

Report to the Minister

For the Year Ending December 31, 2015

April 20, 2016

Taking action to promote effective competition and a culture of compliance and accountability in Alberta's electricity and retail natural gas markets

www.albertamsa.ca

MARKET SURVEILLANCE
ADMINISTRATOR

#500, 400 – 5th Avenue S.W.
Calgary AB T2P 0L6

April 20, 2016

The Honorable Margaret McCuaig-Boyd
Office of the Minister Energy
408 Legislature Building
10800 - 97 Avenue
Edmonton, AB T5K 2B6

Dear Minister

Re: Annual Report for 2015

It is my pleasure to submit the Annual Report of the Market Surveillance Administrator for the year ending December 31, 2015. The report is provided to you pursuant to subsection 38(1) of the Alberta Utilities Commission Act.

Thank you for your support during the year.

Yours truly,



Matt Ayres

Market Surveillance Administrator

cc: Willie Grieve, Chair Alberta Utilities Commission

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1 Introduction

The Market Surveillance Administrator (MSA) is an independent law enforcement agency created under the *Alberta Utilities Commission Act* (AUCA). This Annual Report for 2015 is pursuant to section 38(1) of the AUCA which requires that the MSA provide the Minister of Energy with an annual report that (a) reports on the MSA's activities in the fiscal year, and (b) contains the audited financial statements for the fiscal year.

The MSA's mission is to take action to promote effective competition and a culture of compliance and accountability in Alberta's electricity and retail natural gas markets. The MSA's mandate is set out in the AUCA and, at its core, provides that market participant conduct and market structure be monitored to ascertain how they affect competition. Competition in turn provides benefits to all Albertans by ensuring prices are, over time, no higher than necessary to secure a reliable supply of electricity now and in the future. The MSA is empowered to investigate market conduct, bring enforcement actions before the Alberta Utilities Commission (AUC) and to publish guidelines to support the fair, efficient and openly competitive operation of these markets. The MSA may investigate and seek administrative penalties or other remedies before the AUC for contraventions of the market rules, the Alberta Reliability Standards, the *Electric Utilities Act* (EUA), or the *Fair, Efficient and Open Competition Regulation* (FEOC Regulation). The MSA also has a role bringing matters to the AUC where it believes there may be an adverse effect on the structure and performance of the electricity market.

During 2015, the MSA provided support to the Department of Energy and the Alberta Climate Leadership Panel on matters related to electricity. The MSA brings a unique perspective to bear understanding how the competitive market for electricity works and can most readily adapt to a transition from coal generation to renewables and natural gas.

In 2015 the MSA continued to address its broad mandate through the implementation of its strategic plan, which focusses on the following five areas:

- Promotion of Effective Competition;
- Promotion of Compliance and Accountability;
- People Development;
- Strategic Review; and
- Enhancing Use of Technology.

Harry Chandler retired as Administrator following the appointment to that position of Matt Ayres on December 17, 2015.

2 Promotion of Effective Competition

Key to the MSA's yearly activities are the actions taken to promote effective competition. Those activities range from fostering confidence in the market by transparent reporting on both market

events and MSA activities; taking action to ensure market structure does not adversely affect competition; and taking action to ensure appropriate market participant conduct.

2.1 Fostering market confidence through transparent reporting

For many years, the MSA has published [Quarterly reports](#) that comment on market trends, specific events, assessment of possible contraventions of regulations and other activities of the MSA. These are supplemented by annual reports, which focus on retail markets, offer control in the wholesale market, an annual assessment of trends with respect to compliance with ISO rules and Alberta Reliability standards, as well as special reports. The purpose of these reports is to be transparent about how the Alberta electricity market functions so that stakeholders can be confident that it is competitive and that the MSA is performing its role appropriately.

In 2015 the MSA published a [Retail Market Update](#). The report recognized that competition among retailers had effectively passed low wholesale prices on to customers. For typical residential customers only 40-50% of the total bill was composed of charges related to energy. Contracts continue to be available whereby customers could cancel contracts or switch to alternate providers without penalty.

The MSA is also considering updates to the Offer Behavior Enforcement Guidelines (OBEGs). In late 2015, the MSA solicited feedback from stakeholders on whether the OBEGs should be revised. Rather than a change in the overall approach, the MSA's intent is to update, remove, or modify content by the end of Q2 2016 that may now be seen as redundant, inaccurate or irrelevant in light of AUC Decision 3110-D01-2015.

2.2 Taking action to ensure market structure does not adversely impact competition

Electricity markets are complex. Rules, standards, regulations and business practices all provide a structure within which competition occurs. Part of the MSA's work is to pro-actively assess whether the resulting structure, rather than participant conduct, impedes competition to the detriment of Albertans.

In December 2015, having consulted extensively with stakeholders and the Independent System Operator (ISO), the MSA brought an application before the AUC in respect of the ISO's publication of Historical Trading Report (HTR). The MSA is concerned that this report, which contains hourly information related to generator's offers to supply power to the Alberta market, undermines the fair, efficient and openly competitive nature of the wholesale electricity market. The matter is expected to be heard in a public hearing at the AUC later in 2016. The MSA's application, and the evidence of interested parties, both in support and in opposition to the application, is available to the public from the AUC's e-filing system.

The regulations governing the Alberta electricity market, place a number of requirements on market participants. One such requirement is that before certain information can be shared

between market participants, perhaps as the result of a joint venture or other commercial arrangement, approval must be granted by the AUC. The MSA plays a key role in these proceedings, both in assisting potential applicants and by participating to ensure there are sufficient safeguards in place such that shared information will not be used for purposes inconsistent with the competitive market.

2.3 Taking action to ensure market participant conduct supports fair, efficient and open competition

In addition to pro-actively addressing issues relating to market structure, the MSA's mandate extends to enforcement actions where it believes market participants have contravened legislation, rules or standards. Much of the MSA's work during 2015 focused on the enforcement proceeding (AUC proceeding 3110) against TransAlta Corporation, TransAlta Energy Marketing Corp. and TransAlta Generation (collectively, TransAlta), Mr. Nathan Kaiser and Mr. Scott Connelly (collectively with TransAlta, the respondents). This matter was brought forward to the AUC in 2014. The proceeding included a two week hearing before the AUC and a number of preliminary hearings wherein the MSA was the subject of complaints about its conduct in relation to the investigation and application submitted to the AUC. On July 27, 2015 the Commission affirmed that the MSA conducted its investigation in a fair and reasonable manner, as against the respondents, and supported the MSA's interpretations of Sections 2(h), 2(j), and 4 of the FEOC Regulation concerning anticompetitive behavior, price manipulation and trading using non-public outage records, as against TransAlta.¹

Having received the decision from the Commission, a second phase of the proceeding was initiated to determine the administrative penalty, or other order, to be imposed on TransAlta. On October 21, 2015 the MSA and TransAlta submitted a consent order to the AUC to resolve all outstanding issues. In its Decision dated October 29, 2015, the Commission approved the consent order wherein TransAlta agreed to pay an administrative penalty in the amount of \$51,920,814.31 and MSA hearing and investigation costs of \$4,327,542.29.² Under the AUCA, administrative penalties are paid to the General Revenue Fund of the Province of Alberta. The hearing and investigation costs reimbursed to the MSA will allow the MSA to avoid drawing its revenue from the AESO trading charge in 2016 as is more fully described in Section 6 of this report.

3 Promotion of Compliance and Accountability

The MSA promotes compliance and accountability through a variety of means including outreach with market participants, adopting processes that encourage accountability and where necessary issuing fines where rules or reliability standards have been breached.

¹ [AUC Decision 3110-D01-2015.](#)

² [AUC Decision 3110-D03-2015.](#)

3.1 Promotion of compliance and accountability through outreach

During the year the MSA meets regularly with market participants seeking guidance or feedback. The MSA also presents to industry groups and speaks at industry conferences. Opportunities to meet with stakeholders and present at conferences provide a low cost way for the MSA to re-enforce the importance of compliance and accountability within the markets it monitors.

During 2015 the MSA organized a mergers and acquisitions workshop, in conjunction with the Van Horne Institute. At the workshop, representatives of the Competition Bureau, including the Commissioner of Competition, spoke to stakeholders about the importance of competition and the Bureau's process for merger review. MSA staff also spoke at industry conferences and meetings, including the Alberta Compliance Discussion Council, Alberta Power Summit, Alberta Power Symposium, Energy Risk Canada, and CanSIA West.

3.2 Compliance with market rules and reliability standards

The MSA's compliance approach with respect to market rules and reliability standards is directed at the prevention of future harm through the enforcement of appropriate standards of conduct and care. The MSA has established a process that, in conjunction with AUC rules, provides incentives for robust internal compliance programs, self-reporting and mitigation plans. Since 2008, this work has also resulted in approximately \$1,500,000 in financial penalties being levied on market participants. Detailed results for 2015 are the subject of a separate MSA report, [Compliance Review 2015](#), published on February 19, 2016.

4 People Development

The MSA is staffed by a small but dedicated team of professionals with depth of expertise in wholesale and retail electricity markets drawing from diverse backgrounds including economics, law, engineering, and finance. The current staffing complement of 13 is evenly split between experienced senior management and relatively new but highly qualified professionals. To fulfill the MSA's broad mandate with a modest staffing complement, several staff assume multiple responsibilities within the organization.

During the last few years the MSA has addressed the retention of more junior staff and senior management close to retirement. This has been achieved by encouraging staff to pursue relevant training opportunities, providing flexibility around working hours, improving performance appraisal processes and reassigning responsibilities between staff.

5 Strategic Review

During 2015, the MSA and the Department of Energy finalized the MSA's Mandate and Roles document as required under the *Alberta Public Agencies Governance Act*. During 2015 the MSA also initiated a strategic review to reassess its internal and external policies to ensure they are clear and effective.

6 Enhancing Use of Technology

To leverage limited resources, the MSA uses technology enhancements in several key areas. For investigation purposes, specialized software tools were assessed and implemented in 2015 to support more effective review and management of vast quantities of evidence in the form of electronic documents and other electronic records. For monitoring purposes, the MSA has dedicated substantial efforts to develop standardized tools and dashboards. For records management and workflow purposes, a Sharepoint solution was implemented and will be further developed during 2016.

7 Financial Statements

In accordance with AUC Decision 3110-D03-2015, TransAlta reimbursed the MSA \$4,327,542.29 for hearing and investigation costs in Q4 2015. The AUCA requires the MSA to recognize revenues to the extent required to match expenses in order that no profit or loss results in a fiscal year. As a result of the TransAlta cost reimbursement during 2015, and the earlier than anticipated termination of Proceeding 3110, surplus contributions of approximately \$5.1 million will be deferred and realized as revenue against the MSA's expenses during fiscal 2016. The utilization of this extraordinary budget surplus for general operating purposes means the MSA will extract no revenue from the energy market trading charge in 2016 which effectively returns the MSA's investigation costs to consumers – the ultimate contributors to the trading charge. There is also a reasonable probability of residual surplus at the end of 2016 such that the MSA's 2017 revenue requirement will be lessened by the 3110 costs payment.

The MSA audited financial statements for the year ended December 31, 2015 follow. The format of the financial statements reflects accounting standards for not-for-profit organizations.

Market Surveillance Administrator

Financial Statements
December 31, 2015 and 2014



February 29, 2016

Independent Auditor's Report

To Management of Market Surveillance Administrator

We have audited the accompanying financial statements of Market Surveillance Administrator, which comprise the balance sheets as at December 31, 2015 and 2014 and the statements of operations and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian accounting standards for not-for-profit organizations, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audit is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Market Surveillance Administrator as at December 31, 2015 and 2014 and the results of its operations and its cash flows for the years then ended in accordance with Canadian accounting standards for not-for-profit organizations.

PricewaterhouseCoopers LLP

Chartered Professional Accountants

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Market Surveillance Administrator

Balance Sheets

As at December 31, 2015 and 2014

	2015 \$	2014 \$
Assets		
Current assets		
Cash	5,305,158	2,445,323
Contributions receivable	15,555	-
Prepaid expenses and deposits	33,095	38,144
	<u>5,353,808</u>	<u>2,483,467</u>
Capital assets (note 3)	62,299	25,083
	<u>5,416,107</u>	<u>2,508,550</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	276,171	1,133,008
Deferred contributions (note 4)	5,139,936	1,375,542
	<u>5,416,107</u>	<u>2,508,550</u>

On behalf of the Corporation

/s/ Matt Ayres

Matt Ayres
Market Surveillance Administrator

/s/ Doug Doll

Doug Doll
Chief Financial Officer

The accompanying notes are an integral part of these financial statements.

Market Surveillance Administrator

Statements of Operations

For the years ended December 31, 2015 and 2014

	2015 \$	2014 \$
Revenue		
Alberta Electric System Operator (note 4)	4,038,597	5,219,198
Expenses		
Salaries and benefits	2,289,018	2,210,937
Consultants and audit	44,469	121,840
Legal fees	1,228,602	2,436,006
Operating, office and administrative	454,933	436,844
Amortization	21,575	13,571
	<u>4,038,597</u>	<u>5,219,198</u>
Excess of revenue over expenses	<u>-</u>	<u>-</u>

The accompanying notes are an integral part of these financial statements.

Market Surveillance Administrator

Statements of Cash Flows

For the years ended December 31, 2015 and 2014

	2015 \$	2014 \$
Cash provided by (used in)		
Operating activities		
Net earnings for the year	-	-
Item not involving cash		
Amortization	21,575	13,571
Change in non-cash working capital		
Increase in contributions receivable	(15,555)	-
Decrease in prepaid expenses and deposits	5,049	6,987
(Decrease) increase in accounts payable and accrued liabilities	(856,837)	430,298
Increase in deferred contributions	3,764,394	1,303,867
Cash provided by operating activities	<u>2,918,626</u>	<u>1,754,723</u>
Investing activity		
Expenditures on capital assets	<u>(58,791)</u>	<u>(8,583)</u>
Increase in cash	2,859,835	1,746,140
Cash – Beginning of year	<u>2,445,323</u>	<u>699,183</u>
Cash – End of year	<u>5,305,158</u>	<u>2,445,323</u>

The accompanying notes are an integral part of these financial statements.

Market Surveillance Administrator

Notes to Financial Statements

December 31, 2015 and 2014

1 Nature of business

The Market Surveillance Administrator ("MSA") was incorporated as an independent, stand-alone entity on June 1, 2003 under the Electric Utilities Act of the Province of Alberta.

The business and affairs of the Market Surveillance Administrator are overseen by an individual appointed as Market Surveillance Administrator by the Minister of Energy for the Province of Alberta.

As of January 1, 2008, the Market Surveillance Administrator was continued under the Alberta Utilities Commission Act with a broad mandate including surveillance, investigation, and enforcement to help ensure fair, efficient, and openly competitive electricity and retail natural gas markets in Alberta. The Market Surveillance Administrator is responsible for keeping a close eye on the behaviour of market participants and the overall performance of the market to ensure there are no anti-competitive activities and that rules are appropriate and are working as intended. The Market Surveillance Administrator communicates information arising from the various activities of the Market Surveillance Administrator within its mandate, to foster transparency and confidence for stakeholders. It responds to matters brought to the attention of the Market Surveillance Administrator through complaint or referral, and resolves issues before they become complaints. It examines the conduct of market participants to ensure compliance with legislation, regulations and rules; making sure sufficient remedies exist to avoid untoward market behaviour or activity. The Market Surveillance Administrator also issues guidance to the market and makes recommendations to the Department of Energy and other parties where appropriate, toward the development and operation of a fair, efficient and openly competitive market.

The Market Surveillance Administrator has no share capital. The Alberta Utilities Commission Act requires that the Market Surveillance Administrator prepare a budget for each fiscal year, for approval by the chair of the Alberta Utilities Commission. Once approved, the Alberta Electric System Operator is required to pay the Market Surveillance Administrator the budgeted costs and expenses, net of any other revenues. The Market Surveillance Administrator is to be managed so that no profit or loss results on an annual basis from its operation.

2 Significant accounting policies

Cash

Cash consists of cash in bank less outstanding cheques.

Capital assets

Capital assets are stated at cost. Amortization is provided using the following methods and annual rates:

Computer hardware	Straight-line	3 years
Computer software	Straight-line	3 years
Furniture and equipment	Straight-line	5 years

Market Surveillance Administrator

Notes to Financial Statements

December 31, 2015 and 2014

Income taxes

No provision has been made for income taxes as the Market Surveillance Administrator is a not-for-profit organization as set out in the Alberta Utilities Commission Act of the Province of Alberta.

Financial instruments

The Company's financial instruments consist of cash, accounts receivable and accounts payable and accrued liabilities. Due to the current nature of the MSA and financial instruments, fair value approximates the carrying value. It is management's opinion that the MSA is not exposed to significant interest rate, currency or credit risks associated with these financial statements.

Revenue recognition

MSA follows the deferral method of accounting for contributions.

Consistent with the requirements of the Alberta Utilities Commission Act that the Market Surveillance Administrator operates with no annual profit or loss, contributions from the Alberta Electric System Operator are recognized as revenue to the extent of annual operating costs including amortization of capital costs. In circumstances where annual contributions are in excess of annual costs, the excess is deferred and recognized in future periods. In the event of a shortfall between contributions and costs, the shortfall in revenue will be accrued and be collected in a subsequent period from the Alberta Electric System Operator.

Measurement uncertainty

These financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. Because the precise determination of many assets, liabilities, revenues and expenses are dependent on future events, the preparation of financial statements for a period necessarily includes the use of estimates and approximations which have been made using management's best judgement. Actual results could differ from those estimates.

3 Capital assets

			2015	2014
	Cost \$	Accumulated amortization \$	Net \$	Net \$
Computer hardware	147,224	128,780	18,444	4,698
Computer software	65,750	39,346	26,404	1,052
Furniture and equipment	132,246	114,795	17,451	19,333
	<u>345,220</u>	<u>282,921</u>	<u>62,299</u>	<u>25,083</u>

Market Surveillance Administrator

Notes to Financial Statements

December 31, 2015 and 2014

4 Deferred contributions

The collections from the Alberta Electric System Operator are set to recover the operating and capital costs of the Market Surveillance Administrator. Any excess or shortfall in collections is deferred to or accrued for future years.

	2015 \$	2014 \$
Opening balance – January 1	1,375,542	71,675
Contributions	3,475,448	6,207,115
Legal settlement	4,327,543	-
Revenue recognized in the year	(4,038,597)	(5,219,198)
	5,139,936	1,059,592
Contribution for January	-	315,950
Closing balance – December 31	5,139,936	1,375,542

During the year, in response to Alberta Utilities Commission Decision 3110-Do3-2015 dated October 29, 2015, TransAlta Corporation was ordered to pay to MSA, an amount of \$4,327,543 for legal and related costs incurred in the course of the MSA's investigation and participation in AUC Proceeding 3110. The payment of this amount was received by the MSA in November 2015 and will be used for general operating purposes in 2016.

Accordingly, the MSA submitted its 2016 budget to the Chair of the Alberta Utilities Commission for approval in accordance with section 37 of the AUCA but requested no payment from the Alberta Electric System Operator in relation to its 2016 budget. Consequently, the Alberta Electric System Operator electricity trading charge for 2016 contains no MSA component.

5 Commitments

The Market Surveillance Administrator is committed under a lease agreement for its current premises until October 2019. Total lease costs including estimated operating costs are approximately as follows:

	\$
2016	264,563
2017	276,941
2018	288,195
2019	252,353

The Market Surveillance Administrator has entered into a service agreement with the Alberta Electric System Operator, under which the Market Surveillance Administrator receives certain information technology and office services. These services are provided for a monthly fee of \$3,500, plus an hourly fee for special projects and will continue until termination notice provided by either party.

Market Surveillance Administrator

Notes to Financial Statements

December 31, 2015 and 2014

6 Credit facility

The Market Surveillance Administrator has a demand operating facility. Under the terms and conditions of this facility, the Corporation can borrow up to \$300,000 at the prime rate plus 0.75% of interest. No pledges of security are required from the Corporation for the facility and no amount was drawn on this facility at year-end. A \$500 fee per annum is paid by MSA to maintain this facility.