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MSA REPORT

TPG Investigation Report November 2005 Event

23 August, 2006

MARKET SURVEILLANCE
ADMINISTRATOR

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1 INTRODUCTION

On November 8, 2005, the Market Surveillance Administrator (MSA) heard concerns from market participants who had observed trading activity believed to be inconsistent with the Trading Practices Guideline (“TPG”). In accordance with its mandate under the Alberta Electric Utilities Act (Act) and its MSA Investigation Process and Assessment Guidelines, the MSA undertook an investigation into certain trading activity affecting the Alberta electricity market(s) during November, 2005.

This report describes the investigation findings with respect to conduct involving ENMAX Energy Corporation and ENMAX Energy Marketing Inc., both of which will collectively be referred to as “ENMAX” for the purposes of this report. Specifically, the investigation scrutinized the disclosure and trading conduct in relation to a generating unit outage which commenced November 8, 2005, which appeared to be in breach of the TPG.

2 TPG BACKGROUND

The MSA has a broad mandate of surveillance and investigation around all aspects of the province’s electricity markets, and seeks to ensure the fair, efficient and openly competitive operation of the market. As part of its mandate, the MSA has the ability to establish guidelines in furtherance of the market. In this regard, the MSA published its Trading Practices Guideline (“TPG”) in February, 2004, concerning the use of asset outage information for trading.

“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.”¹

The MSA guidance provides the view that the potential for trading on outage information that is not in the public domain creates the perception and/or reality of unfairness in the market. The TPG was established to alert market participants to the view of the MSA.

In order to facilitate the ability of market participants to readily comply with the TPG, the MSA and market participants implemented an Information Disclosure Procedure (“IDP”) through which outage disclosure would be made, and through which the precise timing of that disclosure would be established.

The IDP utilizes existing disclosure protocols under the ISO rules, specifically Operating Policy and Procedure (OPP) 601.

An outage is to be disclosed to the System Controller in accordance with OPP 601 of the ISO rules. Insofar as the TPG and IDP are concerned, the outage is deemed

¹ Full document available on MSA Website under subsection “TPG & IDP”

to have been made public at that point, such that a party can appropriately trade around the outage.

Under the PPA and the ISO rules, the PPA Buyer (as the STS contracting party) is responsible for disclosure via OPP 601.

3 INVESTIGATION FACT SUMMARY

On the morning of November 8, 2005, ENMAX (as PPA Buyer) was advised of a possible generation outage through communications with its counterpart PPA Owner (the “Possible Outage”).

The communications regarding the Possible Outage began at approximately 7:00 a.m. on Tuesday November 8, 2005, with the forwarding to ENMAX of a restatement sent from the generating plant. The restatement indicated “full load – Suspected Boiler Leak – should last till (sic) weekend”.²

An ENMAX staff member was thereafter involved in a telephone communication with the plant operator in order to attempt to gain further clarity on the operating condition of the unit and the timing of the Possible Outage. Thereafter, ENMAX sent an e-mail to the PPA Owner indicating as follows: “[Plant] has a second boiler leak. Small enough that they will not be coming off till (sic) the weekend. There is no definite outage scheduled as of yet so we are not entering into EDS (sic) until we have a definite notification from the plant. Most likely coming off Friday night or Saturday morning.”³

This Possible Outage information was not of a public nature at that point.

During the morning of November 8, 2005, based on the Possible Outage information, ENMAX entered into a series of seven trades (the “Trading Activity”).

At 14:07 on November 8, 2005, ENMAX received definitive information to the effect that an outage would occur at approximately 21:00 on November 8, 2005 (the “Actual Outage”).

At 14:13 on November 8, 2005, a TDE value for the plant was entered into the AESO system by ENMAX.

At 14:29 on November 8, 2005, additional information was received in the form of a restatement that prompted a subsequent revision to be entered by ENMAX regarding the TDE for the plant.

At 20:52 on November 8, 2005, the plant went offline.

4 ADDITIONAL VIEWS OF THE PARTIES

From the perspective of the TPG and IDP, information is regarded as disclosed to the public to the extent that it has been provided to the AESO through the TDE system and OPP 601. ENMAX was of the view that the information received during the morning of November 8, 2005 in connection with the Possible Outage

² Restatement Form sent via email Tuesday, November 8, 2005

³ Email dated Tuesday, November 8, 2005 7:08 AM

could not, for several reasons, be submitted to the AESO in the form of a TDE. The MSA does not necessarily accept that view, and in any event takes the position that ENMAX should not have engaged in the Trading Activity until the Possible Outage had been duly disclosed to the AESO.

There is no question that an Owner will be aware of an outage at the PPA unit which they operate. The Buyer can also clearly be said to ‘know’ the information to the extent that details of the outage have been disclosed to them.

The MSA has taken the view that outage information is considered “known” when it is certain enough to be acted upon. The MSA letter to participants posted on the MSA site on June 28, 2004 reiterated this point:

“OPP 601 requires that asset owners submit outage information when a “decision” has been made with respect to scheduling an outage. The AESO’s operating policy does (sic) not define “decision” and effectively leaves it to the discretion of the asset owner. With out the benefit of a definition for the term “decision”, the MSA will use the criteria “known and actionable” to determine when outage information should be submitted for purposes of the IDP. Fundamentally, outage information should be submitted when it becomes good enough to trade on (i.e., known and actionable).”⁴

In the view of the MSA, ENMAX’s policies and procedures were inadequate to ensure compliance with the TPG.

5 SUMMARY OF INVESTIGATION RESULTS

As set out in the INVESTIGATION FACT SUMMARY above, ENMAX traded before the Possible Outage information in their possession was made public. Upon review, these trades were determined to have settled “out of the money” and were therefore not found to be profitable Trading Activity for ENMAX. Nevertheless, the trading occurred prior to disclosure of the Possible Outage information, and thus constituted a breach of the TPG. In the view of the MSA, such trading negatively impacts market confidence, irrespective of ex-poste profitability.

The concept of not disclosing outage information considered insufficient for TDE submission is not an acceptable justification for the lack of disclosure prior to engaging in trading activities. Given the nature of the Possible Outage information provided to it, ENMAX had an obligation to either disclose the information to the AESO or to refrain from trading on that information until the Actual Outage information was received and disclosed to the AESO.

The view of the MSA in this regard was discussed at the June 10, 2004 workshop at which ENMAX representatives were in attendance and was subsequently included in the workshop summary in the June 28, 2004 MSA “Notice to Market Participants” which was published to the MSA website.⁵

³ ibid

⁴ ibid

Specifically the notice included the phrasing:

“...the MSA will use the criteria “known and actionable” to determine when outage information should be submitted for purposes of the IDP. Fundamentally, outage information should be submitted when it becomes good enough to trade on (i.e., known and actionable). “

In this instance, the action taken prior to the disclosure was the act of trading to cover the potential short position associated with the Possible Outage. Therefore, by taking this action, ENMAX was in breach of the TPG.

6 OUTCOMES AND RESOLUTIONS

In this instance, the MSA is satisfied that ENMAX has breached the TPG by its conduct on November 8, 2005.

At the completion of any investigation, s. 59 of the Alberta Electric Utilities Act provides the MSA an option for to pursue a Tribunal that would render a decision on the case brought before the Tribunal.

The Act states:

59(1) If the Market Surveillance Administrator is satisfied that a market participant

(a) has contravened this Act, the regulations or ISO rules, or

(b) has engaged in conduct that is not in accordance with the fair, efficient and openly competitive operation of the market,

Market Surveillance Administrator may give written notice to the chair of the Board and to the market participant named in the notice.

There are various reasons to request a Tribunal, including the need for sanctions which the MSA cannot obtain through other means. That said, the Tribunal approach should only be used where required.

As with many quasi-judicial processes, there exists an alternative to a protracted hearing process in the form of a negotiated settlement. From the perspective of the MSA, if a suitable outcome can be achieved that would not be substantially different from the most optimistic Tribunal decision, the negotiated settlement outcome would be favored.

To this end the MSA has concluded a negotiation with ENMAX in order to effect a change in conduct and ENMAX has agreed to appropriate sanctions for the TPG breach. The details of the negotiated outcome (Settlement Agreement) are as follows:

(a) by a Notice and other communications, ENMAX will acknowledge its activities, confirm its continued intention to comply with the TPG, and confirm the facts relevant to the TPG investigation, analysis, conclusions and outcome;

(b) ENMAX will implement policies and procedures intended to ensure TPG compliance, and document those undertakings in a Compliance Plan filed

with the MSA. The Compliance Plan will address, among other things, relevant standards of conduct, corporate governance, employee training, and internal monitoring and reporting;

- (c) ENMAX will carry out and report to the MSA on a review of the effectiveness of the compliance plan and related policies and procedures as at 6 months and 12 months after the effective date of the Settlement Agreement and will work with the MSA to address any deficiencies; and
- (d) ENMAX will plan and execute in cooperation with the MSA, a speaking/education event for the benefit of the Alberta electric industry as a whole. The full cost of such an event will be borne by ENMAX.

The MSA is satisfied the above negotiated sanctions are appropriate for the TPG transgression on November 8, 2005.

The MSA wishes to acknowledge the fact that ENMAX was highly cooperative and accessible throughout the investigation. Moreover, since the inception of the investigation, ENMAX has been proactive in terms of modifying internal policies and procedures pertaining to outage disclosure and trading.

The MSA will continue to steadfastly enforce the TPG and remains accessible to market participants should there be any aspect of the TPG that requires greater explanation or guidance.