NOTICE TO MARKET PARTICIPANTS AND STAKEHOLDERS

Date: October 29, 2010
Re: Offer Behaviour Examples #2

Subsequent to the 17 September 2010 roundtable discussion a market participant provided the Market Surveillance Administrator with a series of additional hypothetical illustrative examples. We met with representatives of the market participant and discussed our analysis of the issues raised and the action we would likely take.

These additional examples and our responses are recorded below. Our responses accept the facts as stated and for the most part don't get into evidentiary or investigative issues in order to keep focus on the analytics.

Feedback is always welcome but unless you see an assessment as dramatically off base, the next formal opportunity for comment will be when we release the draft enforcement guideline that will incorporate some of this material.

Harry Chandler

In scenarios 1 - 3, Participant A has a boiler leak at a thermal unit. The nature of the leak does not require an immediate outage and thus is discretionary – although the unit must come off (either voluntarily or forced) in the near future. Typically, lost revenue for the outage will be less if the outage can be delayed until the weekend. However, a situation could occur in a tight market where a forced outage would cause a spike in price which would benefit the rest of the portfolio. If this were the case, the best way to mitigate the cost of the outage would be to take the outage at the point where it would have the maximum impact on pool price.

1.1 SCENARIO "1" – DISCRETIONARY OUTAGE

Wednesday afternoon Participant A finds it has a unit with a boiler leak. The leak is such that a 48 hour forced outage will be required at some point within the next 72 hours but is not required immediately.

Based on the flat corporate position, Participant A decides to wait until late Friday evening. The estimated impact on pool price is negligible over the 48 hour weekend outage.

1.1.1 MSA Comments

This fact pattern does not raise an issue for the MSA.

1.2 SCENARIO "2" – DISCRETIONARY OUTAGE

Wednesday afternoon Participant A finds it has a unit with a boiler leak. The leak is such that a 48 hour forced outage will be required within the next 72 hours but is not required immediately.

Based on the **long** corporate position, Participant A decides to take the unit off at the top of the hour. With the unit coming offline, the estimated price impact is $100 for 4 hours in the evening and $20 to the flat pool price the next day. The portfolio impact is favourable to taking the unit off immediately.

1.2.1 MSA Comments

Taken alone and assuming that Participant A complies with the relevant ISO rules and the FEOC Regulation, this action would not be seen by the MSA as a potential breach of the fair, efficient and openly competitive standard, including subsection 2(j) of the FEOC Regulation ('manipulating'). However, it may be catalogued and reported upon (on a no names basis) as part of our responsibilities to explain market outcomes. It would probably be identified as a Pool price change caused by a forced outage. We may make routine inquiries with the AESO to understand its perspective on the event. Participant A would have an opportunity to review and comment on the MSA description prior to publication.

1.3 SCENARIO "3" – DISCRETIONARY OUTAGE AND ECONOMIC WITHHOLDING

Wednesday afternoon Participant A finds it has a unit with a boiler leak. The leak is such that a 48 hour forced outage will be required within the next 72 hours but is not required immediately.

Based on the **long** corporate position, Participant A decides to take the unit off at the top of the hour. In addition, Participant A prices up 200 MW on another unit to $900 outside T-2, but before it notifies the AESO of the outage. With the unit coming offline, the estimated price impact is $900 for the first two hours and then Participant A's offer sets price at $900 for 3 more hours that evening. The next day prices are $100 higher than the expected day's forecast price. The portfolio impact is favourable to taking the unit off immediately.

1.3.1 MSA Comments

This information suggests possible breaches of ISO Rule 5.2 and FEOC Regulation subsections 4(1), 4(2) and 2(h) and 2(j). If, as a result of an investigation, the MSA was satisfied of a breach or breaches, it would likely seek a comprehensive remedy within the terms of section 63 of the AUCA. The size of the penalty sought would depend on when participants were made known of Participant A's outage and our assessment of the impact of Participant A's actions on market prices.

With respect to ISO Rule 5.2, the investigation would seek to establish whether Participant A failed to submit a schedule to the AESO immediately after a decision was made to correct an anomalous operating situation.

With respect to subsection 4(1) of the FEOC Regulation the investigation would seek to establish whether Participant A used the knowledge of its outage decision to trade before the AESO had made the outage record in question available to the public and whether under subsection 4(2) it had provided the outage record to the AESO as soon as reasonably practicable. In our view, the term "trade" in subsection 4(1) includes offering into the Pool.

Finally, assuming we found that Participant A did not comply with these provisions, we would investigate whether there was evidence in support of the elements contained in subsections 2(h) and 2(j) of the FEOC Regulation.

Subsection 2(j) is brought into play because Participant A's action to price up 200 MW before notifying the AESO of its outage appears to be a conscious effort to manipulate Pool prices to its benefit. Its long position supports this theory as does taking the action before its competitors are in a position to respond. Its action appears to be intended to manipulate market prices "away from a competitive market outcome" because if its competitors had knowledge of the imminent outage they would have been in a position to react. Simply put, a "competitive market outcome" is prevented by virtue of the denial of material information to competitors in the marketplace. These same findings would be equally applicable to subsection 2(h) insofar as they support a finding of "restricting or preventing competition, a competitive response…by another person".

In summary, the response is markedly different from Scenario 2 because of Participant A's ancillary action to impede competition.

SCENARIO "3" CONTINUED

Based on the short corporate position, Participant A decides to take the unit off at the top of the hour. In addition, Participant A prices down 200 MW on another unit to $0 outside T-2 but before it notifies the AESO of the outage. With the unit coming offline, the estimated price impact is $0 for the first two hours and then Participant A's offer sets price at $0 for 3 more hours that evening. The next day prices are $20 lower than the expected day's forecast price. The portfolio impact is favourable to taking the unit off immediately.

1.3.2 MSA Comments

Our assessment is conceptually identical to what is described above in section 1.3.1.

1.4 SCENARIO "4" – SALE OF FINANCIAL SWAP TO IMPORTER AT DISCOUNT TO REDUCE IMPORTS

Participant B is short energy in Alberta due to a unit outage. Consequently they are importing 150 MW from Mid-C to cover their position. Participant A is long energy. Participant A then offers financial swaps to Participant B at a discount to the cost of the landed imports. The hope is that Participant B will be motivated to reduce its imports as it covers its position with financial swaps and thus pool price will rise. Although Participant A will lose money on its swaps sold to Participant B, it will profit on the rest of its portfolio from the resulting higher pool price.

1.4.1 MSA Comments

This information suggests potential breaches of subsections 2(h) and 2(j) of the FEOC Regulation. With respect to subsection 2(h), Participant A's action appears intended to restrict or prevent competition by attempting to stop imports from bidding down the Pool price. The fact of Participant A's long portfolio position and that it either expects to lose money on the sale of the swaps or does indeed lose money on the transaction, supports the anticompetitive nature of its behaviour. Because this could be perceived as an agreement between competitors to lessen competition, Participant B, may wish to record evidence of its refusal of Participant A's overture and report the matter to MSA to protect itself if there is an investigation into collusion and perhaps the referral of the case to the Competition Bureau.

The assessment of a potential breach of subsection 2(j) is conceptually similar to that described for Scenario 3 above. Participant A's offer to sell financial swaps at a loss to Participant B with the "hope" that it will reduce B's imports that are depressing the Pool price is consistent with a conscious effort to manipulate Pool prices "away from a competitive market outcome". This competitive market outcome is denied if Participant B stops importing as a result of an inducement from Participant A.

The evidence of a breach here is not as strong as in Scenario 3. While there is evidence of intent to undermine the *fair, efficient and openly competitive standard*, the fact pattern does not provide evidence of 'effect', i.e., that the overture to Participant B achieved the intended outcome. Nevertheless, the evidence is sufficient to support a formal investigation to determine the facts.

1.5 SCENARIO "5" – FLOW POWER ON THE TIE LINE UNECONOMICALLY

If you can generate power at a loss based on your portfolio, it stands to reason that you can import at a loss. And if you can import at a loss, can you also counter-flow or export at a loss?

The market is tight due to a unit trip. Participant A has a long portfolio position. Participant B is importing 75 MW at a $5 profit. Participant A believes that if these MW were not being imported, pool price would increase by an estimated $60. The next hour (when possible) they counter-flow 75 MW to Mid-C and pool price spikes to $100. On the export, Participant A loses money but benefits on its long position.

1.5.1 MSA Comments

This fact pattern does not raise an issue for the MSA. While the Pool price rises in one hour, there is no attempt to limit competition by Participant A. This is unilateral behaviour, which one would expect to stimulate a competitive response in subsequent hours. If Participant B was originally making a profit importing, a spike to $100 would increase the profit opportunity for B, and other participants who see an arbitrage opportunity.

1.6 SCENARIO "6" – IMPACT OF MARKET POSITION ON OFFER STRATEGIES

Does the MSA place any consideration on the size of the financial position that a Participant may have when executing offer strategies? If Participant A had a 5000MW long financial position, would any of the above scenarios still be acceptable?

1.6.1 MSA Comments

The consideration of the size of the financial position would not cause a change in the MSA's assessment of whether or not there was a breach in the earlier scenarios. It is always useful and relevant to know a participant's portfolio position, both physical and financial, because it goes to motivation and intent. While there would be no change in the assessment of breach, the size of a financial position would be relevant to the size of the financial penalty (including disgorgement) sought by the MSA in those cases that already raise issues (i.e., Scenarios 3 & 4).

1.7 SCENARIO "7" – INFORMATION SHARED BETWEEN PPA OWNERS AND BUYERS

Uprate offers: Participant B (PPA Owner) gives their uprate offers to the Participant A (PPA Buyer). This information is shared with Participant A's real time traders, in order for the traders to put the offers into ETS. Participant A would have price and quantity information before the market.

Participant A receives Participant B's offers submits them into ETS then readjusts their own offers due to this new information and resubmits these adjusted offers.

1.7.1 MSA Comments

As a point of clarification, the term uprate offers is used in the context of Power Purchase Arrangements and means offers in respect of increased capacity and excess energy as conveniently defined in AUC Decision 2010-293. In simple terms the former is the amount of capacity that exceeds the nominated capacity the Owner is required to make available to the Buyer and the latter is the energy generated above the total of the nominated capacity and the increased capacity, again made exclusively available to the Buyer.

This fact pattern raises a potential issue under subsections 2(h) and 2(j) of the FEOC Regulation. In our view the Commission's order in AUC Decision 2010-293 was based on a finding that the sharing of price and quantity records between the Owner and Buyer in relation to increased capacity and excess energy is within the exemption provided for in subsection 3(2)(e) of the FEOC Regulation. It does not go further or exempt market participants from prohibitions in other sections of the FEOC Regulation. To the extent that this sharing of preferential records is used to coordinate the pricing of offers between competitors our view is that there is no protection afforded by the Commission's order from the application of section 2 of the FEOC Regulation.

On the face of it this fact pattern falls short of establishing a conspiracy between Participant A and Participant B or "manipulating" Pool prices; however, because information of this nature would likely lead to a MSA investigation, it would be prudent for Participant B to report as soon as possible any suspicions it has that Participant A may be using the uprate information inappropriately. Participants should be aware that any suggestion of coordinated behaviour will be carefully scrutinized by the MSA.

An investigation into a potential breach of subsection 2(h) would focus on whether there is an understanding between Participants A and B that the forwarding of uprate information is a mechanism to coordinate pricing. An investigation of a potential

breach of subsection 2(j) would assess the impact on Pool prices (or bilateral contract prices) of Participant A's readjusted prices. As a working hypothesis the MSA would view any assessed change in prices attributable to Participant A as "away from a competitive market outcome" because A's readjusted offers are not the result of a competitive process.

SCENARIO "7" CONTINUED

Participant A inputs offer prices that are different from the ones they received from Participant B, then settled financially with Participant B based on Participant B's offers.

1.7.2 MSA Comments

The assessment of this fact pattern is the same as described in 1.7.1

SCENARIO "7" CONTINUED

If Participant A & Participant B offers are always consistent. For example, Participant A's 3rd offer block is consistently $0.01 more than Participant B's offers.

1.7.3 MSA Comments

The assessment of this fact pattern is the same as described in 1.7.1

1.8 SCENARIO "8" – ECONOMIC WITHHOLDING

Participant A offers 1000MW of energy at a price of $900 setting system marginal price. During the period of this offer strategy, there is a supply cushion of 800MW (i.e. 800MW remain undispatched in the merit order) of which 500MW of offers are controlled by Participant A. Import ATC is fully utilized during this period. Historical observation suggests supply cushions of 800MW are usually associated with prices significantly lower than $900. Participant A takes no other action to impede or otherwise prevent market response.

Participant A used this strategy once and the price was set at $900 MWh for 1 hour.

1.8.1 MSA Comments

This action would not be seen by the MSA as a potential breach of the fair, efficient and openly competitive standard, including subsection 2(j) of the FEOC Regulation ('manipulating'). However, it would be catalogued and reported upon (on a no-names basis) as part of our responsibilities to explain market outcomes. Participant A would have an opportunity to review and comment on the MSA description prior to publication. Similar instances would be compiled, categorized and reported.

SCENARIO "8" CONTINUED

Participant A used this strategy once and the price was set at $900 MWh for 24 hours of the 40 hours they used this strategy.

1.8.2 MSA Comments

The MSA would respond in a similar manner as described in 1.8.1 but with a greater sense of urgency. We would focus on the circumstances of the 40 hours in question and what an assessment reveals about the state of competition in the Alberta market. If, based on our analysis, it appears that the *fair, efficient and openly competitive* standard was being undermined; we would consider remedies to address the situation. If we remain satisfied, as stated in the fact pattern, that Participant A is not taking "other action to impede or otherwise prevent market response", then we would request a hearing under section 51(1)(b). Our application would identify the conduct of Participant A as part of

the fact pattern but not allege wrongdoing or seek any penalty against it. Rather, after presenting evidence that the operation of the market is not *fair, efficient and openly competitive*, we would propose other remedies addressing the ISO rules or other elements of the existing market framework to restore it. Depending on our assessment of the situation, we may also apply to the Commission for an interim order under subsection 8(5)(c) of the AUCA until such time as a more permanent remedy may be put in place.

SCENARIO "8" CONTINUED

Participant A used this strategy for 50 separate periods and they were successful moving price to $900 per MWh for 80% of the hours the offer strategy was employed.

1.8.3 MSA Comments

The answer in 1.8.2 applies. It may well be that action has already been taken or is underway if there is an assessment of market failure.

SCENARIO "8" CONTINUED

Participant A used this strategy 300 times and they were successful moving price for 100% of the hours the offer strategy was employed.

1.8.4 MSA Comments

The answer in 1.8.3 applies.

1.9 SCENARIO 9 "DISPATCH SERVICES INFORMATION SHARED WITH REAL TIME TRADERS"

Participant A will dispatch all units of Participant B. Participant A will set up a dispatch services desk to manage the dispatch of all units of Participant B.

All generation dispatched will be $0 (price is not mentioned or is otherwise understood to be zero). Participant B has applied for and received AUC approval for the preferential sharing of price and quantity pairs. Participant A does not have offer control. Participant A's dispatch services desk shares with Participant A's real time traders the price and quantity offers provided by Participant B to Participant A.

1.9.1 MSA Comments

On the face of it, the sharing of price - quantity information between competitors flies in the face of the *fair, efficient and openly competitive* standard so we would carefully review the AUC's decision and order allowing it. The sharing of the price and quantity offers between the dispatch services desk and the real time traders within Participant A also raises potential concerns. We would be particularly interested to understand how the Commission had been satisfied that "the records will not be used for any purpose that does not support the fair, efficient, and openly competitive operation of the market, including the conduct referred to in section 2" (subsection 3(3)(a) of the FEOC Regulation). We would also carefully review the "terms and conditions the Commission considers appropriate" in issuing its order (subsection 3(3)). We would closely monitor the implementation of these terms and conditions to determine if there is a potential breach of subsection 2(k) of the FEOC Regulation (circumvention). If we were satisfied of a breach of subsection 2(k), that might also imply a breach of one of the substantive provisions, e.g. 2(h) – collusion or 2(j) - manipulating.

SCENARIO "9" CONTINUED

All generation dispatched has a price above $0. Participant B has applied for and received AUC approval for the preferential sharing of price and quantity pairs. Participant A does not have offer control. Participant A's dispatch services desk shares with Participant A's real time traders the price and quantity offers provided by Participant B to Participant A.

1.9.2 MSA Comments

The answer in 1.9.1 applies.

SCENARIO "9" CONTINUED

Participant A has offer control of all units of Participant B. In other words, Participant A has the ultimate control and determination of the price and quantity offers made to the power pool for all units of Participant B. There is no preferential sharing of price and quantity pairs. Participant A's dispatch services desk shares with Participant A's real time traders the price and quantity offers for all units of Participant B.

1.9.3 MSA Comments

As with all matters related to agreements between competitors, the MSA remains to be convinced that the behaviour does not breach the *fair, efficient and openly competitive* standard or indeed the *Competition Act*. Some forms of coordination, such as PPAs, are explicitly approved. However, the conduct standard in section 6 of the EUA remains applicable. It does not mean that anticompetitive conduct by a market participant possessing less than 30 percent is held blameless or is exempt from the application of the statutes in question.

The scenario does not state whether the fact of Participant A's offer control of all units of Participant B has been made known to the MSA. While this is not formally required under section 5 of the FEOC Regulation it is certainly implied by virtue of the MSA's obligation to update its offer control report when required (see subsection 5(4)). Participants failing to do so run the risk of an investigation of a potential breach of subsection 2(h) or a referral to the Competition Bureau for a possible inquiry as to

whether there is an offence under section 45 of the *Competition Act*. Such an investigation or inquiry under the federal legislation would be *per se* in nature; the breach or offence would flow from the fact of an agreement between competitors without a need to show competitive harm.

The reporting of the change in offer control by Participants A and B is certainly prudent and a better place to be, but it does not exempt the transaction or subsequent behaviour from a need to comply with competition rules. For example, if we believe that the assumption of offer control by Participant A potentially undermines the *fair, efficient and openly competitive* standard, we would consider applying to the AUC for an appropriate remedy under subsection 51(1)(b) of the AUCA. Alternatively, the matter might be referred to the Competition Bureau for consideration whether Participant A's control of price/quantity decisions constitutes the acquisition of a "significant interest" under the terms of the *Competition Act*'s merger provision.

To be clear, under either the notice or no-notice scenario, Participant A and B would not be exposed to double jeopardy. The MSA is required under section 45 of the AUCA to notify another body, including the Competition Bureau, where a matter under investigation also appears to be within the jurisdiction of that other body. In determining whether to take enforcement action itself, the MSA will take into account the course of action of the other body. A third alternative is always available also – that there is no perceived competition issue, so we take no action.

Finally, to complete the response, if we assume that notice had already been given about the acquisition of offer control and those hurdles had been passed, then the MSA would simply monitor the behaviour of Participant A as it would any other participant. Since the fact pattern does not describe any market outcomes, no further comment is possible.