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MSA REPORT

ENMAX 2005 Investigation

04 December, 2009

MARKET SURVEILLANCE
ADMINISTRATOR

1 INTRODUCTION

The Market Surveillance Administrator (“MSA”) advised market participants in a notice dated October 28, 2005 that it had commenced an investigation under the Alberta Electric Utilities Act (“EUA”) into certain importing activity and related conduct allegedly affecting the Alberta electricity market, during calendar year 2005.

The subject of the investigation concerned the conduct of ENMAX Corporation and its affiliates ENMAX Energy Corporation and ENMAX Energy Marketing Inc. (collectively, “ENMAX”) in relation to importing activity during 2005. Although the scope of the investigation covered the period between January and the end of October 2005, the focus of much of the work related to ENMAX import trades that were negotiated between HE18 on September 27, 2005 and HE13 on September 28, 2005 (the trades on those days will be referred to as the “Events”).

The purpose of this Report is to report on the closure of this investigation. After careful consideration the MSA finds no wrongdoing by ENMAX or any other Alberta market participant during the period under review.

The investigation took approximately four years to conclude. This was due in part to certain procedural issues raised during the course of the investigation that are well known and on the public record. The MSA believes that this experience and the resulting clear jurisprudence will allow it to manage future reviews in the efficient and expeditious manner expected by stakeholders.

The section that follows explains the conduct that led to the investigation. Section 3 summarizes the key findings and Section 4 formally states the conclusion.

2 CONDUCT AT ISSUE

Prior to the Events ENMAX experienced a forced outage at its Keephills 2 generating unit (“KH2”), resulting in a desire to find alternative supply. During the period of time when the Events occurred, ENMAX entered into a number of trades which appeared to be at higher prices than were available within Alberta based upon the AESO market (pool) price and upon information provided to the MSA by other market participants.

The MSA commenced the investigation because the importing activities appeared to be contrary to its guidance provided to market participants regarding ‘uneconomic imports’, and potentially in breach of Section 6 of the EUA.

The concern with uneconomic imports is that they may be seen as distorting or manipulating the Alberta price. In addition to the MSA having flagged the conduct through its monitoring, the MSA heard concerns with respect to the Events from two market participants on September 28, 2005.

Over the course of the Events, ENMAX appeared to be importing energy from the Mid-C market in the United States across the Alberta/BC interconnection during a number of hours when the Mid-C prices (after applying the prevailing exchange rate and transmission costs) were higher than hourly prices available in the

Alberta market. Based upon the existing treatment of imports under the pool rules, the effect of the importing activity is to lower Alberta prices from what they would otherwise have been, all other things being equal. This was presumably to the benefit of ENMAX because of its portfolio position at the time. In carrying out the investigation the MSA also considered whether ENMAX governing documents and incentive compensation structures that existed in 2005 may have contributed to or induced traders to undertake uneconomic imports.

3 MSA KEY FINDINGS

Facts collected during the investigation showed that the perception of uneconomic importing arose in large part as a result of the decision by ENMAX to purchase multi-hour coverage in order to hedge the exposure it was facing as a result of the KH2 generation unit outage.

Faced with the outage, ENMAX actively pursued alternative supplies in the physical and financial markets and tried to purchase a multi-hour product to avoid exposure to anticipated price spikes in the Alberta market. ENMAX explained that it wished to hedge its exposure to the volatility of the Alberta market for a longer time period than could be done by a series of one-hour purchases.

During interviews, ENMAX personnel stated that potential Alberta counter parties offered one-hour financial products but were not willing to enter into multi-hour commitments. A review of trading voice tapes and additional interviews confirmed these statements¹.

As a result of its inability to obtain multi-hour products within Alberta, ENMAX proceeded to import electricity from Mid-C at higher prices than those prevailing in Alberta. ENMAX personnel justified this action as commercially reasonable in light of its objectives and the circumstances it faced during the Events.

The investigation of the Events required the MSA to consider how one should compare multi-hour transactions with one-hour offerings and whether one should look at individual transactions or the total strategy being implemented over several hours in deciding if uneconomic imports were occurring. Previous MSA guidance had not explicitly spoken to this aspect.

The MSA concluded that a finding of uneconomic importing must be determined on the basis of the price of similar products in the Alberta and import markets, entailing an assessment of whether the importing party undertook commercially reasonable efforts when choosing an import over the intra-Alberta alternative(s). The MSA also believes that the concept of 'commercially reasonable efforts' cuts both ways; that is, both the prospective buyer and seller should act in a commercially reasonable manner (i.e. each party should act in good faith).

The MSA accepts that it was commercially reasonable for ENMAX to pay a premium to obtain a multi-hour product over an extended time frame when price spikes might reasonably be expected. The investigation also showed that in the early hours of the Events, when ENMAX was importing hourly product, it did

¹ There is, of course, no obligation on market participants to make specific products available.

moderate its volumes as pool price declined. This was in keeping with the published guidance of the MSA at the time. In addition, there were hours where the market also counter-flowed the ENMAX imports. These are all signs that the market was working.

During the course of the investigation the MSA also considered whether ENMAX's traders could have been inappropriately influenced by its governing documents and incentive compensations scheme, particularly its "Wholesale Risk Standards", which included a number of performance benchmarking mechanisms for the energy portfolio.

One of these benchmarks seemed to indicate that the spot pool price could be influenced by ENMAX traders by adding supply through importing or reducing supply through exporting, and thereby creating a net position benefit.

On further examination, the MSA was unable to find any cases where the net position benefit concept was used to justify a transaction or was taken into account in setting bonuses with regard to the Events.

4 CONCLUSION

After consideration of all the facts in this case the MSA accepts that it was commercially reasonable for ENMAX to pay a premium over the time frame when price spikes might reasonably be expected. ENMAX actively pursued alternative supplies in the physical and financial markets and it tried, where it could, to purchase a multi-hour product to avoid exposure to price spikes in the Alberta market. ENMAX modified its volumes in the early hours of the Events as provided for within the MSA guidance.

In the view of the MSA, ENMAX imports during the period at issue did not amount to uneconomic imports because the record shows that the longer term product ENMAX wished to purchase was not available in Alberta at that time.

Therefore, the MSA concluded that the Events were not contrary to the guidance provided with respect to uneconomic importing; ENMAX did not breach Section 6 of the EUA; and that there are no reasonable grounds to extend this investigation.

While it does not bear directly on this investigation, the MSA notes that the ability of the market to self-correct without regulatory intervention has improved materially since 2005, principally through a more symmetrical calculation of transmission losses at the tie lines that allows market participants to better arbitrage between adjacent markets. The effect is that this has allowed market discipline to counteract the impact of potentially anomalous imports. The MSA also notes that the industry and the AESO continue to work to improve the capacity of the tie lines and to improve the rules related to imports.

Accordingly, the MSA has closed its investigation into this matter.