Electricity Services Agreement

A Report into Alleged Violations of Sections 6 and 95 of the *Electric Utilities Act*

September 2010

Market Surveillance Administrator | 403.705.3181 | #500, 400 – 5th Avenue S.W., Calgary AB T2P 0L6 | www.albertamsa.ca

The Market Surveillance Administrator is an independent enforcement agency that protects and promotes the fair, efficient and openly competitive operation of Alberta's wholesale electricity markets and its retail electricity and natural gas markets. The MSA also works to ensure that market participants comply with the Alberta Reliability Standards and the Independent System Operator's rules.

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Executive Summary

Key Findings:

In June 2009 a market participant complained that the Electricity Services Agreement between ENMAX and the City of Calgary undermined the fair, efficient and openly competitive nature of the Alberta electricity market and as such was contrary to the *Electric Utilities Act*. The MSA has now completed its investigation in this matter and has found:

- the Alberta electricity market is protected from distortions caused by the possibility of unfair advantages for government-owned participants by a two stage process: in the first instance by the section 95 review and authorization, and secondly through the continuing responsibility of the MSA to enforce the section 6 obligations.
- the Electricity Services Agreement between the City of Calgary and ENMAX does not put the parties in breach of the *Electric Utilities Act* because:
  - ENMAX's participation in the relevant generating units was approved by the Minister as required pursuant to section 95; and
  - the Electricity Services Agreement does not contravene section 6 as it did not give ENMAX an unfair advantage in acquiring generation units and does not diminish competition in either the wholesale electricity market or the green energy market.

Why we investigated

A market participant submitted a written complaint to the Market Surveillance Administrator (MSA) in June 2009 alleging that the non-arm's length status of ENMAX and the City of Calgary had undermined competition in the Alberta energy market contrary to the *Electric Utilities Act*. The complaint alleged ENMAX's exclusive long term agreement with the City for the sale of 'green' energy provided an unfair advantage leading to ENMAX's acquisition / development of three major power projects: the McBride Lake, Taber and Kettles Hill wind farms. Shortly afterwards a second market participant wrote the MSA in support of these allegations.

One of the responsibilities of the MSA under the *Alberta Utilities Commission Act* is to investigate whether the conduct of market participants "…supports the fair, efficient, and openly competitive operation of the electricity market". The MSA can commence an investigation on its own initiative or upon receipt of a complaint. In this matter, the MSA observes that there is a widely held belief among ENMAX's rivals that its behaviour and the alleged unfair advantages it receives as a wholly owned subsidiary of the City of Calgary distorts competition in the Alberta electricity market. The complaint provided sufficient grounds to investigate the facts and test this proposition.

What we looked at

The MSA investigation took several months and involved extensive requests for public and confidential information to ENMAX and the City of Calgary. It included a number of briefings and interviews with their senior officials. We interviewed representatives of several market participants, several Alberta municipalities, government officials, industry experts and project developers and had access to

confidential bid information for the contested acquisition of the Kettles Hill Wind Farm. We also engaged senior external legal counsel and a leading industrial organization economist to assist in the development of our analytical framework and advise on the significance of our findings.

The purpose of the analytical framework was to develop a plausible theory with which to critically assess, in light of the complaint, the ability of ENMAX and the City to distort competition in Alberta's wholesale electricity market. We focused on ENMAX's successful acquisition of the Kettles Hill Wind Farm in 2008 as the most promising set of facts to test the allegations. The relevant provisions of the *Electric Utilities Act* examined were:

- the purposes of the *Electric Utilities Act* and in particular the desire to provide rules so that neither the "market nor the structure of the Alberta electric industry is distorted by unfair advantages of government owned participants or any other participant" (subsection 5(c));
- the core competition principle of the Alberta market design that requires market participants "…to conduct themselves in a manner that supports the fair, efficient and openly competitive operation of the market." (section 6), and
- the special onus on municipalities to structure their interests in generating units to prevent (unfair) advantages (section 95).

The analysis and sifting of evidence relative to section 6 centered on whether the actions of ENMAX and its arrangements with the City of Calgary materially foreclosed competition in either the wholesale market or the smaller market for green energy. The section 95 investigation turned on applying the relevant facts to a reasonable interpretation of proscribed "benefits" or "advantages" as described in the provision. On July 5, 2010, after the completion of our investigation, the Alberta Court of Appeal released its decision in a separate matter, setting out the limits of Alberta Utilities Commission's jurisdiction with respect to section 95, and by the application of similar reasoning, the MSA's jurisdiction. Accordingly, this paper does not comment on the independent assessor's assessment on the matters raised by the complaint. While this development did not change our essential finding of no fault, our focus then turned to whether ENMAX had prejudiced the independent assessment of its acquisition of the Kettles Hill Wind Farm by failing to advise of the potential expansion of its long-term sales agreement with the City of Calgary.

What we found

We found the evidence does not show contraventions of the *Electric Utilities Act* or conduct not supporting the "…fair, efficient, and openly competitive operation of the electricity market" on the part of ENMAX or the City of Calgary.

The City of Calgary's exclusive purchase of energy from its wholly owned subsidiary, ENMAX, represents a relatively small share of Alberta's conventional and green energy markets and there remain significant opportunities for competitors to expand in these markets. ENMAX's participation in these markets, measured by its current market share and the relative ease of entry, does <u>not</u> raise concerns about market power so a theory of competitive foreclosure is <u>not</u> supported as a grounds for a section 6 contravention. Importantly, neither the complainant nor the market participant who supported the complaint provided probative information concerning competitive harm past, present or future, nor were we able to find evidence of such harm.

While the acquisition of the Kettles Hill Wind Farm was put forward by the complainant as evidence of ENMAX's unfair advantage compared to privately funded market participants, our investigation did not find support for this contention with respect to section 6 of the *Electric Utilities Act*. First, ENMAX's access to load through its supply agreement with the City is not something intrinsic or unique to a municipality. Private sector entities routinely enter into supply agreements or opt to build their own generation (e.g., cogeneration facilities). Second, in our soundings of the marketplace, we determined that while a long-term supply agreement would be desirable, municipalities are not the only potential counterparties for these arrangements and there are other ways for privately funded entities to achieve the same ends. Finally, and most persuasively, a review of key information provided by all six final bids for the Kettles Hill Wind Farm revealed a relatively tight cluster, with a private sector entity's bid higher than ENMAX's winning bid.

Of special note to market participants

The report contains several first time observations on the state of the law affecting market participant conduct and the enforcement policy to be pursued by the Market Surveillance Administrator. These include:

- the Alberta electricity market is protected from distortions caused by the possibility of unfair advantages for government-owned participants by a two stage process: in the first instance by the section 95 review and authorization, and secondly through the continuing responsibility of the MSA to enforce the section 6 obligations. In short, section 6 is about a market participant's conduct once in the market; section 95 is about eligibility to be in the market;
- the MSA has a limited role with respect to subsection 95(10) matters, largely around whether a proponent misled the Independent Assessor;
- the MSA enforces the section 6 obligations in matters involving municipalities just as it would if the case involved a privately funded market participant; section 95 is a wholly contained separate provision and the MSA does not read in a special onus on government-owned participants in its enforcement of section 6;
- the MSA assesses each of the elements (fair, efficient, openly competitive) of section 6 individually but treats the provision as single test of an overall standard of conduct;
- a breach of section 6 by a single market participant ('unilateral effects') requires at the minimum evidence of significant market power and exclusionary practices; and
- it is of assistance to the MSA if market participants alleging anti-competitive behaviour by one of their rivals can show evidence of competitive harm resulting from the alleged wrongful behaviour.

1 Introduction

In June and July 2009 the Market Surveillance Administrator (MSA) received separate complaints from a single market participant alleging that ENMAX[1] had contravened the *Electric Utilities Act* (*EUA*). This report summarizes our investigation and findings with respect to the first of these matters. (The second is the subject of a separate report.)

Pursuant to subsection 42(1) of the *Alberta Utilities Commission Act* (AUCA) the MSA is required to conduct an investigation if the complaint is not "frivolous, vexatious, or trivial or otherwise does not warrant an investigation". After assessing the complaints against the standards in the legislation, reviewing public information sources and holding preliminary discussions with the complainant, we proceeded to commence an investigation.[2]

During the course of the investigation, the MSA met with the complainant and the market participant who supported the complaint, and also ENMAX and the City of Calgary to ensure that we had an accurate understanding of the allegations and the scope of work required for the investigation. In addition, we conducted background research, issued information requests, and met with a variety of parties including green retailers, wind project developers and municipalities to obtain information to assist us in the investigation. We carried out our work according to the MSA's published *Investigation Procedures*.[3] Upon completion of the investigation, we briefed the complainants, and also ENMAX and the City of Calgary.

As a result of our investigation, we conclude there is no violation of the *EUA*.

The purpose of this report is to describe the nature of our investigation, the analytical framework employed and our findings of fact. We have taken care not to disclose any confidential or commercially sensitive information obtained during the course of our work.

We believe the report is important for two reasons. First, there is a broad concern among stakeholders about how publicly funded entities such as ENMAX compete in the Alberta energy market and how the legislative framework addresses this concern. The report provides a clear summary of why our in-depth investigation did not disclose a violation based on the facts of this case. Second, we spent some attention to developing a sound analytical framework that fits with the legislation and is consistent with well-established competition analysis. This framework embodies our current thinking and we expect to employ the same framework in similar circumstances in the future. We are our hopeful that publishing it provides useful guidance to market participants.

[1] The complaint specifically refers to ENMAX Corporation and ENMAX Energy Corporation. However, the MSA also considered the possibility that the complaint might also apply to other entities within ENMAX Corporation such as ENMAX Green Power Incorporated. For convenience, throughout this report, we refer to ENMAX Corporation including its wholly-owned subsidiaries as "ENMAX".

[2] It is worth noting that in investigating a matter, the MSA does not act as agent or advocate for the complainant. Rather, we take the issue brought to our attention, translate it into a legal and analytic context that makes sense to us (as the specialist agency responsible for enforcing the provision) and then proceed to test hypotheses, discover the facts and decide whether there is a case to be answered before the Alberta Utilities Commission. This is not to say that we should not be responsive to whoever brings a matter to our attention but the objective, arm's length and expert aspects of our public policy role takes precedence.

[3] *MSA Investigation Procedures*, July 2008.

This report is organized in the following manner. Section 2 summarizes the nature of the allegations. Section 3 sets out the legal framework relevant to the matters under investigation. It reviews an important Alberta Court of Appeal decision affecting MSA jurisdiction and sets down other legal interpretations that will guide the MSA's future work. Section 4 applies our legal and analytic frameworks to the facts obtained during our investigation. Section 5 addresses whether ENMAX misled the Independent Assessor in his review of the acquisition of the Kettles Hill Wind Farm.

2 Nature of Allegations

The complaint alleged contraventions of "sections 5(c), 6 and/or 95(10)" of the *EUA* as a result of unfair advantages that it claims ENMAX received under its long-term Electricity Services Agreement – Retail with the City of Calgary for the purchase and sale of "green" energy (Electricity Services Agreement).[4] The complaint pointed to the "non-arm's length Agreement", available only to ENMAX, the City of Calgary's wholly owned subsidiary and claimed that it:

- provides unfair advantages to ENMAX, and in doing so distorts the electricity market in Alberta in favour of a government-owned participant;
- granted either a direct or indirect financing or other advantage to ENMAX as a result of its association with the City;
- undermined the fair, efficient and openly competitive operation of the Alberta electricity market; and
- presents a continuing breach of the *EUA* by establishing and maintaining an advantaged position as either a developer or purchaser of power generation assets in Alberta.

The complaint stated that the Electricity Services Agreement provides long-term output security and backstopped the acquisition/development by ENMAX of at least three major wind farm projects in Alberta, namely McBride Lake, Taber and Kettles Hill. While acknowledging that all three projects had been subject to independent assessments pursuant to subsection 95(11) of the *EUA*, the complaint alleged that the signing of amendments to the Electricity Services Agreement after the assessments of the McBride Lake and Kettles Wind precluded a proper review.

3 Legal Framework

This is an investigation into potential contraventions of sections 6 and 95 of the *EUA*. The complaint also identified subsection 5(c), but subsection 5(c) is one of the purpose clauses of that Act that, in our view, provides "direction on how the substantive provisions of the legislation are to be interpreted and applied"[5] but is not, in and of itself, capable of contravention. In July 2010, after the completion of this investigation, the Alberta Court of Appeal released its Decision in *Maxim v. AUC*[6] setting out the limits to the jurisdiction of the Alberta Utilities Commission (AUC or the Commission) with respect to section 95 of the *EUA*. The MSA believes its jurisdiction is similarly limited. We describe this below.

[4] The Electricity Services Agreement relates to the consumption of electricity by municipal plant and equipment and not residents of the City.

[5] *Sullivan on the Construction of Statutes*, Fifth Edition, p. 388.

[6] Court of Appeal of Alberta, *Maxim Power Corp v. Alberta (Utilities Commission)*, 2010 ABCA 213.

There is no jurisprudence relating to section 6 and the *Fair, Efficient and Open Competition Regulation* (FEOC Regulation) provides only limited direction relevant to the subject matter of this case. In the face of this, we developed a working interpretation of section 6, as described below. Until overtaken by jurisprudence, regulation[7] or convincing arguments by stakeholders, the MSA intends to apply this framework for both sections 95 and 6 to its work going forward.

3.1 SECTION 95 - PERMISSIBLE MUNICIPAL INTERESTS IN GENERATION UNITS

Subsection 5(c), one of the purpose clauses of the *EUA*, identifies a potential concern with government-owned participants given voice in the first instance through the regulatory scheme set out in section 95.[8] It reads as follows:

> 5 The purposes of the Act are…
>
> (c) to provide for rules so that an efficient market for electricity based on fair and open competition can develop in which neither the market nor the structure of the Alberta electric industry is distorted by unfair advantages of government-owned participants or any other participant;
>
> ….

Section 95 of the *EUA* prohibits a municipality from holding an interest in a generating unit unless it is structured in such a way that prevents any advantage or benefit as a result of association with the municipality. The relevant subsections read as follows:

> ….
>
> 95(1) – No municipality and no subsidiary of a municipality may hold, directly or indirectly, an interest in a generating unit except in accordance with any or all of the provisions of this section and the regulations.
>
> 95(10) - A municipality or a subsidiary of a municipality may, with the authorization of the Minister, hold an interest in a generating unit if the arrangement under which the interest is held is structured in a manner that prevents any tax advantage, subsidy or financing advantage or any other direct or indirect benefit as a result of association with the municipality or subsidiary.

In a 2009 judgment, *Transcanada v. Alberta (Energy)*[9], the Alberta Court of Queen's Bench confirmed the procedural fairness of the section 95 process involving the interaction between the Minister of Energy and an Independent Assessor.

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[7] Under section 59 of the *AUCA* the Minister of Energy may make regulations on a variety of matters including: "…respecting conduct or any other matter relating to or that supports the fair, efficient and openly competitive operation of the electricity market…"

[8] See para. 50 of the Alberta Utilities Commission's January 18, 2010 ruling in Proceeding ID 241 where it found "…section 95 of the *Electric Utilities Act* establishes a process that specifically addresses the concern identified in subsection 5(c) of that Act."

[9] Court of Queen's Bench of Alberta, Transcanada Energy Ltd. V. Alberta, 2009 ABQB 717, 86 C.L.R. (3d) 310.

In this ruling, the Court of Queen's Bench characterized section 95 as a 'threshold' or 'eligibility' test when it stated:

> The purpose of s.95 is solely to confirm the eligibility of the municipally-affiliated generation proponent, in this case Enmax, to hold an interest in a generation unit in Alberta. [10]

In its January 18, 2010 ruling in AUC Proceeding ID 241, an application for approval of the proposed ENMAX Shepard generating facility pursuant to the *Hydro and Electric Energy Act*, the Commission considered the purposes of the *EUA*. The Commission held that in relation to government owned entities, subsection 5(c) is addressed by section 95; in particular, subsection 95(10). The Commission therefore determined that, in the context of Proceeding 241, it had no jurisdiction to consider the "level playing field" issues described in subsection 5(c) other than to ensure that the proposed generating facility had the necessary ministerial approval pursuant to subsection 95(10). On that basis, the Commission refused standing to certain parties claiming their interest by virtue of "level playing field" issues.

The Commission's ruling on standing was appealed.[11] In its decision on this matter, the Alberta Court of Appeal confirmed that the Commission's decision on its jurisdiction was correct. In doing so, the Court also stated that:

> It does not detract from the Commission's overall responsibility to determine the public interest and the other purposes set out in *Electric Utilities Act* and *Hydro and Electric Energy Act*. This can be achieved after the Minister has examined level playing field issues. The Commission must consider <u>all</u> other aspects of the public interest. The fact that questions about a level playing field are subject to a separate procedure does not mean that municipally-owned power plants will undergo 'only a threshold assessment' or a 'weak' assessment or that the result is 'irrational and inequitable' as Maxim suggests in its factum at paras. 60 and 61. Nor is the Legislature's method of dealing with level playing filed (sic) issues contrary to procedural fairness. *Transcanada Energy* held otherwise.[12]

In our view, any direct jurisdiction or role of the MSA in respect of subsection 95(10) is similarly limited, by virtue of the direct role given to the Independent Assessor and the Minister. The MSA is not placed to replicate the assessment contemplated in subsection 95(10), nor does it have any review role. However, just as the Court of Appeal found the Commission was responsible for "…<u>all</u> other aspects of the public interest", the MSA still has the broad mandate set out in section 39 of the *AUCA*. Included in that mandate is "…conduct that does not support *the fair, efficient and openly competitive* operation of the electricity market…" (subsection 39(1)(b)(ii)) and whether the person carrying out the conduct has complied with the regulations under the *EUA* (subsection 39(3)(b)(i)). Issues pertaining to the "level playing field" are part of that mandate.

It is also worthy of note that, apart from its general mandate as described above, the MSA is given responsibility under the *Municipal Own-Use Generation Regulation* for approval of compliance plans required in other circumstances under which a municipality or its subsidiary may hold an interest in a generating unit. These circumstances are expressly noted to be "in addition" to those set out in section 95.

[10] *Transcanada v. Alberta (Energy),* para. 3.
[11] *Maxim v. AUC*.
[12] *Ibid*. para. 43.

Insofar as the matters under investigation here, the MSA's view is that, while it is out of the MSA's jurisdiction to reach a separate judgment as to whether the standard set out in subsection 95(10) of the *EUA* was achieved, we can properly consider whether one of the parties provided misleading information to the Independent Assessor. Section 2 of the FEOC Regulation prohibits the provision of misleading records and misrepresentation of other matters; that Regulation of course describing conduct which would be inconsistent with the obligation on market participants to support the *fair, efficient and openly competitive* operation of the market, per section 6 of the *EUA*.

In summary, our view is that the MSA has a limited role to play in respect of subsection 95(10) of the *EUA*, unless it involves, for example, investigating whether a proponent misled the Independent Assessor (in contravention of section 2 of the FEOC Regulation and section 6 of the *EUA*). Further, the MSA has a general responsibility to investigate and enforce the section 6 (*fair, efficient and openly competitive*) standard, a contravention of which may result from an unaddressed advantage or benefit flowing from association with a municipality. However, in such a case it would be a contravention of section 6, not section 95.

To conclude, our view is that the Alberta market is protected from being distorted by the possibility of unfair advantages for government-owned participants, in the first instance by the section 95 review procedures, and secondly through the continuing responsibility of the MSA to enforce the section 6 obligations. In brief, section 6 is about one's conduct in the market; section 95 is about eligibility to be in the market.

3.2 SECTION 6

Section 6 places obligations on participants to support the *fair, efficient and openly competitive* operation of the market. There is no jurisprudence on this provision; however, the FEOC Regulation lists specific matters that the MSA must consider insofar as they are relevant to our investigation.

The MSA views '*fair, efficient, and openly competitive*' as a single test. We assess each of the terms individually, but consider them constituent elements of an overall standard of conduct.[13] If the legislature intended any one of these terms to stand on its own, it would have done so and since that did not happen we see the terms as intertwined to express a single concept. This involves a weighing of the elements depending on the circumstances of the alleged contravention and the strength of the evidence. Therefore, in the case at hand, our job is to investigate and assess how the actions of ENMAX and the City of Calgary contribute or fall short of a reasonable expectation of supporting the *fair, efficient and openly competitive* operation of the Alberta electricity market and whether, taken together, we are satisfied of a breach.

Finally, we view section 6 and section 95 as separate provisions implementing the purposes of the *EUA*. Once again, if the legislature had intended that additional burdens were to be placed on municipalities under section 6, or otherwise, the EUA would have included such provisions. In its absence, the MSA intends to apply section 6 to matters involving municipalities just as we would if the case involved a private sector market participant.

[13] See pp. 4-6 of the April 2010 MSA Discussion Paper – *Foundational Elements.*

3.3 FEOC REGULATION SECTION 2 – INTERPRETING SECTION 6 OF THE ELECTRIC UTILITIES ACT

Given the nature of the allegations here, we undertook this assessment from the perspective of section 6 of the *EUA* as particularized in the relevant provisions within section 2 of the FEOC Regulation. Those provisions cite specific conduct inconsistent with the obligation to support the *fair, efficient and openly competitive* operation of the market, including provision of misleading records.

The FEOC Regulation came into effect after the period in which the independent assessment regarding the Kettles Hill Wind Farm occurred, but in our view nevertheless provides useful guidance regarding criteria upon which to assess conduct in light of section 6 of the *EUA*.

Section 2 of the FEOC Regulation sets out a non-exhaustive list of conduct by a market participant that does not support the *fair, efficient and openly competitive* operation of the market, including subsection 2(a): "providing misleading records to the market or to any other person".

Records may be misleading if they tend to lead a person to an error in understanding or to a misapprehension of facts. Records can be misleading by virtue of the information they contain as well as by information that the records fail to include or state. We also considered materiality, relevance, completeness and accuracy of the records as part of the assessment.

In our view, it is not necessary to show that the records actually did mislead the recipient. Further, the term "misleading" does not necessarily involve the intent to deceive. However, the more likely it is that a reasonable person would be misled the greater the case that the market participant providing the records intended to mislead the recipient through a form of misrepresentation of the facts. In the context of an omission of certain information, the assessment would go to whether a reasonable person would think the omitted information to be relevant and material to the matter at issue, here being the independent assessment of the proposed Kettles Hill Wind Farm acquisition as against the requirements of subsection 95(10) of the *EUA*.

As noted above, an independent assessment pursuant to subsection 95(11) is a key component of the process through which the eligibility of a municipality or its subsidiary to hold an interest in generation is determined. Approval by the Minister rests entirely upon the independent assessment.

We also noted above that section 6 of the *EUA* is about conduct once in the market, whereas section 95 is about eligibility to be in the market. Both sections entail consideration of so-called 'level playing field' issues however, and are therefore to a degree inter-related.

In the case of the arrangement under which an interest in a generating unit is held, the section 95 process is intended to address the concern that a municipality or its subsidiary would have an unfair advantage that tips the playing field against other market participants. If the independent assessment is flawed and the playing field therefore left tipped in favour of the municipally owned market participant, the *fair, efficient and openly competitive* operation of the market is undermined.

ENMAX was a market participant apart from the proposed acquisition of the Kettles Hill Wind Farm, and accordingly was bound by the section 6 obligation at all relevant times, during the independent assessment and thereafter. However, even in the case where a municipality or its subsidiary is not yet a

market participant at the time of an independent assessment, they would become a market participant by holding the generating unit. To the extent that there is a continuing obligation to remain onside subsection 95(10), there will be a continuing obligation to remedy provision of misleading records.

Conduct that misleads the Independent Assessor, and thereby affects the integrity of the section 95 process, will be inconsistent with the section 6 obligation to support the *fair, efficient and openly competitive* operation of the market.

4 Section 6 Assessment: Electricity Services Agreement

As stated, '*fair, efficient and openly competitive*' is a single test. However, in reaching a view on whether there is a breach of section 6, it is helpful to consider the evidence as it relates to each term before making an overall assessment.

4.1 "FAIR"

In assessing '**fair**' we look to the reasonable expectations placed on ENMAX and the City of Calgary[14] relative to the practices of other participants in the Alberta market. Among the questions we address are:

- The legal or other requirements that purchasers of electricity (conventional and 'green') use competitive procurement before entering into long term supply agreements;
- The prevailing procurement practice among both municipalities and privately owned enterprises;
- Whether the actions of either ENMAX or the City of Calgary are at odds with obligations or prevailing practice, and in particular, whether the City should have invited competitors of ENMAX to compete for, or participate in, the Electricity Services Agreement, the Alliance Agreement or the Energy Management Office[15]; and
- Whether ENMAX's long-term-supply agreement with the City gave it an unfair advantage over the other bidders in its successful bid for the Kettles Hill Wind Farm.

The MSA reviewed the *Municipal Government Act* and determined that there is no explicit direction with respect to the method of procuring energy. In fact, subsection 3(b) of the Act gives broad discretion to municipal councils to decide on how to provide services and facilities. We also reviewed the federal-provincial Agreement on Internal Trade and the Trade, Investment, Labour and Mobility Agreement. While these agreements and the Alberta Purchasing Connection facilitate the competitive procurement of a range of products by the public sector the proposed energy chapter to the Agreement on Internal Trade has not been ratified. Therefore, municipalities, such as the City of Calgary, are free to decide how they wish to procure their electricity.

To understand how municipalities in Alberta actually procure energy supplies, we contacted eight major municipalities representing approximately sixty-four percent of the Province's population. We learned that Alberta municipalities use a wide variety of procurement methods including competitive procurement, sole source supply and self-supply through investment and ownership in generation

[14] The MSA considers the City of Calgary to be a market participant pursuant to subsection 1(1)(ee)(i) of the EUA.
[15] The Alliance Agreement and the Energy Management Office are described in section 4.3.2 below.

facilities. We also reviewed the procurement practices of the Alberta Urban Municipalities Association. The Association acts as an energy aggregator for a number of smaller municipalities in the province and competitively procures energy and natural gas for them.

Competitive procurement is the predominant method of procuring energy supplies in terms of numbers of municipalities. However, on a population basis, the predominant method is sole source and/or self-supply. These procurement methods tend to occur where the municipality has some type of connection with the generation of energy such as ownership of a generating unit.

Outside of the municipal sector, commercial enterprises have available to them a wide array of choices of how to be supplied electricity. Some purchase on a spot basis at the pool price. Others enter into supply contracts, and some have chosen to build their own generation and operate cogeneration facilities.

In summary, there is a variety of electricity supply arrangements in the province, nothing precluded the City of Calgary entering into the Electricity Services Agreement with ENMAX and doing so without entertaining competing offers. In principle, the City could have self-supplied by directly owning generation and thereby not provide a competitive opportunity to others. Based on the evidence and all of the considerations summarized above, we conclude that the actions of the City and ENMAX do not appear unusual or unfair.

We also investigated whether there was reason to believe that the Electricity Services Agreement gave an unfair advantage to ENMAX in bidding for the Kettles Hill Wind Farm. This acquisition was alleged to be the best and most current example of an unfair advantage that ENMAX exploited in the Alberta market. Our assessment is summarized below.

Discussions with Wind Developers

The MSA met with five wind project developers including small independents and large diversified energy companies. The developers have approximately 5,153 MW under development – 1,400 MW, which are 'active projects', and 3,700 MW 'in progress'.[16] The purpose of those meetings was to determine the key factors developers consider when putting together a wind project and the importance of long-term sales agreements.

The developers were consistent in their remarks about key factors. Generally, they include an adequate wind resource, transmission access, site location, community support, available financing and access to major equipment such as wind turbines. All of the developers indicated only the top tier projects will proceed.

The consensus view among developers is that long-term agreements are not available in the Alberta market. Developers acknowledged the benefits of having a long-term agreement; however, no developer gave failure to access such an agreement as a reason for cancelling a project.

The larger developers indicated projects are financed 'on the balance sheet' while the smaller developers indicated they are actively looking to partner with companies that have strong balance sheets. One

[16] The 'in progress' projects were in the AESO's previous transmission queue. The developers advised that when the AESO provided an option to recover the $50,000 deposit, developers were eager to take advantage of the opportunity. Developers expressed the view that the projects were deferred, not cancelled.

independent developer stated that the ideal partner has a balance sheet, internal load and/or a requirement for carbon offsets.

Kettles Hill Wind Farm Acquisition

ENMAX submitted its initial binding bid for the Kettles Hill Wind Farm on February 26, 2008, pursuant to the established bidding process. The vendor advised ENMAX that its bid was not the highest. ENMAX subsequently increased its bid and was advised again that it was not the highest bidder. Several days later, the vendor notified ENMAX that it had been unable to come to commercial terms with the other (higher) bidder and the vendor was prepared to continue discussions with ENMAX. The deal was subsequently closed with ENMAX as the successful bidder on June 26, 2008.

In our analysis, we considered whether the acquisition was dependent upon the Electricity Services Agreement or if it was supported by market fundamentals at the time. Accordingly, we reviewed the assumptions that were used to determine the different bid values prepared by ENMAX. In this regard, we reviewed documents presented to ENMAX's Board of Directors along with supporting analysis and documentation concerning the acquisition, ENMAX's financial models and various sensitivity assumptions based on pool price, price of green attributes, wind discount factor, and capacity factor. We considered ENMAX's energy portfolio and whether it could support the addition of Kettles Hill's energy. We also compared ENMAX's bid to other bidders in the auction.

ENMAX developed its initial bid value based on the assumption that the energy would be sold into the merchant market at spot prices. ENMAX justified the increased bid value on a number of factors but primarily on the assumption, that Kettles Hill's energy would be sold to its GreenMax[17] retail customers at a premium price.

The MSA met with a number of green retailers and confirmed that sale of green energy is at a premium to brown energy sales. ENMAX assumed that its GreenMax retail customers would pay a price premium for a Renewable Energy Credit (REC), the amount of which was consistent with what other retailers said a retail customer was willing to pay.

We then considered if ENMAX's green energy portfolio would be able to absorb the additional energy supply without including the additional City load. In this regard, we determined that, based on existing contracts and ENMAX's growth forecast, it was reasonable to assume that ENMAX's green energy portfolio would be able to accommodate the increase in supply without relying on the City's additional load. In our view, the Kettles Hill's acquisition could have been completed without relying on the Electricity Services Agreement.

The MSA compared ENMAX's bid to other bids. We obtained the bid values for the final six bidders and in some cases we were able to obtain price assumptions and financial models used by some of the bidders. We also had access to pool price forecasts and a green attributes price forecast prepared by third party experts.

[17] 'GreenMax' is ENMAX's trade name for a green energy product sold to various consumers.

The four highest bids were within a very tight range suggesting the bidding was highly competitive. It is noteworthy that ENMAX was not the highest bidder in the auction; as indicated previously, the highest bidder was unable to come to commercial terms regarding some of its conditions.

Based on our analysis, we are of the view that ENMAX's bid was clearly competitive, and was supported by market fundamentals at the time. Accordingly, we conclude that the Kettles Hill could have been acquired without benefit of the Electricity Services Agreement. While access to a long-term supply agreement is desirable, it is not a unique or decisive attribute supporting the purchase or development of a facility, such as Kettles Hill. In that sense, ENMAX did not have an unfair advantage vis-à-vis its private sector competitors who bid for Kettles Hill.

4.2 "EFFICIENT"

In assessing '**efficiency**', we consider:

- Whether the actions of ENMAX or the City had an impact on economic efficiency in the sector, or would likely in the future; and
- Whether the assessed impact on efficiency was positive, negative, neutral or simply unknown.

The MSA's April 2010 discussion paper *Foundational Elements* sets out our view of the meaning of efficiency in section 6 of the *EUA*. As noted, we consider both static efficiency (market price equals the short run marginal cost of production) and dynamic efficiency. Static efficiency analysis looks at the underlying resource cost to produce a given quantity of output at one point in time. The assessment of dynamic efficiency reviews the rate of new capital investment and the introduction of new products and processes over time.

Our investigation did not identify any evidence that the arrangement between ENMAX and the City and related actions undermined efficiency. One way that static efficiency losses can be caused is when lower cost resources needed to satisfy market demand are withheld; however wind generated energy is a price-taker in the Alberta market and, as explained in the next section below, neither ENMAX or the City has the requisite market power to profitably withhold energy from the market. Consequently, it seems unlikely that the market was denied lower cost resources because of the ENMAX/City arrangements and related actions.

Some might allege that the Electricity Services Agreement displaces lower cost fossil-fired generation and hence undermines economic efficiency in the sector. There are two responses to this assertion. First, in a market economy the customer chooses what it wishes to consume. As long as the value the consumer places on the product is commensurate with the higher price, there can be no loss in economic efficiency. Second, whether or not the City of Calgary chose to be supplied green energy by ENMAX or a competing supplier, the same wind generation farms would have been deployed (Kettles Hill, Taber and McBride Lake). It is always possible that other entities could operate these facilities more efficiently than ENMAX, but we have no persuasive evidence either way.

We reach the same conclusion with respect to our assessment of dynamic efficiency. Representatives of the City see a strategic alliance with its wholly owned subsidiary, ENMAX, as the most effective way to

'go green' and provide leadership toward developing a more sustainable environment. ENMAX stated that the partnership had contributed to creating a market for green energy and was if anything promoting competition just as early innovators in other industries have done. Based on the public record, it is difficult to conclude that ENMAX has had an adverse influence upon or lagged in the introduction of green technology and products. Indeed, ENMAX's growing prominence in the area is one reason for the complaints that led to our investigation; the complainants, competitors of ENMAX were concerned that they were being denied participation in the developing green market.

4.3 "OPENLY COMPETITIVE"

Regarding '**openly competitive**', we review the provisions of section 2 of the FEOC Regulation and apply well-established competition analysis. In principle, concerns around competition fall into two categories: unilateral effects and coordinated effects, that is, the behaviour of a single entity or the coordinated anticompetitive behaviour of more than one entity. The investigation focused on whether the vertical linkage (the purchase/supply chain or the linking of downstream and upstream activities) between ENMAX and the City of Calgary reduces competition, in other words an assessment of unilateral effects from vertical foreclosure.

In assessing vertical foreclosure in this instance, we consider:

- Whether ENMAX or the City restricted or prevented a competitive response or market entry by another person (FEOC Regulation, subsection 2(h));
- Whether the actions of ENMAX or the City materially foreclosed competitive opportunities to market participants or potential participants;
  - To what degree the Electricity Services Agreement, the Alliance Agreement, or the Energy Management Office, tied the City as customer to ENMAX; and
  - What portion of the relevant market is tied up, now and in the foreseeable future?

Before examining the facts, it is useful to briefly review the analytics related to foreclosure.

4.3.1 Defining Foreclosure

Vertical foreclosure is defined to occur when a dominant incumbent (or a dominant group of incumbent firms acting in concert) in a market pre-empts or otherwise deprives competitors or potential competitors of a major source of supply of a critical input or a major downstream outlet or customer for their product. If there are no suitable alternative sources of supply of the input concerned or if there are no suitable alternative routes to market, existing competitors may be obliged to leave the market and/or potential competitors may not be able to enter. Competition is lessened as a consequence and the lessening could be substantial.

There are numerous means of effecting vertical foreclosure. It can take the form of a refusal by a dominant vertically integrated firm either to sell critical inputs to non-integrated downstream rivals or to purchase or distribute the output of non-integrated upstream rivals. It can also take the form of arm's-length exclusive dealing contracts. These can be either explicit or implied exclusive dealing contracts. Explicit exclusive dealing contracts are also called 'tie-outs'. These contracts can take the form of either

exclusive supply agreements or exclusive distribution agreements. Implied exclusive dealing occurs when the terms of a contract are such as to make it advantageous to deal with only one buyer or one seller.

In otherwise unregulated markets, competition law generally does not oblige a vertically integrated firm to buy from or sell to outsiders. Competition problems may come about when a vertically integrated firm has been selling to, or buying from non-integrated outside competitors and then decides to cut them off – essentially leaving these competitors without access to the vertical production-distribution chain.

Competition problems also arise (indeed, they may be most common) in industries in transition from regulation to partial deregulation. An illustration is the continuing disputes over the terms of access (access pricing) of competing 'resellers' to the networks of incumbent facilities-based telecommunications providers. In setting access prices, the regulator often walks a fine line between facilitating downstream competition and not discouraging incumbents from reinvesting in their facilities and resellers from becoming facilities-based competitors.

The analysis of possible anti-competitive vertical foreclosure begins with a theory of the case. This usually involves the identification of competitors or potential competitors, which a dominant incumbent could profit from excluding or marginalizing. Attention then turns to whether observed conduct is more consistent with this exclusionary objective than with normal business practice. Contractual foreclosure of suppliers, distributors or customers is regarded as potentially anti-competitive under the following circumstances:

- a significant fraction of the potential suppliers (distributors, customers) is tied up for a significant period of time;
- contracts are staggered so that only a small fraction of potential suppliers (distributors, customers) becomes contestable at any point in time;
- roll-over is automatic (negative option rollover);
- there are significant penalties for breach of contract; and
- there is a right of first refusal (matching any competitive offers)

The alleged anti-competitive effect of the Electricity Services Agreement is that it ties up a major customer (the City of Calgary) for a long time thereby depriving competitors or potential competitors of ENMAX of a significant competitive opportunity and substantially weakening their ability to compete in the future. The answer to the question of whether the Electricity Services Agreement results in anti-competitive foreclosure turns first, on the degree to which the it and the Energy Management Office tie the City up as a customer of ENMAX and, second, on the portion of the relevant market that is tied up.

We first deal with the former question, whether the Electricity Services Agreement and Energy Management Office tie up the City of Calgary as a customer of ENMAX for a significant period thereby foreclosing it to competitors or potential competitors.

4.3.2 Is the Electricity Services Agreement a Long-term Exclusive Dealing Arrangement?

The Electricity Services Agreement is a 20-year, fixed price agreement between ENMAX and the City that went into effect on January 1, 2007. The City has historically purchased its energy supply requirement from ENMAX and, in this context, the Electricity Services Agreement essentially formalizes that relationship.

The Electricity Services Agreement contains a number of key characteristics. The agreement designates ENMAX as its exclusive electricity retailer of choice subject to the terms of the agreement. ENMAX is to supply green energy to the City to assist the City in meeting its environmental objectives. The agreement provides that ENMAX may develop a portfolio of green energy projects that are dedicated to the agreement. Pricing is determined using a cost-based approach plus a rate of return. In the initial agreement, the Taber wind project was the sole unit in the portfolio and its energy was used to meet the City's load requirement. The initial agreement was revised in February 2009 to include energy output from the Kettles Hill Wind Farm. The energy from Kettles Hill is used to meet the City's own growing load demand and provide additional green attributes to meet the City's green energy requirements.

The Energy Management Office was established under the terms of an Alliance Agreement that was developed over the April 2004 to June 2008 period. Under the oversight of an Alliance Committee, the purpose of the EMO is to manage jointly the energy agreements between ENMAX and the City and to work on other matters related to the City's environmental objectives. The City selected the alliance approach with ENMAX for a number of reasons including:

- The City wanted to take a more proactive approach in managing procurement and energy use;
- The City wanted a partner with a wide range of resources that was willing to work out details;
- The City felt that no one else could provide the services it wanted or put the alliance into effect;
- ENMAX is a historical partner. The City has always purchased its energy from ENMAX; and
- ENMAX had the necessary billing systems in place. The City was of the understanding that no other wholesalers could provide the necessary billing systems.

In summary, we reviewed the evidence pertaining to the terms and conditions in the Alliance Agreement, the Electricity Services Agreement and the operation of the Energy Management Office. All of these arrangements, and particularly the Electricity Services Agreement, do tie up the City of Calgary as a customer for a long period. Therefore, it does satisfy the first requirement for foreclosure.

4.3.3 Does the Electricity Services Agreement Foreclose a Significant Fraction of the Relevant Market?

The second question we must deal with is whether the effect of the arrangements between ENMAX and the City, particularly the Electricity Services Agreement, is to foreclose a significant fraction of the relevant market to competitors or potential competitors and, if so, whether this will result in less

competition in the future. The portion of the market or market opportunities tied up by the Electricity Services Agreement requires that the market be defined. It is to the definition of the relevant market that we now turn.

The relevant market has both a geographic and a product dimension. Markets may also be defined at various stages in a vertical chain of production and distribution, for example, wholesale and retail markets. A reasonable starting point in this case is to define the relevant market as the Alberta wholesale market for electrical energy, that is, all power offered into the Pool. The geographic dimension of this market is straightforward given that there are no serious transmission constraints and thus no local wholesale markets for electric power in Alberta. Generators can offer electric power into the grid from any location and receive the Alberta-wide market-clearing price. In particular, there is no Calgary or southern Alberta wholesale market for electric power.

A narrower definition of the product market is 'wholesale green energy'. Green energy is also called renewable energy. Sources of green energy include biomass, low impact hydro and wind. Green energy has two components – energy and a green attribute[18] that is created when energy is generated. Green attributes can be sold (bundled) with energy or the attribute can be stripped off and sold either as a REC or as an offset credit. Generally, green attributes are consumed by two types of wholesale customers, 'voluntary' customers and 'compliance' customers.

Voluntary customers include residential and small businesses that contract with green energy retailers for green energy at a premium (over 'brown' energy) for social or environmental reasons. In discussions with green retailers, the MSA found that their customers typically pay a premium (known as the 'green premium') of approximately $20/MWh over the cost of brown energy. Voluntary customers also include government organizations (municipal, provincial and federal) and, possibly, other types of customers for unbundled renewable energy credits outside Alberta. For voluntary customers, green and brown energy are imperfect substitutes and these customers might not switch in large numbers between green and brown energy in the event of a small but significant increase in the green premium.

Compliance customers purchase (or produce their own) green attributes as carbon offsets in order to meet regulatory obligations.[19] The wholesale price or premium associated with a green attribute presently ranges from $9 to $12/MWh.[20] Compliance customers have four basic options for meeting regulatory obligations – (1) internal improvements to operations; (2) emission performance credits; (3) Alberta offsets; and (4) payments to the Climate Change and Emissions Management Fund.[21] In addition to renewable energy generation projects referred to above, Alberta carbon offsets may also be obtained from other sources, such as no tillage agricultural projects, waste heat recovery, acid gas injection, composting, landfill gas and enhanced oil recovery projects. These projects must be registered and conducted in

[18] A green attribute is a general term and may also be referred to as a green tag, Renewable Energy Certificate (REC) or an offset. A green attribute is derived from processes that reduce greenhouse gas emissions. A key constituent of a green attribute is that it is based on some sort of certification system and must be measurable and quantifiable and typically subject to some sort of third party audit. Canada's Offset System for Greenhouse Gases, the EcoLogo Program, the Specified Gas Emitters Regulation in Alberta, and Leadership in Energy and Environmental Design (LEEDs) are examples of certification processes. The audit process provides assurance to consumers that they have received the benefit of a green product.

[19] When used by Alberta compliance customers, green attributes from renewable energy projects are converted to carbon offsets at the rate of 1 MWh = 0.65/tCO_2e.

[20] This was the range of wholesale prices generally mentioned by retailers and project developers; however, we did hear quotes as low as $2/MWh.

[21] Subsection 8(1) of the *Specified Gas Emitters Regulation* states that, for each $15 contribution to the fund, a fund credit of one tonne reduction in CO_2e is obtained. In effect, the regulation provides a price cap for green attributes in the wholesale market.

Alberta. Compliance customers have the option of switching among compliance alternatives and in particular, of switching away from carbon offsets sourced from renewable energy generation projects in the event of a price increase in this form of offset.

There are reasons to believe that the elasticity of demand for Alberta green energy could be high enough to limit the extent to which Alberta suppliers of renewable energy, either individually or collectively, could profitably raise its price (i.e., raise the green premium) above prevailing levels. The elasticity of demand for renewable energy depends on the ability, and the willingness, of voluntary and compliance consumers to embrace substitutes when its price is increased. The many substitutes for green attributes that are available to compliance customers have been listed above.[22] Voluntary customers also have options. If the green premium increases too much, some voluntary customers may return to or remain with brown energy. Voluntary customers can also 'green up' brown energy by purchasing green attributes separately. There are many sources of 'green attributes' other than RECs derived from Alberta-based renewable energy generation. RECs can be acquired from other jurisdictions as well.[23]

An implication of the many available substitutes for Alberta green energy is that even if it had a large market share, an Alberta producer of green (renewable) energy would likely have a limited ability to raise the price of green attributes much above the competitive level.

Having defined two possible markets (the Alberta wholesale energy market and the Alberta wholesale renewable (green) energy market), we now turn to the respective proportions of these markets accounted for by the Electricity Services Agreement and by ENMAX.

Dealing first with the Alberta wholesale energy market, we find that the Electricity Services Agreement itself accounts for less than 1 percent of this market over the life of the agreement. Put another way, only a tiny fraction of the Alberta wholesale energy market is tied up under the Electricity Services Agreement. We also assessed ENMAX's share of total generation capacity (by offer control) for the period 2009 to 2015 based on AESO metrics and MSA calculations.[24] We estimate that ENMAX's share of generation capacity by offer control is substantially below 20 percent and will continue to average below this level between 2010 and 2015. A market share of this magnitude is well below the threshold normally associated with market dominance.[25]

Turning to the Alberta wholesale market for green (renewable) energy, we estimate that at present the Electricity Services Agreement accounts for less than 20 percent of this market during the 2009 to 2015 time-period. Put another way, the Electricity Services Agreement itself leaves more than 80 percent of the Alberta wholesale market for green (renewable) energy open for competitors or potential competitors to contest. In our view, the portion of the market foreclosed by the Electricity Services Agreement is not sufficient to deter competition or potential competition.

ENMAX has also sold green energy to other customers under medium and long-term supply agreements so its total share of this market also matters. ENMAX's estimated share of the green energy market in

[22] As noted previously, the $15 fund fee establishes an implied price cap in the compliance market of approximately $10/MWh for a green attribute from a renewable energy project.
[23] Based on our discussions with green retailers we understand that Alberta voluntary customers tend to have a preference for RECs sourced from wind projects however there is no reason why they could not be obtained from other jurisdictions and other technologies.
[24] AESO Metrics, Feb. 2010.
[25] FEOC Regulation, ss. 5(5); Competition Bureau Abuse of Dominance Guide, pp.12-14.

2009 (including the Electricity Services Agreement with the City of Calgary) was approximately 30 percent and is estimated to be in the range of 20 percent in 2010 based on the AESO metrics and MSA calculations.[26] While this is not a trivial market share, it leaves in the order of 70 to 80 percent of the relevant market in the hands of competitors, one of whom is much larger than ENMAX. Moreover, we note that ENMAX has signed other medium and long-term green energy supply agreements and that ENMAX secured these agreements through competitive processes.

There are several other reasons to believe that ENMAX's current market share implies little or nothing in the way of market power or potential market power. First, the best information available is that ENMAX's share of renewable energy generation is likely to fall over time based on the AESO's metrics and MSA calculations. There are currently approximately 6400 MWs of additional wind capacity in the AESO's queue waiting for access to transmission which was considered as part of the MSA's market share analysis. Barriers to entry into wind generation are relatively low. While there is a limit on the number of sites in Alberta suitable for wind generation, these appear to be in a variety of firms and there is nothing to indicate that ENMAX has attempted to tie them up (nor has this been alleged). Wind farms are not mega-projects and they can be, and are, financed in a variety of ways. Firms with limited access to finance have the option of partnering with others who have internal load or a need for RECs or both. This is not to deny, however, that access to a long-term contract with a creditworthy counterparty such as the City of Calgary would make external financing of a project easier for many market participants.

Second, as explained above, there are many sources of green attributes and this effectively places a ceiling on the green premium. As a result, the scope for profitable exercise of market power even by a monopoly producer of renewable energy would be limited.

Third, wind generators are price-takers rather than price-setters. As well, ENMAX has sold much of its wind generation forward under the Electricity Services Agreement and other long-term contracts. Consequently, ENMAX has little incentive to raise the price of renewable energy even if it had the ability to do so. It would not profit by doing so.

In summary, on either definition of the relevant market, the Electricity Services Agreement with the City of Calgary does not itself result in anti-competitive foreclosure. Moreover, ENMAX has no realistic prospect of exercising market power in either the wholesale green energy market or the wholesale energy market. We view the Electricity Services Agreement as simply an exercise of business strategy rather than a mechanism to exclude rivals.

4.4 OVERALL ASSESSMENT – *FAIR, EFFICIENT, AND OPENLY COMPETITIVE*

The central finding is that ENMAX and the City of Calgary lack the market power to foreclose competition now or in the near future. Therefore, competition is undiminished in both the Alberta wholesale energy market and in the wholesale green energy market in spite of the arrangements and actions of ENMAX and the City of Calgary. The separate assessments of *fair* and *efficient* do not detract from this conclusion; indeed, they reinforce it.

It could be argued that the City of Calgary should be required to procure all its products, including, energy on a competitive basis. If such an application was to be made under section 6 to the Commission,

[26] AESO Metrics, Feb. 2010.

it would rely on the meaning given to the words "Market participants are to conduct themselves in a manner that supports…" and "…openly competitive operation of the market" (emphasis added). As stated in an earlier paper, this language implies a conduct-oriented test as opposed to the more traditional outcome-based standard.[27] In other words, an expectation placed on participants to make special efforts to foster the development of a competitive marketplace. Under this line of reasoning, the "openly competitive" operation of the market would be supported by introducing competitive procurement and all eligible suppliers are given the opportunity to win the City's business. However, this suggestion fails to recognize that the City is under no greater obligation under s. 6 than is any large energy customer that self-supplies or single-sources.

As already stated the MSA views section 6 as standing on its own and separate from section 95. As such, a remedy requiring the City of Calgary to change its procurement practice would not be equitable or fair unless it was applied across the board and encompassed privately funded market participants. Since this is very unlikely to happen, such an approach would not meet our view of the single blended concept (*fair, efficient and openly competitive*) expressed in section 6.

In our view, the evidence does not support a finding of a breach of section 6 of the *EUA*.

5 Section 2 (FEOC Regulation) Assessment

Our investigation also considered whether ENMAX or the City misled the Independent Assessor or the Minister with respect to information pertaining to the review and subsequent approval of ENMAX's acquisition of the Kettles Hill Wind Farm. In particular, we considered whether the existence of discussions between the City and ENMAX regarding possible amendments to the Electricity Services Agreement was information that should have been provided to the Independent Assessor, and whether the failure to provide that information rendered other information misleading. We also considered what the impact of such records, if misleading, would be under the circumstances.

5.1 INDEPENDENT ASSESSMENT - TERMS AND CONDITIONS

The terms and conditions provided to the Independent Assessor specified that ENMAX is to describe the arrangements and that ENMAX is to provide the Independent Assessor with access to all information in its possession required for the independent assessment.

Furthermore, there was an expectation that ENMAX and the Independent Assessor would work in good faith during the course of the assessment. The MSA considers this a very important requirement, given the role of the Independent Assessor and the reliance placed upon records provided by ENMAX for the independent assessment.

5.2 NOTIFICATION TO THE INDEPENDENT ASSESSOR

The allegations regarding provision of misleading information to the Independent Assessor can be broken down as follows:

[27] *Foundational Elements*, p.6.

- ENMAX did not disclose information regarding possible amendments to the Electricity Services Agreement during the independent assessment of the Kettles Hill Wind Farm which was or may have been material to the independent assessment;
- The failure to disclose that information was a contravention of section 6 of the *EUA*, as well as a breach of the terms and conditions established for the independent assessment pursuant to subsection 95(11) of the *EUA*, and rendered flawed the independent assessment; and
- Accordingly, the authorization given by the Minister cannot be relied upon by ENMAX in relation to subsection 95(1) of the *EUA*.

The MSA determined that the Independent Assessor received an information package dated April 14, 2008, which described the arrangements under which ENMAX would hold an interest in the Kettles Hill Wind Farm. The information package served as the basis for the assessment conducted. The package noted that ENMAX might enter into long-term electricity purchase arrangements for a firmed green product.

During the investigation the City provided to us a City Council document dated April 8, 2008, 6 days before the information package went to the Independent Assessor. That document authorized the City Administration to enter into negotiations with ENMAX for a long-term green energy supply agreement. In addition, we note that the subsequent Alliance Agreement between ENMAX and the City is dated June 6, 2008, and also relates to such negotiations.

The Kettles Hill Wind Farm acquisition team included members of the ENMAX Commercial Group who would have been knowledgeable about its green energy portfolio. In addition, the Energy Management Office included employees from the City and from ENMAX's Commercial Group who would have been in a position to know and share information regarding the City's growing electricity demand and the Kettles Hill Wind Farm acquisition. Moreover, the Strategic Alliance and the Electricity Services Agreement contemplated that new renewable energy projects might be added to the Agreement supply base.

The Independent Assessor confirmed that he was not specifically informed by ENMAX during the period of the independent assessment that it had entered into discussions with the City regarding possible amendment of the Electricity Services Agreement. That said, it seems clear that the Independent Assessor was aware of the terms and conditions of the existing Electricity Services Agreement[28] and the information package had disclosed the possibility of new long-term arrangements regarding green energy. There was no indication that the Independent Assessor requested either ENMAX or the City to provide information or assurances regarding possible amendment of that Agreement.

It is for the Independent Assessor to determine if information is relevant and material from the perspective of subsection 95(10) of the *EUA* and the particular independent assessment being undertaken. Based upon information given to us during the investigation, it did not appear that the Independent Assessor had placed emphasis on that existing long-term supply agreement as a key factor in the independent assessment of the proposed Kettles Hill Wind Farm acquisition.[29] Further, while the City

[28] This was made known during the Taber Wind Farm assessment carried out in 2005 by the same Independent Assessor.

[29] Discussions with Wind Developers did not identify long term agreement as a key factor. Discussions with Wind Developers are described in section 4.1 above.

and ENMAX apparently began discussing possible changes to the Electricity Services Agreement at the time of the independent assessment, actual changes were unknown. Accordingly, the parties might not have considered the discussions to be material to the independent assessment. Further, it is evident that no final decision had been made by ENMAX that Kettles Hill, if acquired, would be used to supply green energy to the City of Calgary under the possible amendment to the Electricity Services Agreement.

As noted in Section 4 of this Report, the MSA does not see the Electricity Services Agreement as being inconsistent with the obligations of the City and ENMAX under section 6 of the *EUA*. The arrangement between the parties did not foreclose competitive opportunities to others or give an unfair advantage to ENMAX.

5.3 MINISTERS APPROVAL LETTER OF JUNE 18, 2008

The allegations in this investigation also raised the issue of whether amendment of the Electricity Services Agreement after the Minister's approval has implications in the context of section 95 of the *EUA*. Those implications would come from the wording of subsections 95(1) and 95(10), as well as the terms of the Minister's approval regarding the Kettles Hill Wind Farm acquisition.

The Minister's letter authorizing ENMAX to hold an interest in the Kettles Hill Wind Farm states:

> In the interest of ensuring that fair and open competition is maintained in the generation industry, ENMAX is expected to provide the Department of Energy with notification prior to any changes being made to the arrangement described in the Assessment that would result in non-compliance with section 95(10).

Based upon information obtained during our investigation, the sales assumption used by ENMAX to justify the increased bid offer for the Kettles Hill Wind Farm assumed that energy would be sold to ENMAX's GreenMax customers.[30] These contracts had fixed prices and 5-year contract terms, and therefore were different than the sales to the City under the Electricity Services Agreement. With regard to contract risk, the City has stated:

> Short-term contracts provide the consumer with the greatest amount of flexibility over the short-term, however, also exposes the consumer to price uncertainty at the end of the contract term. Short-term contracts allow consumers to take advantage of falling market prices, but also expose the consumer to increased costs during periods of high prices.
>
> Long-term power contracts provide the consumer with limited flexibility but greatly reduce exposure to extreme price volatility. A substantial risk premium is included in price of long-term contracts to protect the retailer against having to procure energy on the open market during periods of extreme price volatility.

It is arguable that the plan to sell energy from the Kettles Hill Wind Farm to the City rather than to base the acquisition on the GreenMax program constitutes a change in the arrangement under which the interest in that asset is be held. However, that determination ultimately relates more to section 95 than to section 6. The Minister's letter of approval for the Kettles Hill Wind Farm acquisition allowed ENMAX

[30] See Section 4.1 of the report - Kettles Hill Wind Farm Acquisition.

the discretion to make the determination concerning whether a change in the arrangement would result in non-compliance with subsection 95(10). This requires ENMAX to determine relevance as well as materiality. Our comments below therefore go to process alone.

5.4 FINDING

The evidence does not indicate that there was any intention by ENMAX to mislead the Independent Assessor in relation to the proposed Kettles Hill Wind Farm acquisition. There was no expressed request to disclose information or give assurances about possible changes to the existing Electricity Services Agreement, the changes were undetermined, and there was uncertainty about relevance and materiality. Indeed, there may be little of substance in the amended Electricity Services Agreement that the Independent Assessor had not already reviewed. For example, the price schedule of the project economics reviewed by the assessor is the same price schedule as contained in the Electricity Services Agreement. All of that made the lack of formal disclosure of the extension to the Electricity Services Agreement by ENMAX, in our opinion, reasonable in the circumstances.

Accordingly, we find the lack of disclosure about possible changes to the Electricity Services Agreement was not a breach of subsection 2(a) of the FEOC Regulation or section 6 of the *EUA*, which it describes.

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The Market Surveillance Administrator is an independent enforcement agency that protects and promotes the fair, efficient and openly competitive operation of Alberta's wholesale electricity markets and its retail electricity and natural gas markets. The MSA also works to ensure that market participants comply with the Alberta Reliability Standards and the Independent System Operator's rules.

Market Surveillance Administrator | 403.705.3181 | #500, 400 – 5th Avenue S.W., Calgary AB T2P 0L6 | www.albertamsa.ca