MARKET SURVEILLANCE
ADMINISTRATOR

MONITORING THE ELECTRICITY INDUSTRY IN A CHANGING MARKET

ANNUAL REPORT 2008

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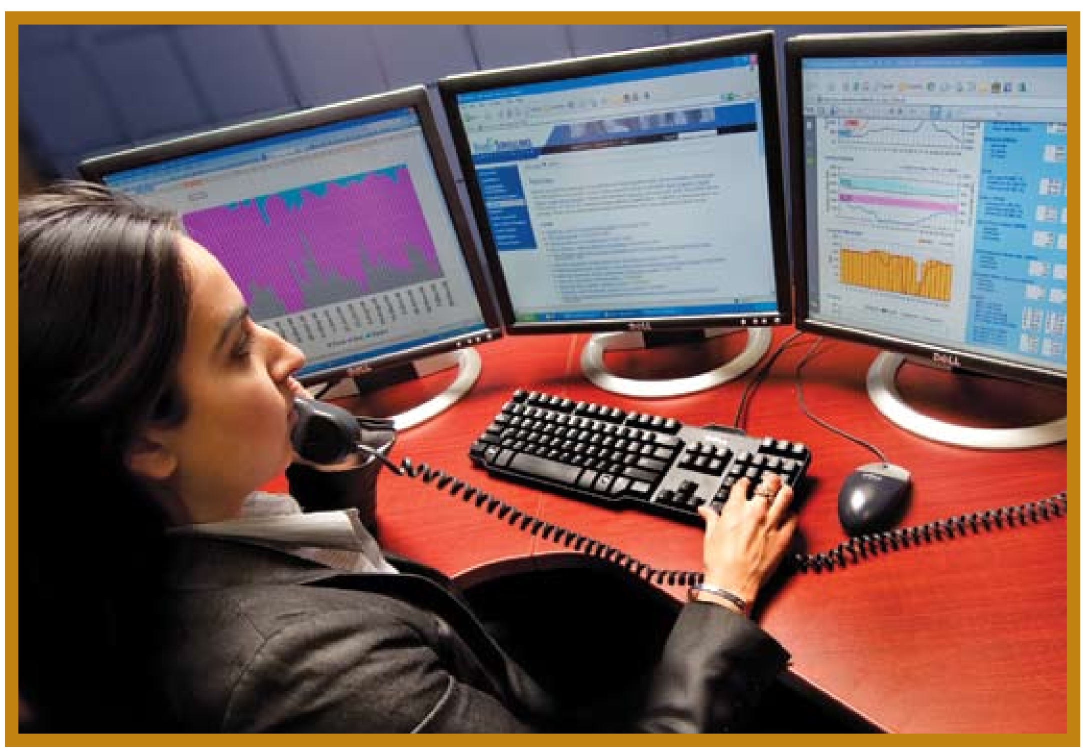
WE MONITOR INDUSTRY BEHAVIOUR AND OUTCOMES, CHANGING PATTERNS AND MICRO-DETAILS TO ENSURE ALBERTA'S ELECTRICITY AND RETAIL NATURAL GAS MARKETS ARE FAIR, EFFICIENT AND OPENLY COMPETITIVE.



PRESIDENT'S MESSAGE

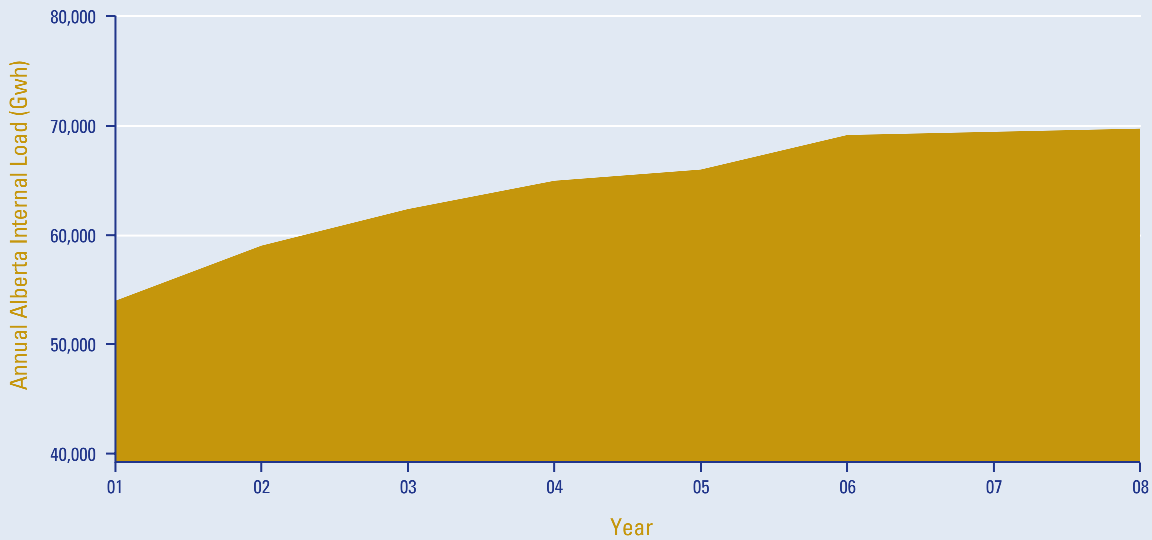
MARTIN MERRITT

PRESIDENT AND CHIEF EXECUTIVE OFFICER

Talk of global recession and the credit crunch has dominated the news for the last six months. It has become obvious that the problems are deep enough and broad enough that they will affect us all. We are just beginning to understand how these impacts will ripple through the electricity market. There is little doubt that they will bring about change, but it is my belief that Alberta's electricity market will continue to demonstrate its ability to adapt and serve the needs of Albertans.

We don't yet know how the recession will impact the growth in electric demand in Alberta and evidence suggests we may be foolish to attempt predictions. Through 2006 and 2007, many pundits were worried that the high load growth experienced since 2000 would continue unabated, leading to concerns about the adequacy of new generation construction. Instead, we have experienced something of a pause in load growth – something the forward market anticipated with soft forward prices in the two preceding years. There's no better demonstration of the power of the market than its ability to outperform bullish pundits while providing new generating capacity when we need it. The same market that rapidly developed several thousand megawatts of generation at the beginning of the millennium has now ensured that no significant funds have been committed to major generation projects, the need for which has likely been deferred. Score: Pundits 0, Market 2.

GROWTH IN ALBERTA INTERNAL LOAD



Pundits 0, Market 2:
Most pundits expected growth in electric load to continue at the rapid rates experienced from 2001 to 2006. Instead, there's been something of a pause. Even if the pundits got it wrong, soft forward market prices through 2006 and 2007 got it right – growth was slowing.

NO BETTER TIME FOR INFRASTRUCTURE

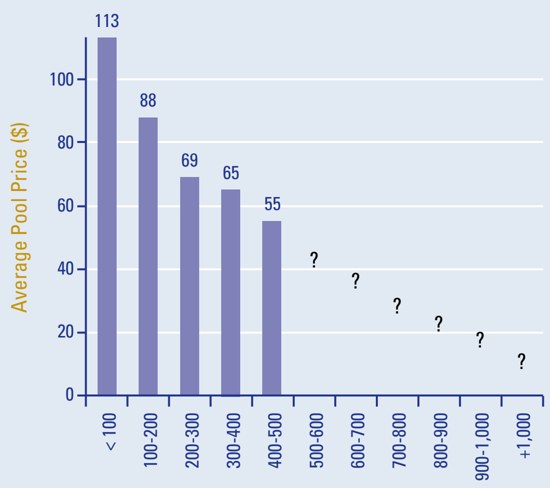
The pause in demand may also give us a slight reprieve from the problems associated with an insufficiency of transmission. In last year's Annual Report I commented on these issues.

Beyond any concerns around reliability of the system, a congested system is inefficient, resulting in higher energy losses from transportation, and is less effective in delivering efficient competitive outcomes. During the year, some important transmission work was completed. But as we know from driving around our cities, upgrading an already congested road can be a painful experience. One notable project, transmission work in the Keephills-Ellerslie-Genesee area, kept significant generation out of the market, resulting in far higher prices than we would typically see at that time of year. If the pause in demand growth gives us a window to complete necessary transmission upgrades while avoiding some of the interim pain, I hope we are able to seize this opportunity.

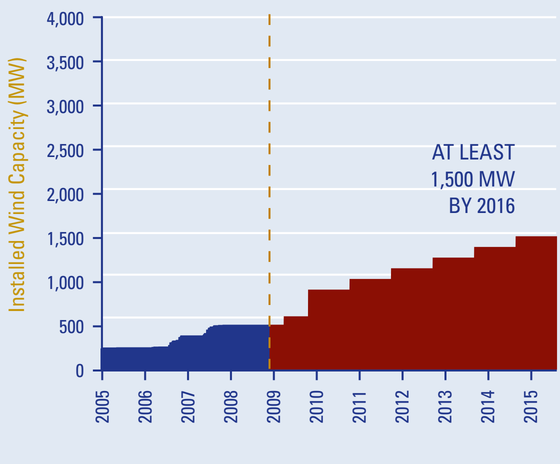
GREEN BUT PRICE CANNIBALIZING?

Alberta's deregulated market has been successful in attracting development of wind power, often not by large established generators but by smaller entrepreneurs. At the end of the year, companies proposing over 10,000 MW of wind generation (approximately the same as Alberta's current peak demand!) had expressed interest in developing in Alberta. The credit crunch will likely complicate the financing of many of these projects, resulting in some being delayed or cancelled. While the credit crunch is an unwelcome external constraint, forces were already at work in the market that ultimately had and will continue to have a similar effect. As market monitor, we have observed that concentrated wind development in the southwest of the province has a price-cannibalizing effect – correlated output from a large number of wind turbines has a suppressing influence on price. This effect has not been lost on investors and is sure to result in far less actual investment than headline numbers have been suggesting.

RELATIONSHIP OF POOL PRICE TO WIND GENERATION



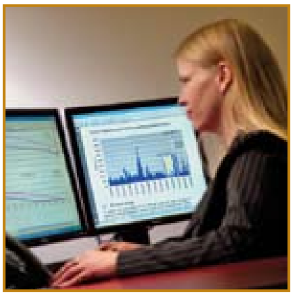
EXPECTED GROWTH IN INSTALLED WIND CAPACITY



Price Cannibalizing?

Currently, 500 MW of wind generation are connected to the Alberta system and this is forecast to grow rapidly. In 2008, higher levels of wind generation were associated with lower prices – when total wind generation is less than 100 MWh, average pool price is $113 and when wind generation is above 400 MWh, average pool price is only $55. This negative relationship stems from the high correlation between the output of different wind generators that results from their concentration in the southwest of the province. If new wind developments remain geographically concentrated this trend is likely to continue, providing a natural brake on wind development and an incentive for investors to look for wind generation sites in other areas of the province.

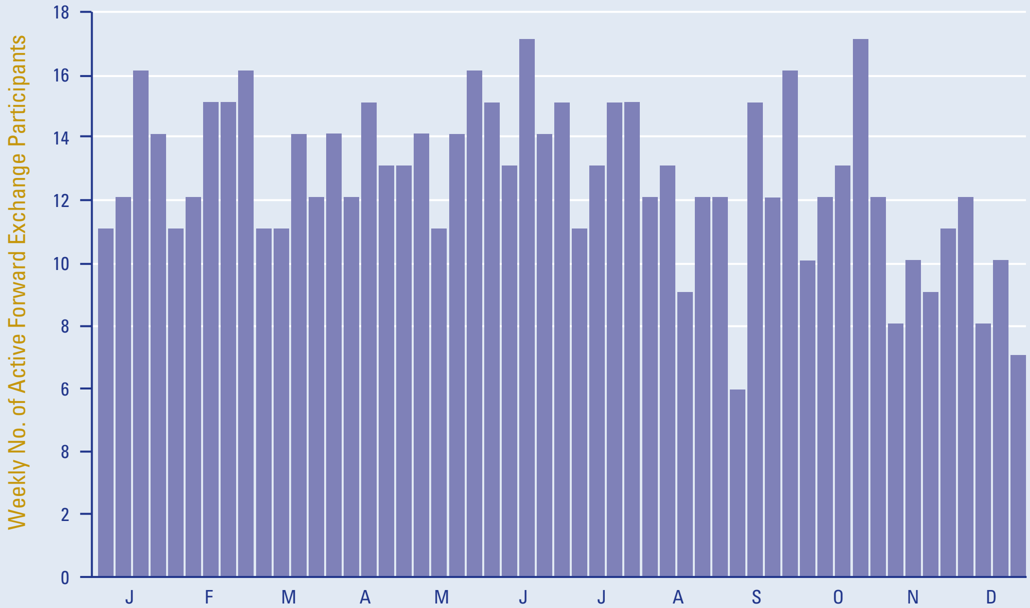
THE CANARY IN THE COAL MINE?



One concern arising out of recent credit tightness in the broader economy is that of liquidity in the forward electricity market. Easier availability of credit used to permit generators and large consumers to lock in prices for electricity months or years in advance. In a liquid market, they would do so in the confidence that should their view change they could adjust those positions. Speculators also play an important role in greasing the wheels of the market by expanding the number of potential trading parties. Contributing much of this market "grease" have been the banks and their associated trading arms, some of which have been hit hard and have pulled back from non-core activities including trading commodities such as Alberta electricity.

Many market participants also face increased credit constraints of their own and in such times may be less inclined to tie up scarce credit capacity with long-term forward transactions. The net impact is that forward market trading is likely to suffer at least in the short-term. In recent months, we have been seeing lower trading volumes and fewer participants (see graph below) – we continue to watch developments closely in this area.

ACTIVE FORWARD EXCHANGE PARTICIPANTS (2008)



Active Forward Exchange Participants

Watching developments in forward market liquidity can give us a leading indicator of how the credit crunch will impact the efficiency of Alberta's electricity market. Since summer 2008, the overall number of market participants trading in a given week has declined. With about 10 market participants trading, liquidity remains adequate – but we continue to watch with interest.

NEW ROLES. NEW CLARITY.

Outside the influence of the overall economy, 2008 was a significant year for developments in the regulatory area. The Alberta Utilities Commission Act (AUCA) established new responsibilities for the MSA and reduced overlap between the agencies.

The Act confirmed the MSA's role as investigator and prosecutor and has seen us pick up the role of dealing with participant breaches of ISO rules. During the year, we examined 71 suspected breaches with 21 resulting in sanctions, of which seven saw monetary penalties being issued. Participants issued a penalty may choose not to pay, in which case a hearing is held before the Alberta Utilities Commission (AUC). As of year-end, three matters had resulted in applications to the AUC for a hearing, two of which had resulted in the AUC confirming the penalties issued by the MSA. The third application concerned the late payment of a specified penalty and was the subject of an order from the AUC on January 26, 2009.

Finally, we believe that lengthy consultation among industry, government and agencies could soon bear fruit with the promulgation of the new "Fair, Efficient, Openly Competitive Conduct" (FEOC) Regulation in early 2009. The regulation is intended to add clarity for all by further defining the range of acceptable market behaviours.

It would likely take some time and perhaps some AUC decisions for both market participants and the MSA to fully digest all of the practical implications of the FEOC Regulation. In any event, this quest for clarity is certain to be a benefit to market efficiency and to the investment climate that our market depends on.

In addition to general behavioural surveillance, the MSA monitors the effect that market rules have on market efficiency and the competitive environment. At the end of 2007, the major package of ISO rule changes, collectively known as the "Quick Hits," was introduced and we have spent the year examining and testing whether these rules have had the desired effect and/or resulted in any unintended consequences. Overall, the implementation of the new rules has gone well. In a few areas, the MSA has concerns that rules have had outcomes that were not foreseen at the time they were designed. The biggest challenge remains that the rule changes exposed some fundamental weakness in the AESO's information systems underlying the market. The AESO has been diligently working to address these concerns but the development of new systems required to fully address these problems will take considerable time.

SUMMARY

In closing, I hope that some of the insights I have shared will inspire you to dig deeper into the work of this agency. The MSA routinely shares its analysis and views with the market, consistent with its regulatory obligations regarding participant confidentiality. 2008 saw a wealth of analysis published to assist market participants and interested Albertans in making sense of market rules, market outcomes and market drivers. Experience tells us that markets function best when there is a rich supply of information about their workings. In that respect, I am pleased to commend the MSA's 2008 Annual Report to you.

(signed) "Martin Merritt"

Martin Merritt
Market Surveillance Administrator
February 28, 2009

WHOLESALE MARKET EVENTS

In 2008, the Alberta wholesale electricity pool price averaged $89.95/MWh. This was up by 34% from an average pool price of $66.95/MWh in 2007 and up by 11% from an average pool price of $80.79/MWh in 2006. Average monthly prices were significantly higher in the first half of 2008 compared to the previous two years. Natural gas prices increased through the first half of the year, reaching a price above $11/GJ in June followed by a rapid decline in the summer with prices averaging approximately $6/GJ in the latter part of the year. The year averaged an implied market heat rate of 12.2 GJ/MWh, compared to 11.4 GJ/MWh in 2007.

At the end of 2008, the forward market was signalling prices for 2009 of about $79/MWh (equivalent to a 12.2 GJ/MWh heat rate, the same as 2008), and $80/MWh for 2010 (10.3 GJ/MWh heat rate).

Some of the key events driving prices and market outcomes during the year are summarized below:

IMPACT OF THE KEG CONVERSION PROJECT

The KEG conversion project consisted of a number of smaller projects aimed at upgrading the transmission system in the Keephills-Ellerslie-Genesee area. The project, spanning mid-March to the end of May, resulted in a large number of MW of generation unable to access the system (constrained down generation) with the market impact being felt in high pool prices during the normally quiet shoulder season.

LOW AVAILABILITY OF GENERATION LED TO HIGH PRICES

Despite modest loads in the early fall, unusually low availability of gas generation (mostly due to planned outages), combined with erratic availability of coal generation (mostly due to unplanned outages), resulted in some days with high average prices. Instances of high prices earlier in the summer largely coincided with days with low generation availability.

CALGARY AREA CONSTRAINTS

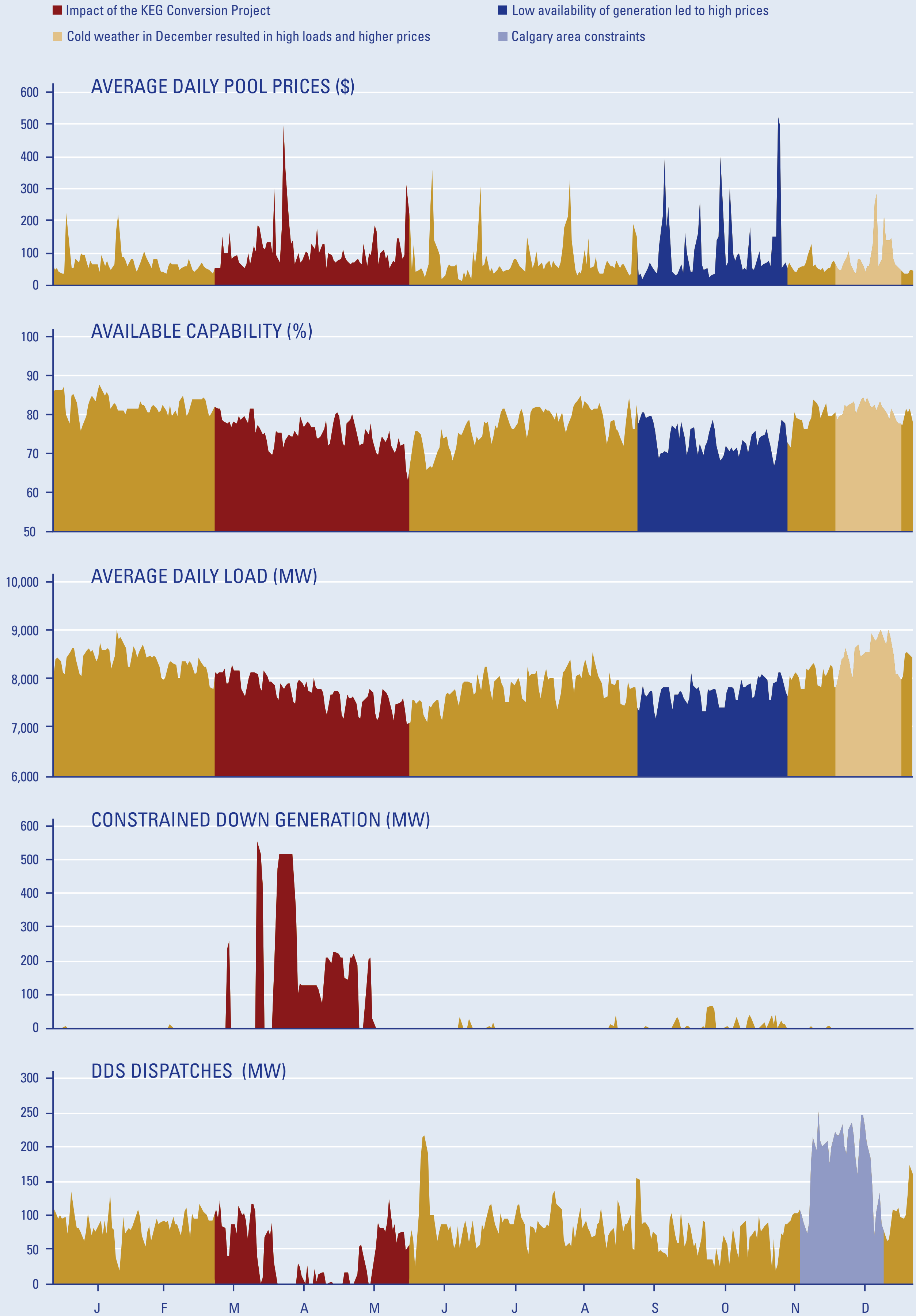
Constraints in the Calgary area in November and December resulted in a significant increase in the amount of Transmission Must Run (TMR) generation required. Corresponding to the additional TMR requirements, more MW of Dispatch Down Service (DDS) were utilized.

COLD WEATHER IN DECEMBER RESULTED IN HIGH LOADS AND HIGHER PRICES

2008 saw record peak demand of 9,806 MW in hour ending 18 on December 15. Overall, average loads in December were also high during a prolonged period of cold weather. Typically, availability of generation is high during December, but a number of unit outages and maintenance at coal units combined with high loads to result in higher prices.

ON THE WEBSITE:

The MSA publishes a wealth of regular and special reports covering market events and outcomes. Among the regular reports are the Daily Snapshot, a weekly Market Monitor and more in-depth Quarterly Reports. See ***www.albertamsa.ca*** for more details.


Impact of the KEG Conversion Project
Low availability of generation led to high prices
Cold weather in December resulted in high loads and higher prices
Calgary area constraints
AVERAGE DAILY POOL PRICES ($)
0
100
200
300
400
500
600
AVAILABLE CAPABILITY (%)
50
60
70
80
90
100
AVERAGE DAILY LOAD (MW)
6,000
7,000
8,000
9,000
10,000
CONSTRAINED DOWN GENERATION (MW)
0
100
200
300
400
500
600
DDS DISPATCHES (MW)
0
50
100
150
200
250
300
J F M A M J J A S O N D

WHOLESALE MARKET DEVELOPMENTS IN-DEPTH

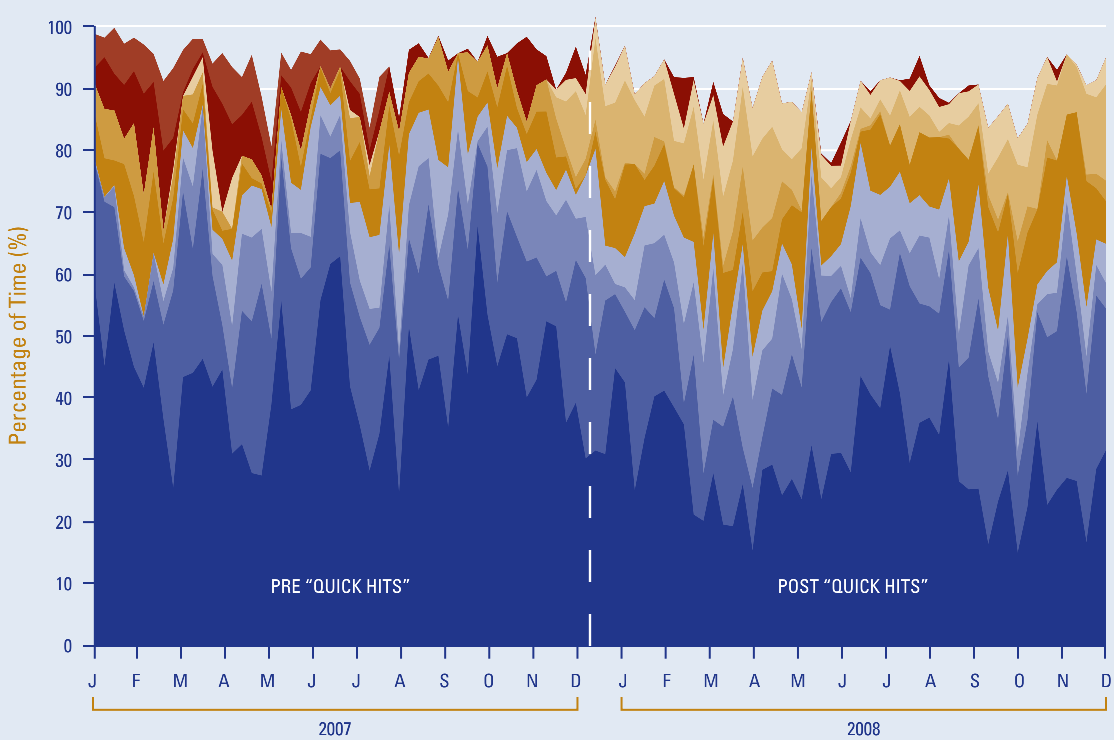
On December 3, 2007 the AESO implemented the "Quick Hits" rules package. This package represented perhaps the most significant change in ISO rules since market opening.

"QUICK HITS" RULES REVIEW

The "Quick Hits" were comprised of four main areas:

- Merit Order Stabilizers
- Reconstitution of Pool Price for Transmission Must Run (TMR) Energy
- Payments to Suppliers on the Margin
- Treatment of Imports/Exports

PRICE SETTING BY SUBMITTING PARTICIPANT



The different colours in the graph above represent different market participants.

MERIT ORDER STABILIZERS

The new rules feature obligations for generators such that they "must offer" energy and "must comply" with dispatches. In addition, the rule changes allow greater flexibility to change offers two hours prior to the hour to which those offers applied (i.e. before T-2) and less flexibility after T-2. The MSA had expected these rules to have a fundamental impact on offer behaviour. This appears not to have been the case but some subtle changes have occurred. For example, in the graph to the left, we can see price-setting by the submitting participant has become less concentrated since December 2007 when the new rules were put in place.

RECONSTITUTION OF POOL PRICE FOR TRANSMISSION MUST RUN (TMR) ENERGY THROUGH DISPATCH DOWN SERVICE (DDS)

In some areas of the province, transmission constraints result in additional energy being needed in a local area. In order to deal with these constraints, the AESO dispatches generators for Transmission Must Run (TMR). Since these dispatches occur outside the normal order of economic merit, they tend to have a suppressing impact on pool price. The "Quick Hits" rules included a Dispatch Down Service to offset the impact of TMR and reconstitute the pool price.

During 2008, the MSA published a major report examining the effectiveness of DDS. Overall, the findings showed that DDS had only achieved a partial reconstitution of pool price and had a number of unanticipated impacts on the market, including:

- Price "stickiness" around the reference price – see next page for more information
- A "free" money problem – see next page for more information

PAYMENTS TO SUPPLIERS ON THE MARGIN

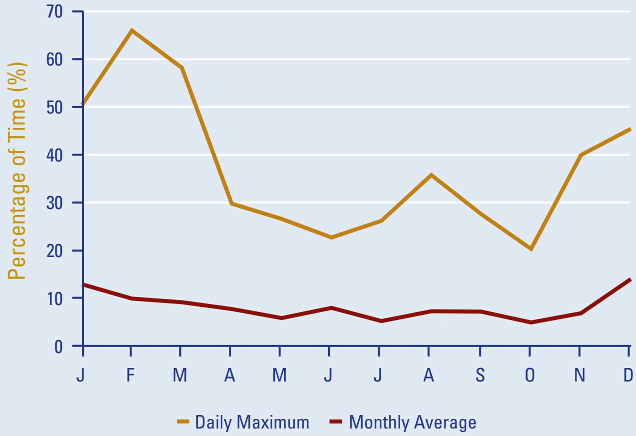
The "Quick Hits" rules feature a payment to suppliers on the margin in order to compensate generators that were responsive to intra-hour price signals. Under the rule, suppliers that are dispatched to provide energy at a high offer price may be eligible for an additional payment if the pool price (the average price for the hour) settles below their offer price.

Overall, the amount of payments made to suppliers on the margin during 2008 was relatively small, at $3.4 million. About one-third of these payments have gone to generators that switch from providing Transmission Must Run (TMR) services to providing energy. The MSA does not believe that the level of payments accruing to TMR providers was widely anticipated at the time the rules were introduced.

TREATMENT OF IMPORTS/EXPORTS

Although the source of much discussion during the formulation of the "Quick Hits" rules, little has changed for importers and exporters other than the inability to change their offers after T-2. The MSA continues to monitor efficiency on the interties. While efficiency does not seem to have declined since the introduction of the T-2 rules, there continues to be room for improvement.

PROPORTION OF TIME SMP WITHIN $1 OF THE REFERENCE PRICE

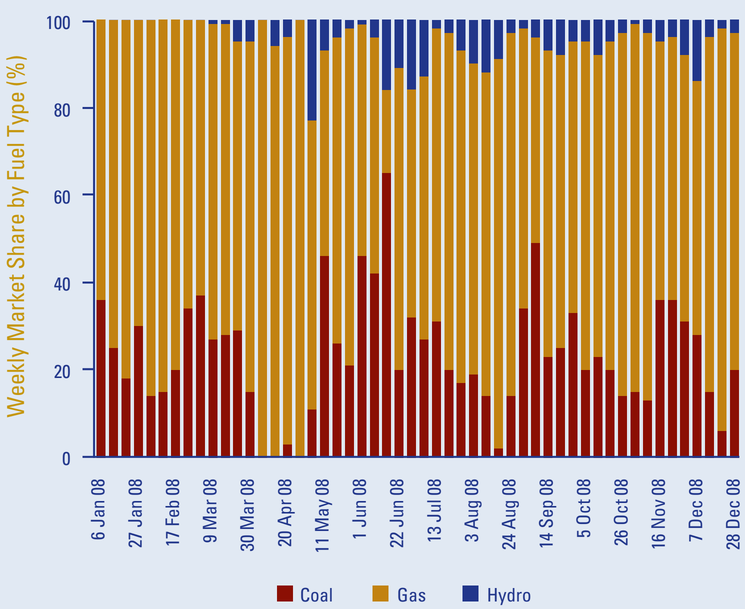


Dispatch Down Service: Price Stickiness

The DDS market features an administratively set "reference" price, only below which does reconstitution take place. Price often becomes "stuck" close to the reference price. The MSA is concerned that price might be unduly influenced by the existence of a reference price and not necessarily reflective of fundamentals.

The graph shows the proportion of time that System Marginal Price (SMP) was within $1 of the reference price. In some months, this averaged over 10% of the time and on some days much more. For example, on February 1, 2008, the price was set within $1 of the reference price 66% of the time.

DDS BY FUEL SHARE, WEEKLY



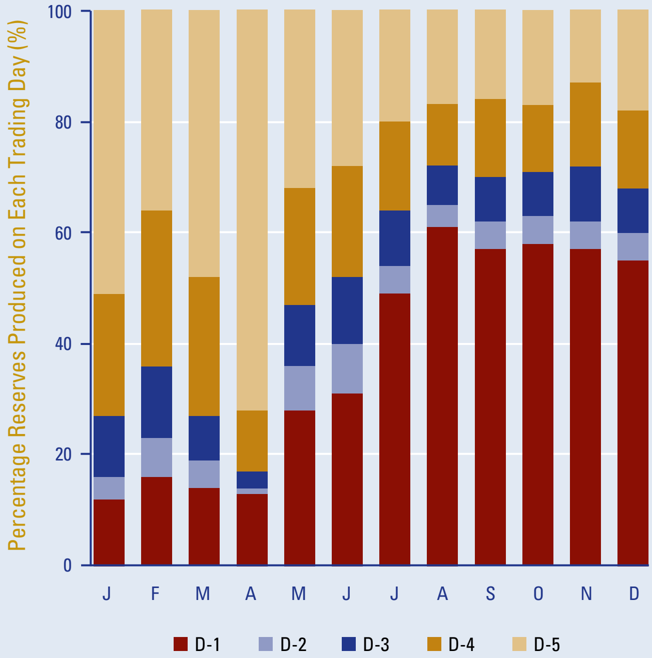
Dispatch Down Service: a "Free" Money Problem

Market participants with in-merit offers can choose to also offer DDS. If participants are successful in being selected for DDS, they avoid the operating costs associated with generating and receive payment for DDS (a discount to pool price). The MSA has observed that the DDS market has attracted some generators to offer DDS that would not otherwise have been running at the prevailing pool price. While these generators often are successful in being dispatched for DDS, the pool price is not fully reconstituted.

Some evidence of this problem can be seen by looking at the fuel type of DDS providers. The proportion of DDS provided by gas and hydro generators is higher than expected. For more analysis and discussion see our July 2008 report.

ANCILLARY SERVICES MARKET

RESERVES PROCUREMENT, MONTHLY



Market Developments in 2008

Throughout 2008, the AESO consulted with stakeholders on a redesign of the ancillary services market. One feature of the redesign under discussion is less active participation by the AESO in the market in terms of pricing and the timing of procurement. Within the current market design, the AESO has already modified its timing of procurement. Since the middle of 2008, a consistently larger amount of reserves has been procured the day before delivery (D-1) rather than on earlier days (D-5 through D-2). The MSA notes that concentrating trading on a single day may serve to reduce the costs of participation in the market and concentrate competition on a single day.

ON THE WEBSITE:

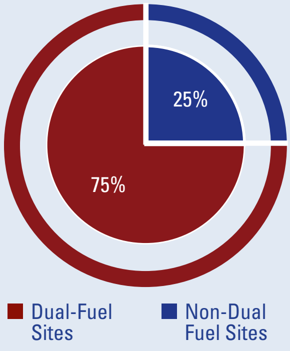
Each of MSA's Quarterly Reports in 2008 and the 2008 Year in Review provide more in-depth analysis on the impact of the "Quick Hits" rules and other market events. For further details on the DDS market, see the MSA's report titled "Quick Hits Review: Dispatch Down Service," available under "Reports" at ***www.albertamsa.ca***.

RETAIL MARKET DEVELOPMENTS

Since 2001, all electricity customers have been able to exercise retail choice. Residential and smaller commercial customers are able to choose between a Regulated Rate Option (RRO) and offerings from competitive suppliers. Retail choice in natural gas began earlier with customers similarly able to choose between a regulated Default Rate Tariff (DRT) and offerings from competitive suppliers.

Dual Fuel Dominates Competitive Offerings

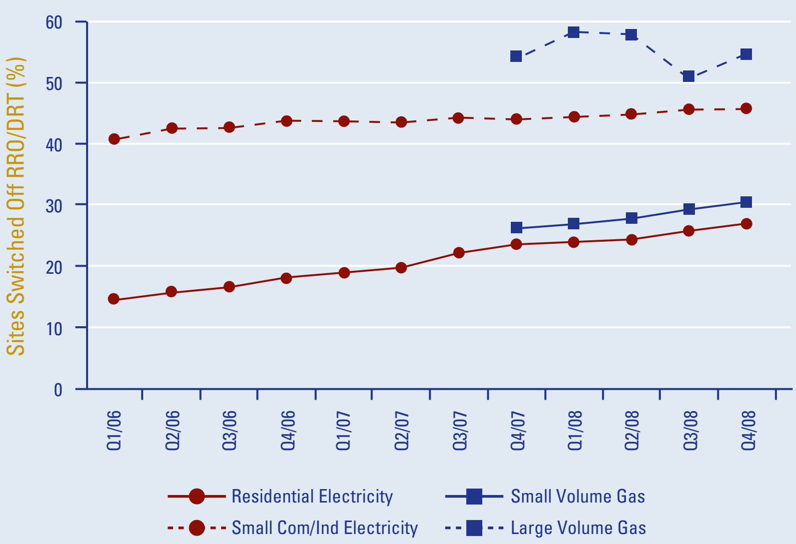
The MSA estimates that about three-quarters of residential customers choosing competitive offerings have opted for dual-fuel contracts (receiving natural gas and electricity from the same supplier).



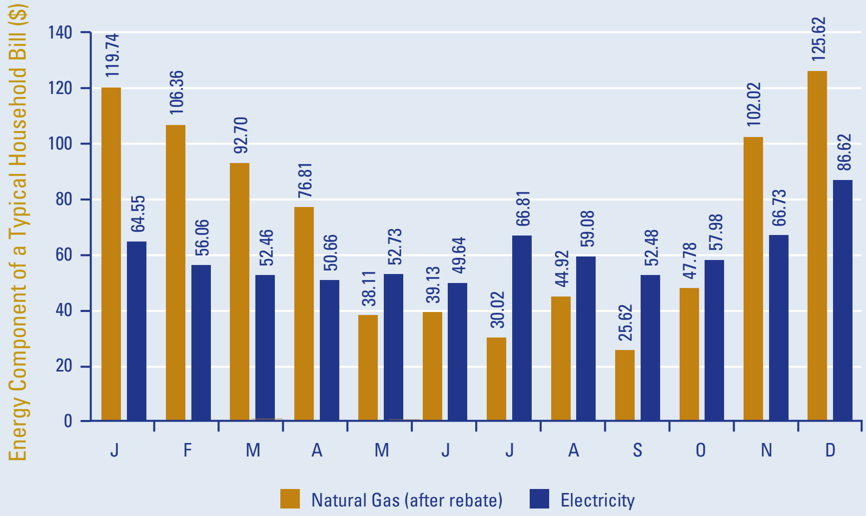
Regulated vs. Competitive Offerings

Switching from regulated gas and electricity products continues slowly, with slightly higher switching rates for natural gas customers. Many competitive offerings allow customers to opt for fixed prices for a number of years while the regulated prices fluctuate each month.

SITES SWITCHED FROM REGULATED TO COMPETITIVE RATES



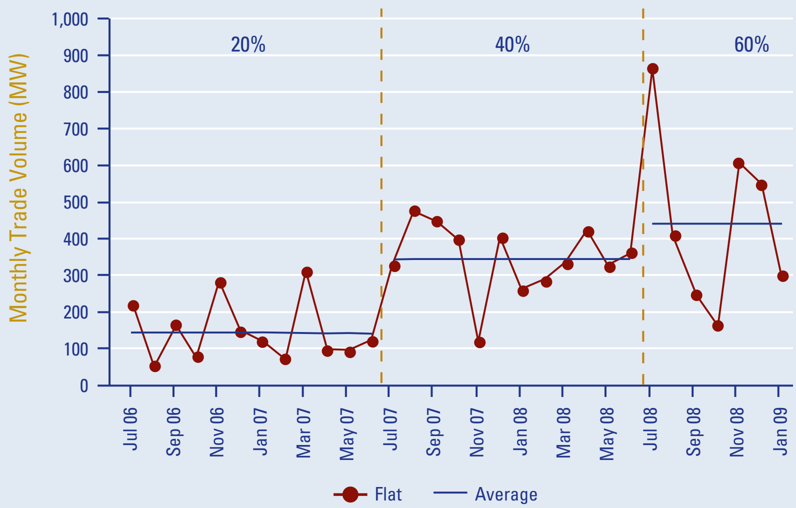
TYPICAL NATURAL GAS AND ELECTRICITY BILLS (REGULATED)



Regulated Energy Bills in 2008

The graph shows the energy component of typical household bills for electricity and natural gas customers on regulated rates in 2008. Electricity usage throughout the year was much more evenly spread than natural gas. Overall, a typical customer's bill for electrical energy is lower and more even than for natural gas. In the future, an increasing proportion of regulated electricity prices will be based on short-term hedges, which is likely to increase the monthly volatility of electricity bills.

RRO ELIGIBLE TRADE VOLUMES



Electricity RRO Prices And Forward Market Activity

Electricity RRO prices each month are determined through a combination of long-term hedges and month-ahead forward prices. In accordance with regulation, the proportion based on month-ahead forward prices increased from 20% in July 2006 to 40% in July 2007 and to 60% in July 2008. The graph shows trading for month-ahead "flat" electricity (i.e. electricity supplied at a constant rate for all hours of the month).

Trading volumes are sometimes volatile in response to market news. Generally, there has been an increase in average month-ahead trading volumes as the proportion of RRO prices based on month-ahead forward prices has increased. This increase in liquidity shows how developments in the retail market can positively influence the wholesale market.

ISO RULES COMPLIANCE ENFORCEMENT 2008

The new Alberta Utilities Commission Act (AUCA), which came into force January 1, 2008, in conjunction with amendments to the Alberta Electric Utilities Act (EUA), clarified the roles and responsibilities of the MSA and AESO as to Independent System Operator (ISO) rules compliance and enforcement. A key driver of these legislative developments, as communicated by the Alberta Department of Energy (DOE), was to clearly partition the roles of rule maker, rule enforcer, and rule adjudicator within the Alberta electricity market.

Under the new legislation, the AESO retained a mandate to monitor the compliance of market participants with ISO rules. The enforcement role now solely rests with the MSA, and the AUC acts as final adjudicator.

The AUCA Transition Regulation governed the manner of transitioning AESO responsibility for rules compliance issues to the MSA. Remaining files handled by the prevailing AESO compliance process continued to be dealt with through the existing ISO rule 12 process.

A significant development during 2008 related to changes to AUC Rule 019. The amended rule categorizes specific ISO rules that can be enforced and adjudicated within the penalty table(s), and specifies the financial penalty based on the rule itself and non-compliance history with the given rule. ISO Rule 6.6 (dispatch compliance) is treated as a separate category and penalty table, with pre-determined financial penalties based on the magnitude and duration of a dispatch variance.

The previous version of the AUC Rule 019 contemplated penalties ranging from a warning letter to a financial sanction. However, warning and non-compliance letters are not contemplated by the new AUC Rule 019. Further, financial penalties were modified to pre-set amounts (as opposed to a range).

The Compliance Flow Chart on the right illustrates how the MSA processed the flow of suspected contraventions of ISO rules during 2008. Suspected breaches are identified through AESO compliance monitoring activities, self-disclosures by participants, or through regular market monitoring activities by the MSA.

As shown in the illustration, compliance-monitoring activities during 2008 resulted in the issuance of nine warning letters and five non-compliance letters. The MSA also issued seven notices of specified penalty totaling $30,000 in financial sanctions ranging from $2,000 to $8,000. In each case where a financial sanction was imposed, the participant in question had contravened the same ISO rule not fewer than three times within the trailing 12-month period.

Two of the notices of specified penalty were disputed and went to litigated hearings before the AUC in 2008 (AUC proceedings ID 71 and ID 75). In both cases, the AUC confirmed the financial penalty assessed by the MSA.

Both of those proceedings involved non-compliance events with respect to ISO Rule 6.6. Although each had a unique fact pattern, both cases were argued on a "strict liability" basis whereby a defence of due diligence is available. In both decisions (AUC 2008-114 and AUC 2008-126), the AUC conveyed a high standard to the claim that the participant took all reasonable steps to prevent the contravention.

In one instance, a payment of a specified penalty was received late leading to the MSA making an application with the AUC (proceeding ID 115). In AUC order M2009-001 dated January 26, 2009, the AUC ordered the payment of accrued interest resulting from the late payment in accordance with subsection 4(2) of the Alberta Judgement Interest Act.

COMPLIANCE FLOWS 2008

AS AT DECEMBER 31, 2008

INVESTIGATIONS UPDATE

In addition to its routine monitoring and ISO rule enforcement, the MSA investigated three major issues during 2008. These issues concerned trading in the ancillary services market, uneconomic importing, and trading in the forward market prior to disclosure of outage information.

TRADING IN THE ANCILLARY SERVICES (AS) MARKET

The MSA investigation determined that the AESO and certain counterparties would periodically, through direct bilateral communications, negotiate the specifics of a trade for operating reserves required by the AESO and to be supplied by the counterparty. These trades would then be posted and executed on the Watt-Ex market, rather than completing the transaction as an Over-the-Counter (OTC) trade. The MSA is of the opinion that this conduct can properly be considered "pre-arranged trading" on the Watt-Ex market.

The MSA conducted a comprehensive investigation and identified a number of pre-arranged trades in the Standby Regulating, Spinning, and Supplemental AS products, as well as a few pre-arranged trades in the Active Term Regulating and Supplemental AS products. The MSA did not find any evidence of intent by the AESO or the counterparties to manipulate or distort market prices. In addition, prices for the pre-arranged transactions were generally consistent with market prices before and after the trades. The MSA found no financial harm to the market as a result of the conduct and, accordingly, concluded the investigation. The AESO subsequently eliminated this procurement practice.

The MSA commends the AESO and counterparties that cooperated with the MSA's investigation and voluntarily provided access to employees, documents and trading records to assist in the investigation.

Trading in the ancillary services market also falls within the jurisdiction of the Alberta Watt Exchange Ltd (Watt-Ex) and the Alberta Securities Commission (ASC). Pursuant to Section 45 of the AUCA, the MSA submitted information it obtained concerning its investigation to Watt-Ex as well as to the ASC for their review and consideration.

ON THE WEBSITE:

The MSA's full report on the Ancillary Services Investigation can be found on our website, www.albertamsa.ca, under "Reports."

UNECONOMIC IMPORTING

The MSA initiated an investigation into certain imports of energy by ENMAX Energy Corporation and ENMAX Energy Marketing Inc. (ENMAX) in October 2005. The MSA is concerned about the uneconomic importation of energy into Alberta and the potential undesirable impact this may have on Alberta energy prices. As part of the investigation, the MSA interviewed employees of ENMAX who were advised by ENMAX's legal counsel not to answer specific questions. The MSA applied to the Court of Queen's Bench on February 15, 2007 for an order compelling the ENMAX employees to answer questions. On January 24, 2008 Mr. Justice A.D. Macleod issued his second decision (2008 ABQB 54) in this matter and dealt with the questions that ENMAX had objected to. The court ruled that all the objected questions were appropriate and the MSA was allowed to re-interview the witnesses who would answer the previously objected questions. Moreover, the MSA was entitled to ask further questions following up on the answers given to the objected questions.

Pursuant to the court's decision, the MSA re-interviewed ENMAX employees and completed its information-gathering process. The MSA subsequently prepared draft Facts and Findings and submitted the document to ENMAX for review and comment. The MSA expects to complete the investigation in 2009.

TRADING IN THE FORWARD MARKET PRIOR TO DISCLOSURE OF OUTAGE INFORMATION

The MSA commenced an investigation into specific forward-market trading activity early in 2008 after receiving a referral from a market participant. The referring party was concerned that the trading activity occurred in advance of outage disclosure and may have been contrary to the Trading Practices Guideline (TPG). The MSA held a number of meetings with the parties involved in the trading activity and determined that it had occurred in a manner consistent with the TPG, and accordingly, closed the investigation.

MSA ACTIVITIES RELATED TO INVESTIGATIONS

In the course of its investigations over the past several years, a number of related matters have come to the attention of the MSA. Some of these matters include: the use of unrecorded instant messages for trade negotiations and confirmations, the extent and adequacy of internal training, clock-setting standards, and the extent and effectiveness of internal governance and oversight. The MSA intends to give these areas further thought during 2009, and may engage market participants in related discussions in order to obtain their input on what might constitute "best practices" in these areas.

REGULATORY UPDATE

NEW FRAMEWORK AND RESPONSIBILITIES

The Alberta Utilities Commission Act (AUCA) came into force on January 1, 2008. The Act clarified roles and mandates of the agencies, seeing the MSA take on responsibility for prosecution of ISO rule breaches and for oversight of retail natural gas in Alberta. Additionally, the Alberta Utilities Commission (AUC) was given the power to adjudicate enforcement matters brought forward by the MSA.

MSA GUIDELINES AND STAKEHOLDER CONSULTATIONS

During the year, the MSA conducted three stakeholder consultations, resulting in an Intertie Conduct Guideline, a revision to our Investigation Procedures and an evaluation of the consultation process.

INTERTIE CONDUCT GUIDELINE

The MSA initiated a Stakeholder Consultation Process concerning the development of a new guideline dealing with intertie conduct on May 7, 2008. Following two rounds of input from stakeholders, the MSA published the final document titled MSA Guideline: Intertie Conduct on July 14, 2008.

The guideline provides guidance to market participants regarding types of transactions to be avoided, what a participant should reasonably expect when considering an import or export, the MSA's expectations concerning the economics of the import or export relative to the next best alternative, and the retention of records necessary to support and explain the intertie transaction.

REVISION TO INVESTIGATION PROCEDURES

The MSA published revised investigation procedures after conducting a stakeholder consultation process on April 4, 2008. The revised investigation procedures provide additional detail on the process that is implemented when a matter is referred to the MSA. Further detail was provided in the revised investigation procedures so that persons referring matters to the MSA, parties under investigation, other market participants, and the public know what types of communications they can expect to receive from the MSA and the primary contact persons.

On July 8, 2008 the MSA further amended its investigation procedures in accordance with the new AUC Rule 019. This rule requires market participants to direct self-reporting of ISO rule contraventions to the MSA and to provide specified information describing the incident. The amended investigation procedures went into effect July 9, 2008.

EVALUATION OF STAKEHOLDER CONSULTATION PROCESS

The MSA, with input from stakeholders, developed its Stakeholder Consultation Process from May to July 2006. At that time, the MSA committed to evaluate the process once it had some experience in the practical application of the process. On July 28, 2008 the MSA published a summary of its views on the efficacy of the process and invited comment from stakeholders. Based on a review of the comments received, the MSA concluded that the process was meeting its objectives.

FINANCIAL STATEMENTS

AUDITORS' REPORT

To the Market Surveillance Administrator

We have audited the balance sheet of Market Surveillance Administrator as at December 31, 2008 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 audits 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, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

(signed) "PricewaterhouseCoopers LLP"

Chartered Accountants
Calgary, Alberta
February 20, 2009

BALANCE SHEET

As at December 31,	2008	2007
	$	$
ASSETS		
Current Assets		
Cash	983,483	384,913
Accounts receivable	-	-
Prepaid expenses and deposits	49,532	48,850
	1,033,015	433,763
Capital Assets (note 3)	18,174	32,014
	1,051,189	465,777
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	407,821	425,231
Deferred revenue (note 4)	643,368	40,546
	1,051,189	465,777
EQUITY (note 1)	-	-
	1,051,189	465,777

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

For the Twelve Months Ended December 31, 2008	**2008**	2007
	$	$
Revenue		
Alberta Electric System Operator (note 4)	3,056,314	3,006,484
Interest & Other Income	29,431	9,953
Total Revenue	3,085,745	3,016,437
Expenses		
Salaries and benefits	2,057,675	2,009,191
Consultants, legal & audit	601,161	610,398
Operating, office and administrative	409,349	373,503
Amortization	17,560	23,345
Total Expenses	3,085,745	3,016,437
Net Earnings (note 1)	-	-

STATEMENT OF CASH FLOWS

For the Twelve Months Ended December 31, 2008	2008	2007
	$	$
Cash provided by (used for):		
Operations		
Net earnings	-	-
Item not involving cash:		
Amortization	17,560	23,345
Change in non-cash operating items:		
(Increase) decrease in accounts receivable	-	-
Increase in prepaid expenses and deposits	(682)	1,771
Increase in accounts payable and accrued liabilities	(17,410)	1,893
Increase (decrease) in deferred revenue	602,822	(14,373)
	602,290	12,635
Investing		
Expenditures on capital assets	(3,720)	(6,901)
Increase in cash	598,570	5,734
Cash, beginning of the period	384,913	379,179
Cash, end of the period	983,483	384,913

NOTES TO THE FINANCIAL STATEMENTS

For the Twelve Months Ended December 31, 2008

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. On January 1, 2008, the MSA was continued under the Alberta Utilities Commission Act.

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 Alberta Utilities Commission Act, is to carry out surveillance and investigation in respect of activities in the electricity and retail natural gas markets 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 Alberta Utilities Commission Act requires that the Market Surveillance Administrator prepare a budget for each fiscal year, for approval by the chair of the Alberta Utilities Commission. 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 Alberta Utilities Commission 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 Alberta Utilities Commission 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

	2008			2007
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
	$	$	$	$
Computer Hardware	65,612	57,436	8,176	11,985
Computer Software	26,498	26,448	50	181
Furniture & Equipment	91,195	81,247	9,948	19,848
	183,305	165,131	18,174	32,014

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.

	2008	2007
	$	$
Alberta Electric System Operator		
Opening balance, January 1	40,546	54,919
Collection for February to December 2007	3,400,000	2,992,111
Less: 2008 Revenue	(3,056,314)	(3,006,484)
	384,232	40,546
Collection for January 2008	259,136	-
Closing balance, December 31	643,368	40,546

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:

	$
2009	128,970

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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2008 NOTICES & REPORTS

- Code of Conduct Testing 2008
- MSA 2009 Budget
- News Release - Keeping Electricity Competitive
- News Release - Albertans risk higher electricity bills if we fail to develop new transmission lines
- Evaluation of MSA Stakeholder Consultation Process
- Calculation of Market Shares
- MSA Guideline - Intertie Conduct
- Quick Hits Review: Dispatch Down Service
- MSA Budget Amendment
- Revision to Daily Snapshot
- Request for MSA Views Regarding Information Sharing
- Martin J. Merritt Op-Ed Article - Edmonton Journal
- New MSA Investigation Procedures
- Publication of Load Outage Report
- Court of Queen's Bench Proceedings MSA v. ENMAX
- Notice Re: ISO Rules Compliance
- Investigation of Locking Restatement Activity

The MSA is committed to ensuring market events and outcomes are transparent for market participants and all Albertans. Transparency increases confidence that our market continues to operate in a fair, efficient and openly competitive manner.

In addition to our regular daily, weekly and quarterly reports, the MSA publishes special reports and updates on MSA activities including details about ongoing consultations with stakeholders. Each of these is available on our website and accompanied by a “Notice.” Visit www.albertamsa.ca and click “Notices” on the left menu to see what is available.

Market Surveillance Administrator

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