Investigation into the Use of Concessionary Government Funds by Competitive Affiliates of ENMAX Power Corporation

November 9, 2010

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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SUMMARY

On July 30, 2009 the Market Surveillance Administrator received a complaint alleging that certain financial transactions between ENMAX Power Corporation and its competitive affiliates may have contravened sections 5(c), 6 and/or 95(10) of the *Electric Utilities Act*. The transactions involved concessionary funds (i.e., at lower interest rates than would otherwise likely be available to a local authority) which are sourced from the Alberta Capital Finance Authority by ENMAX Corporation through The City of Calgary. These funds are made available by the Province for regulated capital projects which meet stipulated funding criteria. The concern expressed in the complaint was that these funds may have assisted unregulated operations of ENMAX Corporation relating to the purchase or development of generating projects and thereby harmed competition in the Alberta power market. The complaint also raised issues involving possible breaches of the *Municipal Government Act* and borrowing bylaws of The City of Calgary.

KEY FINDINGS

- In 2006 and 2007 some relatively small amounts of funds sourced from the Alberta Capital Finance Authority were accessed by non-regulated affiliates of ENMAX Power Corporation. Access to these funds was at Fair Market Value, for short periods of time and immediately callable upon expenditures by ENMAX Power Corporation. The transactions therefore did not raise the potential for material harm to the *fair, efficient and openly competitive* operation of the market.
- In 2009, surplus funds from the Alberta Capital Finance Authority were placed in a separate account pending a final decision by the Alberta Utilities Commission in Proceeding ID 185 and were therefore not accessible by non-regulated affiliates of ENMAX Power Corporation.
- As a result of our investigation, we concluded that there was no violation of section 6 the *Electric Utilities Act*.
- In respect of sections 5 and 95 of the *Electric Utilities Act*, the MSA held, as set out in previous reporting, that: section 5, describes the purposes of the legislation, but is not itself capable of contravention; and section 95 issues are addressed by a process of independent assessment and Ministerial approval which does not contemplate direct MSA involvement.
- The allegations regarding compliance with the *Municipal Government Act* and The City of Calgary bylaws are outside the jurisdiction of the MSA.

1 Introduction

ENMAX Corporation (ENMAX Corp) is a wholly owned subsidiary of The City of Calgary (City). ENMAX Corp carries out its business activities in separately managed, wholly owned subsidiaries two of which are ENMAX Energy Corporation (ENMAX Energy) and ENMAX Power Corporation (ENMAX Power). ENMAX Energy carries out all energy supply and retail functions in its own right and through various subsidiary companies and affiliates such as ENMAX Green Power Inc. ENMAX Power is

responsible for electricity transmission and distribution functions, and is regulated by the Alberta Utilities Commission (AUC or Commission).[1] Capital projects undertaken by ENMAX Power are eligible to use funds sourced from the Alberta Capital Finance Authority (ACFA).

Pursuant to section 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 complaint against the standards in the legislation, reviewing public information sources and holding preliminary discussions with the complainant and ENMAX Corp, we determined that an investigation should be conducted. The investigation was conducted pursuant to the MSA's Investigation Procedures.

We noted that the AUC considered issues related to ACFA funding in Proceeding ID 185 which dealt with ENMAX Power's proposed 2009 debt issuance and whether it was supported by the law and its intended purpose. We relied on the record in AUC Proceeding ID 185 for information pertaining to the governance and operation of ENMAX Corp's cash concentration account.

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; and Section 4 assesses the implications of inter-affiliate transactions from the perspective of section 6 of the *Electric Utilities Act* (EUA).

2 Nature of Allegations

The complainant alleged contraventions of sections 5(c), 6 and/or 95(10) of the EUA related to direct and indirect advantages which may have been conferred on ENMAX Energy (or one of its non-regulated affiliates) as a result of its status as a wholly owned subsidiary of ENMAX Corp. The complainant argued that advantages might have been conferred upon ENMAX Energy in the form of low cost, interim financing which may have been available to it from ENMAX Power. The complainant alleged that the funds may have been loaned by ENMAX Power to ENMAX Energy at interest rates more favourable than what are available to independent power producers (what we call concessionary rates). The complainant noted that ACFA funds are available to ENMAX Power due to its status as a regulated utility and its affiliation with the City. The complainant asserted that ACFA funds provide a financing benefit and may have assisted ENMAX Energy in purchasing and/or developing generation projects to the exclusion of investor owned power producers in the Province.

The ACFA is a provincial authority pursuant to the *Alberta Capital Finance Authority Act* and acts only as an agent of the Alberta Government. The purpose of the ACFA is to provide local entities with financing for regulated capital projects. The ACFA is able to borrow funds in the debt markets at interest rates which would not otherwise be available to local authorities acting on their own. The ACFA loans the borrowed funds to Alberta municipalities, school boards and other local entities at an interest rate that is based on the cost of its borrowings. ACFA loans must be used for the intended purpose.

[1] ENMAX Energy is non-regulated except for its Regulated Rate Option (RRO) business. Although ENMAX Energy is the RRO provider, ENMAX Power administers the RRO. ENMAX Power also provides non-regulated power services through two subsidiaries.

In addition to the above, the complainant alleged that ENMAX Energy's use of ACFA funds could also potentially violate applicable City borrowing bylaws and subsection 253(2) of the *Municipal Government Act* (MGA).

3 Legal Framework

The MSA conducted an investigation into potential contraventions of section 6 of the EUA. Section 6 of the EUA places obligations on market participants to conduct themselves in a manner that supports the *fair, efficient and openly competitive* operation of the market.

While the complainant also alleged possible breaches of subsection 5(c) and subsection 95(10), we have not conducted investigations into these allegations.[2] Our view is that subsection 5(c) is one of the purpose clauses of the EUA and in and of itself is not capable of contravention. In addition, we determined that the MSA has a limited role to play in respect of subsection 95(10) of the EUA, unless it involves potential contraventions of the prohibitions set out section 2 of the FEOC Regulation and section 6 of the EUA (for example, subsection 2(a) of the FEOC Regulation, providing misleading records). We note that the complainant did not raise specific FEOC Regulation issues and we found no evidence that a breach had occurred.

The complaint also alleged possible contraventions of City borrowing bylaws and subsection 253(2) of the MGA. The MSA considered whether we have jurisdiction to interpret and investigate matters related to City borrowing bylaws and the MGA and concluded that we do not. The reason for this conclusion is that, as a statutory creation, the MSA can only carry out the prescribed responsibilities set out in its underlying legislation. The mandate of the MSA does not directly include those matters. However, we did have regard for the authority upon which ACFA funds may have been loaned or made available between the ENMAX entities, as applicable.

4 Section 6 Assessment

In carrying out our assessment of whether inter-affiliate transfers involving ACFA funds contravened section 6 of the EUA, we drew extensively from the record of the AUC that approved ENMAX Power's 2009 debenture issue as being in accordance with the law.[3] We also note that the complainant did not provide evidence of harm to competition nor were we able to find evidence of such harm.

Prior to carrying out a detailed analysis regarding the section 6 assessment, we first looked to answer two preliminary questions forming a two-part test:

1) whether ACFA funds were in fact loaned or made available to affiliates of ENMAX Power, as alleged; and
2) if loaned or made available, whether the funds were material such that there was a potential for harm to the *fair, efficient and openly competitive* operation of the market.

2 For an in-depth discussion on the applicable legal framework see the MSA's report *Electricity Services Agreement: A Report into Alleged Violations of Sections 6 and 95 of the Electric Utilities Act*, September 2010.
3 AUC Proceeding ID 185. See *Decision 2009-097*, June 30, 2009 and *Decision 2010-035*, January 15, 2010.

The need for further investigation hinged on whether the alleged conduct passes or fails the tests. As set out in greater detail below, we found the answers to the preliminary questions to be: 1) Yes, and 2) No. Accordingly there was no finding of a contravention of section 6 of the EUA.

4.1 WERE ACFA FUNDS AVAILABLE TO COMPETITIVE AFFILIATES OF ENMAX POWER?

ENMAX Corp manages its cash resources through a cash concentration system. In this system, the operating account for each of ENMAX Corp's subsidiaries is physically zeroed into a concentration account it holds at the close of business on each banking day.[4] As a subsidiary, ENMAX Power is a part of the cash concentration system. If ENMAX Power's account balance is negative, then funds are drawn from the concentration account and deposited into its operating account bring it to a zero balance.[5] Conversely, any positive balance is withdrawn and deposited to the concentration account.[6] The one month Canadian Dealer Offered Rate (the CDOR) is applied to all funds moving into and out of the ENMAX Corp cash concentration account. [7]

In a typical year, ACFA funds are received by ENMAX Corp at mid-year. (ENMAX Corp financial management is on a calendar year basis.) Prior to that time, ENMAX Power spends on capital projects using internally generated cash flow and/or withdrawals from the cash concentration system. The ACFA funds are first used to offset prior ENMAX Power expenditures and any outstanding balance remains in the concentration system and earns interest at the one month CDOR. In some years there may be a temporary surplus of unspent funds in the concentration system. As ENMAX Power continues to spend on capital projects, the ACFA funds in the concentration system are callable and available to offset capital expenditures. Based on evidence provided by ENMAX Corp senior management, there were no inter-affiliate transfers outside the cash concentration system during the period of time under investigation; 2004 to 2009.

Our investigation found that ENMAX Power borrowed ACFA funds in 2004 and in the years 2006 to 2009. In 2004 and 2008 the funds were fully utilized for regulated capital projects immediately upon receipt. In 2006, 2007 and 2009 cumulative spending on capital projects was less than available ACFA funds, at the time the funds were received, and a positive balance remained in the cash concentration system. With respect to 2006 and 2007, we determined that surplus ACFA funds were available to competitive affiliates through the cash concentration system. However, in 2009 ENMAX Corp placed the surplus funds in a separate account pending a final decision by the AUC in Proceeding ID 185. Therefore, surplus ACFA funds were not available to ENMAX Power's competitive affiliates in 2009.

In summary regarding question 1), we concluded that surplus ACFA funds were made available to competitive affiliates of ENMAX Power only in 2006 and 2007.

4 AUC Proceeding ID 185, *Information Response AUC.EPC-001 Attachment A*.
5 Ibid., Attachment A.
6 Ibid., Attachment A.
7 The Canadian Dealer Offered Rate is determined by the Bank of Canada.

4.2 WAS THE TRANSFER OF ACFA FUNDS TO COMPETITIVE AFFILIATES OF ENMAX POWER 'MATERIAL' SUCH THAT THERE WAS A POTENTIAL FOR HARM TO THE *FAIR, EFFICIENT AND OPENLY COMPETITIVE* OPERATION OF THE MARKET?

To answer this question we considered factors (criteria) that would tend to lessen the potential for harm to the *fair, efficient and openly competitive* market from the use of ACFA funds.

The criteria of note included that the ACFA transactions were:

a) at Fair Market Value;
b) relatively small;
c) for short periods of time;
d) callable at any time; and
e) not part of a continuous supply of surplus ACFA funds.

In our view, inter-affiliate transactions involving ACFA funds meeting these criteria would not entail any material, direct or an indirect subsidy, to their recipients. Accordingly the transactions would not be inconsistent with the *fair, efficient and openly competitive* operation of the market.

4.2.1 Fair Market Value

We reviewed the ENMAX Power *Inter-Affiliate Code of Conduct* (EPC Code) dated January 1, 2004 and concluded that any lending to affiliates must be at Fair Market Value.[8] The EPC Code defines "Fair Market Value" as the price reached in an open and unrestricted market between informed and prudent parties, acting at arms length and under no compulsion to act. [9]

In determining whether the rate for inter-affiliate transactions was a market based interest rate, we relied on the facts as presented to the Commission in Proceeding ID 185 and the decision of the Commission. In this regard, ENMAX Power submitted evidence concerning the relationship between the one month CDOR and ENMAX Corp's average short term investment return (considered to be a proxy for a market based rate) for the period January 1, 2007 to September 14, 2009.[10] The Commission determined that there was a reasonable correlation between the one month CDOR and ENMAX Corp's average short term investment return.[11] Based on the evidence, the Commission found that it is reasonable for ENMAX Power to lend to ENMAX Corp on a short term basis at the one month CDOR with respect to inter-affiliate transfers.[12] The Commission determined it was satisfied ENMAX Power had demonstrated that funds loaned by ENMAX Power to ENMAX Corp were on terms no more favourable than those that

8 ENMAX Power Corporation, *Inter-Affiliate Code of Conduct*, October 1, 2004, pages 13 -15.
9 Ibid., page 8.
10 Ibid., paragraph 47.
11 Ibid., paragraph 48.
12 Ibid., paragraph 48.

ENMAX Corp could obtain as a standalone entity in the capital market[13] and concluded that ENMAX Power's short term lending to ENMAX Corp complied with the EPC Code.[14]

In the view of the MSA, transfers between affiliates that are based on the one-month CDOR are at Fair Market Value. Furthermore, the one month CDOR is similar to interest rates that would be potentially available to independent power producers and accordingly we do not consider it to be a concessionary rate.

4.2.2 Relative Size and Duration of Inter-Affiliate Transfers

With respect to the relative size and duration of the transfers, we determined that the total value of the surplus ACFA funds represented approximately 10 percent of the total value of ACFA funds for the 2004 to 2008 time period and approximately 6 percent of the total capital funding available to ENMAX Power for the equivalent period. Furthermore, the surplus funds represented a very small fraction of ENMAX Corp's overall credit facility, which is up to $750 Million. In terms of the duration of the transfers, ENMAX Corp provided evidence that the transfers were recovered from the cash concentration system within one to three months. Based on our analysis, we concluded that the available surplus ACFA funds were not material to the operation of ENMAX Corp.

4.2.3 Recall of Surplus ACFA Funds

Evidence provided by ENMAX Corp confirmed that the surplus funds were callable when required ensuring the funds were available for their intended purpose. In terms of whether the surplus ACFA funds form part of a continuous source of funding for ENMAX Power's affiliates, we believe it is reasonable to expect that in some years timing differences would occur between when ACFA funds are available and when they are required. One possible cause for a timing difference is construction delays caused by weather. Given that surplus funds were for relatively small amounts and were available to affiliates in only two of the five years in which ENMAX Corp borrowed ACFA funds, we are of the view that the surplus funds do not form part of a continuous source of funds available to ENMAX Power's affiliates.

In summary regarding question 2), we concluded that the inter-affiliate transfers of ACFA funds were not material and accordingly did not carry the potential for material harm to the *fair, efficient and openly competitive* operation of the market. In our view, the transactions can reasonably be characterized as efficient management of ENMAX Corp's cash resources.

13 Ibid., paragraph 49.

14 In EUB Decision 2003-040 (May 22, 2003) at page 36, the Board stated that it agreed that a code of conduct should not be so restrictive as to preclude economically efficient transactions, so long as ratepayers are not harmed by those transactions.

References

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