any preferable and workable alternatives to this approach.

Preferential Information Sharing (Section 3.3.2)

TransAlta requested some clarification of the MSA comments regarding preferential information sharing agreements. TransAlta acknowledged a role for the MSA in monitoring but understood that a preferential sharing of records that complied with an Alberta Utilities Commission (AUC or Commission) order would also comply with section 2 of the Regulation.

Subsection 3(3)(a) of the Regulation requires the market participant seeking a Commission order to establish that the records sought to be shared "will not be used for any purpose that does not support the *fair, efficient and openly competitive* operation of the market, **including the conduct referred to in section 2**" (emphasis added). The MSA understands this to mean that the Commission order will rely in part on preventative measures described by the market participant, and those measures should help to

ensure compliance with section 2 of the Regulation. However, even if followed the measures themselves do not necessarily guarantee compliance with the conduct requirement.

Taking this view into account the MSA does not see a need to change the language in the Guidelines.

Restrictions on trading using outage records that are not available to the public (Section 3.2.3)

In section 3.2.3 the MSA stated that it believed offers to the power pool are caught by the trading prohibition in Section 4. The Regulation defines trade as:

> "trade" means any financial or physical agreement, arrangement, transaction or strategy relating to the exchange, purchase or sale of electricity, electric energy, electricity services or ancillary services involving 2 or more market participants.

TransAlta noted that the power pool was not a 'market participant' and as a result an offer to the power pool could not be a trade. The MSA is not convinced to change its view. The *Electric Utilities Act* (EUA) essentially defines the "power pool" as the scheme operated by the AESO for the exchange of electric energy and related financial settlement. The EUA defines "exchange" to mean "…provide electric energy to or receive electric energy from the interconnected electric system". Any person that exchanges electric energy is by EUA definition a "market participant". Subsection 18(2) of the EUA requires that, with certain exceptions, all electric energy must be exchanged through the power pool.

In the view of the MSA an offer to the power pool is part of the exchange of electric energy, and is therefore a "trade" as contemplated by the Regulation. The MSA also notes that the definition of "trade" uses the words "…involving 2 or more market participants" rather than words such as between 2 or more market participants (emphasis added). The MSA believes that the power pool involves 2 or more market participants.

TransAlta also seeks clarification on whether the MSA believes this is a policy debate. The MSA notes TransAlta's different view, but does not consider this matter requires further policy debate.

Market Share Offer Control (Section 3.2.4 & Section 4.6)

TransAlta noted that an increase in offer control should not in of and itself trigger the need for investigation or further concern. The MSA agrees, further investigation would be triggered only if the increase was expected to adversely impact competition. Merger and acquisition activity that leaves offer control for a market participant under 30%, may well not raise a prospective issue under the *Competition Act* or FEOC, but such a determination will depend on the particular circumstances. For example, acquisitions that result in the elimination of a significant competitor would be more likely to pose concerns than those that do not.

TransAlta also disagrees with the MSA's views around variant D in Section 4.6. Two points of contention: 1) that there is an implied obligation to declare offer control and 2) that the MSA should have no role in merger and acquisition review where control is less than 30%. In this section the MSA is distinguishing how it might treat the fact pattern in different circumstances. Where offer control is not declared the MSA believes there may be a *per se* case for a restriction of competition – whether or not there is an implied obligation for disclosure is secondary to this. In contrast, declaration of offer control shifts concern from the existence of an 'agreement' to whether the transaction has or is likely to undermine the *fair, efficient, openly competitive* standard. In neither case is the MSA alleging a breach of Section 5 of the *Fair, Efficient and Open Competition Regulation*. The MSA is not convinced by TransAlta views to amend the guidelines.

Intertie Conduct

In section 4.4 of the draft guidelines the MSA presented a number of examples on intertie conduct. Powerex requested clarification on fact pattern B, in particular that the guidelines were not intended to discourage financial transactions by participants looking to hedge the expected pool price risk of its physical power position. The MSA confirms this is not our intent. Fact pattern B suggests a number of problematic elements that might indicate a breach of the FEOC regulation, most notably that Participant A is attempting to modify the behaviour of a competitor. Powerex also provided an example to clarify the difference. We have included a modified version of this in the finalized guidelines as Fact Pattern C (re-labeling the previous fact pattern C to D).

TransAlta also raised a concern with fact pattern B, indicating that it saw an inconsistency in the treatment of exports at a loss and offering financial swaps at a loss. As noted in the previous paragraph, the fact pattern is not simply an instance of offering a financial swap at a loss but an attempt by participant A to modify a competitor's

behaviour. The MSA believes that addition of Fact Pattern C should serve to provide further clarification on this point.

TransAlta also suggested an unequal treatment of imports and exports in Section 4.1 and 4.4. In reviewing these sections the MSA notes that Section 4.1 does not deal either with imports or exports. In Section 4.4, a number of illustrative examples are included; some note import and export conduct would be treated consistently. The absence of such an explicit statement is not intended to suggest inconsistent treatment but recognizes that in more complex fact patterns equivalence between importing and exporting has not been considered.

Discretionary Outages

The notice accompanying the draft guidelines requested specific views from market participants on whether the proposed approach to discretionary outages (section 4.7) should equally apply to units subject to Power Purchase Arrangements. Comments on this section were received from Capital Power Corporation, Constellation Energy, Enmax Energy and TransAlta. The MSA believes the issue is sufficiently complex and important that it should be subject of careful consideration outside the development of the OBEGs. Consequently, the MSA has amended section 4.7.2 from the draft guidelines to note that the MSA provides no guidance to market participants on the timing discretionary outages at PPA units. Stakeholders should expect to see a discussion paper outlining the MSA's views in the area of discretionary PPA outages in the next few weeks. An opportunity will be provided for further stakeholder comment at that time.

Request for Clarifications from Capital Power Corporation

1. Immunity Programs – The MSA is not intending to establish an immunity program at this time.

2. Workably competitive market – The MSA uses this term to emphasize that it does not expect the market to return outcomes consistent with the textbook concept 'perfect competition'.

3. Potential competitors v. Potential Entrants – The MSA refers to 'actual and potential competitors' in section 3.2.1.1 providing its views around the meaning of 'another person'. The MSA confirms that in talking about 'potential competitors' it is referring to potential entrants, rather than some hypothetical or theoretical entrant. A hypothetical entity, clearly, would not meet the definition of 'a person'.

4. Example of a Hub and Spoke Conspiracy – The UK Office of Fair Trading recently concluded an investigation into arrangements between tobacco manufacturers and retailers, whereby individual arrangements with each retailer the retail price of a tobacco brand was linked to that of a competing manufacturer's brand. These arrangements restricted the ability of these retailers to determine their selling prices independently.[1] As a second example, the US Federal Trade Commission in 1998 found Toys "R" Us to have organized a horizontal agreement between toy manufacturers, acting as the 'hub' in a hub and spoke conspiracy.[2]

5. Would the MSA pursue a 'hub' in a hub and spoke conspiracy if the hub were not a market participant – The MSA would have to review the circumstances carefully, guided by our mandate to promote FEOC. One possibility is referring the matter to another body having jurisdiction.

6. *For a single contravention would the MSA pursue a participant for multiple contraventions under different subsections* – The MSA would advance arguments under sections of the legislation it thought were relevant. That could include making a case for a contravention under more than one subsection of the FEOC regulation. Once again, we would be guided by the MSA's mandate and the remedy that would most likely promote FEOC. In our view, that does not necessarily mean a finding of breach and penalty under more than one subsection.

7. Does seeking an interim order not circumvent the rule making process? - In some circumstances the MSA could request an interim order that had the effect of changing obligations on market participants. All interim orders requested by the MSA would be subject to AUC approval. The MSA would expect the effect of an order to only apply until a more permanent solution was decided upon, which could include a change to ISO rules.

General Comments from IPPSA

IPPSA made a recommendation to place market event reporting within a broader context. IPPSA suggested this context could be provided in two ways:

1. *Report on degree of contract coverage in Alberta's market* – IPPSA suggested that reporting on load and supply exposure to spot price would put into context the MSA's market event reports. The MSA is inclined to agree and would find the

[1] Press Release 39/10, *OFT imposes £225m fine against certain tobacco manufacturers and retailers over retail pricing practices,* (April 16, 2010) http://www.oft.gov.uk/news-and-updates/press/2010/39-10

[2] For further details, see http://www.ftc.gov/os/1998/10/toyspubl.pdf.

same information useful in its broader monitoring of market participants. The MSA is considering options for the frequency and scope for collecting such information that would balance the benefits and costs associated with collecting this data.

2. *Price excursions should be placed in context of the costs of new generation* – IPPSA suggested the MSA's Q3/10 report was unfair in suggesting a price as 'relatively high' when it was reflective of the cost of new supply. The MSA agrees monitoring the costs of new generation and whether over time the Alberta market generates adequate returns are important metrics. Typically, the MSA has considered a net revenue calculation and believes further variants are possible. The MSA does not agree the cost of new supply is particularly useful metric in considering a single price event. The MSA's comments in the Q3/10 report were indicating that the price experienced was relatively high given the supply cushion during that hour and that had been the primary reason for considering that hour to be an event of interest.