Lingua Franca

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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.

I have called these remarks Lingua Franca. That doesn't mean frank talk, although there is a little of that in here. It means using a system for mutual understanding.

It is a pleasure to be here this morning with my colleagues from the Alberta Utilities Commission and Balancing Pool, Bob Heggie and Bruce Roberts. Alberta is lucky to have such a seasoned professional as Bruce guarding the coffers of the Balancing Pool. And of course Bob has an impeccable regulatory background as co-founder of the annual CAMPUT / Queen's University energy regulation course and inaugural and still standing Chief Executive Officer of the AUC.

I want to pick up where I left off when I spoke at this conference two years ago. The theme of that presentation was the role of the Market Surveillance Administrator in fostering the transition to a market regulated by market forces i.e., competition, and not regulatory fiat. I referenced the explicit Made in Alberta legislative framework supporting this approach and then pointed to the well-established body of competition literature and jurisprudence to draw upon in performing this task. The MSA's *Offer Behaviour Enforcement Guidelines* (OBEGs) released in January 2011 is the explicit statement of this approach and our experience to date, including the work associated with our forthcoming State of the Market Report, does not suggest it needs substantive change. (Of course I will be interested in the perspectives coming out of the panel on the State of the Market Report later today and the comments from stakeholders once the report is out.)

Stepping back, I think it is useful to view the MSA's responsibilities in two ways: the immediate or short term and the longer term. The former is about the daily market monitoring and enforcement of the ISO rules, reliability standards and the competition rules, described under the statutory language: "fair, efficient and openly competitive". The longer term relates to the review of the structure and performance of the electricity market. It is under this heading that we have forged ahead on our State of the Market Report because my view is that the MSA can't do a proper job in its monitoring and enforcement role unless it is informed of the broader context especially in Alberta's energy-only market and the capital intensive and long lead time investment cycle for electricity assets. Of course, we also stay informed of the big picture by watching developments in other electricity markets world-wide (reinforced by getting together with our counterparts in some 15 other markets every six months).

Back to the State of the Market Report for a last comment: we are almost ready for prime time and on track for release of the summary of findings in early December, 2012, hopefully with a minimum of gremlins. (One of our external readers already noticed a phrase about "fragrant abuse" and asked if we would be applying a reverse smell test.) I am proud of the work of the MSA's Chief Economist, Matt Ayres, and his team in doing the hard work to produce some first time findings unique to Alberta and, for that matter, other electricity markets. The release of the summary report and the eight underlying building block reports provides the basis for more sophisticated conversations about competition and efficiency. The work after all constitutes the first ever detailed microeconomic analysis of the operation of the Alberta electricity market. It uses the language and concepts of competition law and (industrial organization) economics. More about that in a moment.

One of the important developments in 2012 from our perspective was the Commission's review and ultimate approval of the MSA's settlement application in the import impediment case, AUC Decision 2012-182 released July 3, 2012. This was the first 'competition' case adjudicated since the market opened and as such of great assistance to all stakeholders, not the least the MSA. As many of you know this case was a practical application of guidance given in the *Offer Behaviour Enforcement Guidelines* so it is gratifying to have the endorsement of the Commission that we are on the right track. At the same time the decision was very helpful in explaining to the MSA how to do a better job in presenting a case in future. We have listened carefully. Some of our takeaways are:

- We need to fully articulate our theory of the case and situate it within the canon of competition law and economics (¶¶80-98)
- MSA evidence needs to more adequately address the market and customer impact, both the magnitude in dollars and how other parties are impacted by the contravention (¶38)
- We need to be forthcoming in explaining how we determine (calculate) harm arising from a contravention and how we take that into account in proposing a remedy (¶48)
- We need to explain why a proposed penalty will be effective as a general deterrent against similar misconduct in the future (¶54)

These are manageable charges and I am confident that the MSA can improve so that next time a proceeding can unfold more expeditiously and efficiently. That is a responsibility placed on the MSA but market participants should not fail to notice that perfecting applications before the Commission means the MSA investigations will need to be more comprehensive especially vis-à-vis the assessment of harm and the factors set out in AUC Rule 013 – Criteria Relating to the Imposition of Administrative Penalties.

I did have a concern as the proceeding unfolded with multiple requests for intervener status and debate over broad policy questions that the prospect of future settlements was becoming as endangered as our grizzly bears. (Actually the bears are just 'threatened', not yet on the endangered list.) Why would any party choose to settle if the process would be virtually as onerous and costly as a litigated proceeding? However, the fact is that this was a first-time proceeding and it takes time to work out the wrinkles and settle questions to clear the way for more straightforward proceedings. I remain a strong advocate of settlements, where appropriate, because as we said in our pleadings, they allow a much quicker resolution of issues and early signal to the marketplace of unacceptable behaviour.

I continue to be of the view that the senior leaders of Alberta's market participants want their firms to operate within the competition rules. The only equivocation I heard from these leaders when I became Administrator in October 2009 was that "we need to know what the rules are so we can compete vigorously to the limit." Well I believe that the MSA has fulfilled its part of the bargain. I challenge you to name any other organized electricity market that is as explicit regarding its enforcement framework and as forthcoming about the application of the framework to real life market scenarios. The *Offer Behaviour Enforcement Guidelines* cover a lot of territory in this regard and in the last year we have begun releasing MSA Feedback notes addressing specific issues. Our quarterly reports and other documents, such as the data transparency report by Charles River Associates, provide further guidance

This brings up what I would call the state of literacy of competition law and economics and the associated vigour of internal compliance among market participants. The statistics show that market participants for the most part have made the transition to working compliance programs that address potential ISO rule breaches, aided by the MSA's Compliance Process document signalling the prospect of some form of forbearance for self-reporting. For example, of the 349 closed investigations into potential ISO rules contraventions this year up to October 31, 2012, more than 80 percent were self-reported by market participants.

The same knowledge is not always apparent with respect to the economic principles at the heart of competition (antitrust) analysis. Anyone who reads AUC decisions on market issues or the various documents released by the MSA should realize that our language and concepts rely heavily on competition law and economics. It may not be as familiar as utility regulation-speak but that is the game being played today and those who are not equipped for that kind of dialogue are at a disadvantage. When the MSA meets with some market participants to acquaint them with our analysis of potential competition problems I think the difficulty of the conversations is only partly because of a tactical

defensiveness but has a lot to do with a basic lack of understanding of classical antitrust principles and precedents.

I don't mean to be condescending in any way. Clearly traders, asset optimizers, market analysts and their supervisors understand the parameters of their competition world: margins, arbitrage opportunities, strategic bets on the market, the calculus of profit/loss, better than I ever will. My point is whether they are able to smoothly situate their actions and strategies as either permissible or challengeable conduct under the *fair, efficient and openly competitive* standard. So this is what I mean by the title of this presentation, lingua franca. Participants who are active in the Alberta market speak the language of real time competition but do they have a cross over language that allows them to assess whether a neutral third party would consider their actions exclusionary or reflective of collective action, i.e. anticompetitive?

I wonder whether senior decision makers have taken the time to inquire and are satisfied that there is an adequate commitment of resources in their organizations to effective compliance programs that educate staff and avoid issues that could potentially be extremely damaging to their companies. I suggest that gone are the days when an all-purpose code of conduct or business ethics is adequate to govern employee conduct when they have not been adequately instructed on the potential *fair, efficient and openly competitive* implications within the range of their activities. Compliance programs that essentially rely on behavioural admonitions to 'do the right thing' are nice but in my view of little value. When I read the testimony of a supervisor, as I did earlier this year, acknowledging that his staff routinely see non-public information but they are instructed "not to use it" in formulating the company's position, I am incredulous that anyone would think that this is in any way satisfactory, or perhaps more to the point would satisfy the Commission should a case land before them.

I think the point I make is obvious to those business leaders who live in the world of enterprise risk management but just to underline it I draw your attention to a recent Order by the U.S. Federal Energy Regulatory Commission to suspend one of the JP Morgan trading entities of its "market-based rate authority" for a period of six months starting April 2013. In other words the firm can only participate in the California and other markets for this period as a price taker. I think most would regard this as a heavy penalty, leaving aside the attendant bad publicity. Note FERC's action addressed not a finding of market manipulation but a procedural matter which the company described in its Show Cause submission as a misunderstanding.

In closing, the MSA accepts the challenge to meet the expectations of the Commission when bringing a matter before it. There remain substantial advantages to participants and the market if this is by way of settlement or even if this is a matter that by its characteristics merits the exercise of forbearance by the MSA. Self-identification, timely correction and full cooperation with the MSA are all responses made possible by vigorous internal compliance programs and open up the possibility of favourable treatment or, better yet, avoiding the problem altogether by taking action before committing a breach. This requires a measure of fluency in the language and concepts of competition law analysis. Participants can address this or not as they choose. After all Alberta is a voluntary market and I have no intention of asking the government to enact some kind of regulation setting compliance program standards to be policed at great cost to everyone. By the same token, enough time has passed since the release of the *Offer Behaviour Enforcement Guidelines* and other guidance to expect participants to have stepped up or, if not, I assume they prefer to 'lawyer up' and face the consequences.

And on that happy note, I end.

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