IN THE MATTER OF

the *Alberta Utilities Commission Act,* S.A. 2007, c. A-37.2

And

IN THE MATTER OF an Application

By the

Market Surveillance Administrator *("MSA")*

Involving

TransAlta Energy Marketing Corp.

("TransAlta")

Final Argument of the MSA

March 28, 2012

FINAL ARGUMENT OF THE MSA

Index

FINAL ARGUMENT OF THE MSA

I Opening/Overview

1. On November 4, 2011 the Market Surveillance Administrator ("MSA") entered into a settlement agreement ("Settlement Agreement") with TransAlta Energy Marketing Corp. ("TransAlta") regarding alleged anti-competitive conduct in the Alberta electricity market. In accordance with the governing legislation the MSA then made application to the Alberta Utilities Commission ("Commission") for approval of that Settlement Agreement.

2. The MSA, like the Commission, has a public interest mandate. In particular, the MSA is established under legislation to promote the fair, efficient and openly competitive operation of the electricity and retail natural gas markets in Alberta, so-called "FEOC". The mandate of the MSA includes surveillance, investigation, enforcement and the making of guidelines in furtherance of FEOC.

3. Market participants such as TransAlta are required to conduct themselves in a manner that supports FEOC. This is a high standard, and essential so that competitive market forces can operate as contemplated, in the public interest. The Alberta government made a policy decision that competition, not regulation, would be relied on to supply electricity at the right price.

4. This proceeding is thus all about FEOC. As stated by the Commission in Decision 2011-017, "*…competition and the amelioration of anti-competitive market power is the thrust of the legislation governing electricity in Alberta*".[1]

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[1] AUC Decision 2011-017, para. 11, http://www.auc.ab.ca/applications/decisions/Decisions/2011/2011-017.pdf

5. It is ultimately up to the Commission to render a view on whether TransAlta breached that standard of conduct and whether the Settlement Agreement is an appropriate outcome. This is the first major proposed settlement being adjudicated by the Commission in respect of the FEOC standard. Its resolution will send an important signal to industry regarding whether acknowledging misconduct and agreeing on a proposed outcome is, in practice, preferable to denial and litigation.

6. It is also noteworthy that the conduct at issue in this proceeding was specifically identified as problematic by the MSA as part of its *Offer Behaviour Enforcement Guidelines* ("OBEGs"). The evidence in the proceeding shows that it was the consultation around the OBEGs that led TransAlta to stop the conduct. The Commission can in this proceeding reinforce the importance of guidelines as a means to help ensure, consistent with the purposes of the legislative scheme, that the market is regulated in a cost effective and efficient manner.

7. The submissions set out below divide the MSA argument into the following components:

- Parts II, III and IV addresses procedural and other background matters;
- Part V addresses key facts in respect of the conduct at issue in this proceeding;
- Part VI addresses the alleged contravention, construing applicable provisions in the legislative scheme and also invoking principles established in competition/antitrust law;

- Parts VII and VIII address the proposed penalty, including relevant legal principles and other guidance; and
- Part IX draws together the submissions by way of concluding points.

II Application

8. The MSA has applied pursuant to the *Alberta Utilities Commission Act*, S.A. 2007, c. A-37.2 ("AUCA"), and in particular Sections 44 and 51 thereof, for approval of the terms of the Settlement Agreement between the MSA and TransAlta ("Parties"). The Application and attached Settlement Agreement is found in Appendix A to Exhibit 004.

9. The key elements of the proposed outcome are set out in paragraph 8 of the Settlement Agreement, which states:

> *8. "The MSA will make application (the "Application") to the Commission pursuant to Section 44(2), Section 51(1)(b), Section 56(3)(b) and Section 56(4)(b), of the AUCA for a decision and order as follows:*
>
> *(a) this Settlement Agreement is approved on the terms and conditions set out herein;*
>
> *(b) TransAlta is found to have contravened section 6 of the EUA in relation to each of the Events, being separate contraventions in each of the 31 hours during the 8-day Period;*
>
> *(c) TransAlta is to pay to the Commission in accordance with section 63 of the AUCA an administrative penalty in the total amount of $370,073.34 as a penalty for the Events, being:*

(i) $245,073.34 as a one-time amount to address the economic benefit received by TransAlta as a result of the Events; and

(ii) $125,000.00 as a penalty for the contraventions."

III Statutory Framework

10. The substantive legislative enactments applicable to the conduct in this matter are:

- Section 6 of the *Electric Utilities Act*, S.A., 2003 c. E-5.1, as amended (the "EUA") which states that "*Market participants are to conduct themselves in a manner that supports the fair, efficient and openly competitive operation of the market*"; and

- Section 2 of the *Fair, Efficient and Open Competition Regulation* AR 159/2009, as amended, (the "FEOC Regulation") which describes conduct which does not support the fair, efficient and open competition of the market, including:

  (h) "restricting or preventing competition, a competitive response or market entry by another person, …".

11. The MSA submits that the scheme of the legislation reflects the intention of the Alberta legislature that matters within the mandate of the MSA should be resolved by agreement where it is fair and responsible to do so. The guiding provisions in this regard include sections 40, 44 and 54 of the AUCA. Also relevant is the stated purpose of the EUA in subsection 5(h), to "*…provide for a framework so that the Alberta electric industry can, where necessary, be effectively regulated in a manner that minimizes the cost of regulation and provides incentives for efficiency*".

12. Subsection 44(1) of the AUCA states that the MSA may negotiate a settlement with a person to resolve any matter that relates to the mandate of the MSA and may enter into a settlement agreement with that person. Subsection 44(2) states that the MSA shall file a settlement agreement with the Commission for approval in accordance with the provisions found in subsection 51(1)(b).

13. Subsection 56(4)(b) of the AUCA states that the Commission may provide direction or make any order it considers appropriate in respect of a matter that the MSA has brought before the Commission under subsection 51(1)(b), and section 63 states that the Commission may, by order, impose an administrative penalty where the Commission determines that a contravention has occurred.

14. Subsection 56(2) of the AUCA notes that in making a decision, the Commission may take into consideration any guidelines made by the MSA.

IV Purposes of the EUA

15. The EUA makes clear that the intent of the legislation is to create a framework within which fair and open competition can deliver efficient outcomes, for the benefit of customers and other stakeholders. Section 5 of the EUA sets out those purposes, including:

(b) "to provide for a competitive power pool so that an efficient market for electricity based on fair and open competition can develop, where all persons wishing to exchange electric energy through the power pool may do so on non-discriminatory terms and may make financial arrangements to manage financial risk associated with the pool price";

(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";

(d) "to continue a flexible framework so that decisions of the electric industry about the need for and investment in generation of electricity are guided by competitive market forces";

(e) "to enable customers to choose from a range of services in the Alberta electric industry, including a flow-through of pool price and other options developed by a competitive market, and to receive satisfactory service"; and

(h) "to provide for a framework so that the Alberta electric industry can, where necessary, be effectively regulated in a manner that minimizes the cost of regulation and provides incentives for efficiency".

V TransAlta Conduct

16. The key facts in this matter are undisputed and are set out in the Application and Settlement Agreement. While this has been a short proceeding and the Commission and the parties are likely very familiar with the facts, for convenience and emphasis the most important facts are set out below.

17. Starting in mid-November, 2010 the MSA observed what appeared to be unusual activity on the transmission intertie between Alberta and British Columbia.[2]

18. At about the same time, a market participant raised a concern with the MSA regarding possible blocking of its attempted import transactions.[3]

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[2] Ex. 004, Application, para 3.

19. The MSA commenced an investigation regarding the timing of export transactions on the intertie and whether the transactions were consistent with the fair, efficient and openly competitive operation of the market.[4]

20. As a result of that investigation, the MSA and TransAlta have agreed to the following facts in the Settlement Agreement:[5]

> *12. "Import ATC on the BC intertie is affected by a number of factors, including the level of exports. In particular, where import ATC is fully taken up by scheduled imports an export subsequently scheduled will have the effect of adding incremental ATC in an amount corresponding to the amount of electric energy being exported. Conversely export ATC on the BC intertie is affected by a number of factors, including the level of imports. In particular, where export ATC is fully taken up by scheduled exports an import subsequently scheduled will have the effect of adding incremental ATC in an amount corresponding to the amount of electric energy being imported.*
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> *17. Generally speaking, in November, 2010 on-peak electricity prices in the Mid-C market in the north-western US. were much lower than Alberta pool prices during on-peak hours, even taking into account relevant transmission costs. Accordingly, consistent with this arbitrage opportunity, some market participants were attempting to schedule significant volumes of imports from the Mid-C market into Alberta.*
>
> *18 Starting in mid-November 2010, the MSA observed an unusually high level of scheduled exports on the BC intertie. In the view of the MSA, the level of exports was unusual in the sense that it was not consistent with the price*

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[3] Ex. 004, Application, para 4.

[4] Ex. 004, Application, para 5.

[5] Ex. 004, Settlement Agreement, Appendix 1, Agreed Statement of Facts, paras as noted.

differential(s), or arbitrage opportunity, between Alberta and the Mid-C market. The MSA also observed that in some of the hours, although the Alberta pool price was high relative to Mid-C, the BC intertie was not full in the import direction. Furthermore, some of the import offers made at (T – 2 hours) were not scheduled, in other words there was no corresponding e-tag submitted to the AESO.

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21. *The MSA recognized that the lack of a scheduling e-tag for an import did not, of itself, mean that the import had been impeded. The screening looked for transactions where an export e-tag was created sufficiently close to gate closure at (T-20 minutes) that there would not reasonably be time for an import e-tag to be created before the gate closure. The assessment also looked for factors which might reasonably explain the timing of the export e-tag creation.*

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27. *The Parties agree that:*

    (a) the timing of the export e-tags created by TransAlta was such that it was not reasonably possible for another market participant to then schedule an import to utilize the incremental ATC;

    (b) the export e-tags could have been created by TransAlta earlier, if it chose to do so;

    (c) TransAlta was aware that the timing of the export e-tags would likely restrict or prevent the ability of another market participant to utilize the incremental import ATC resulting from the TransAlta export; and

    (d) TransAlta was aware that other market participants were or would likely be seeking to schedule the import of electric energy into Alberta, given the arbitrage opportunity.

28. *The MSA alleges, and TransAlta does not contest, that in each of the 31 hours involved in the Events:*

(a) the inability of such imports to reach the market restricted competition and competitive response;

(b) TransAlta expected to derive an economic benefit from the timing of the export e-tags, in that the absence of a subsequent import could result in a higher pool price in Alberta than would have existed if a market participant had successfully imported and thereby counter-flowed the TransAlta export; and

(c) the fidelity of the Alberta market was affected by the conduct involved in the Events, specifically that to the extent the pool price was higher than it would otherwise have been, it affected both sellers and buyers in the market.

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32. TransAlta acknowledges that beginning on November 19, 2010 it undertook a practice of scheduling near to gate closure (T-20 minutes), believing that other market participants were engaging in the same tactic for imports and exports. However, as a result of views expressed by the MSA during the OBEGs consultation, including discussion regarding the timing of intertie scheduling, a member of TransAlta's management team directed on November 27, 2010 that scheduling near to gate closure should be avoided where it was reasonably possible to schedule earlier. The practice ceased on the same day. The MSA accepts the information given by TransAlta that intentional scheduling near to gate closure has not occurred after that time and the MSA has not found any other such issues regarding the timing of e-tags by TransAlta."

21. The parties are in agreement regarding the amount of economic benefit estimated to have been derived by TransAlta as a result of the conduct, being $245,073.34.[6] The reasonableness of this amount has not being challenged by any party to these proceedings.

[6] Ex. 004, Settlement Agreement, Joint Settlement Recommendation, para 3.

22. The parties also agree that TransAlta should pay a further administrative penalty of $125,000.00, the reasonableness of which is discussed later in this submission.[7]

VI Argument With Respect to the Contravention of Section 6 of the EUA

A. Statutory Interpretation – EUA and FEOC Regulation

23. The proposed settlement agreement alleges that by its conduct TransAlta contravened section 6 of the EUA. The specific nature of the contravention is alleged to be as described in subsection 2(h) of the FEOC Regulation.

24. Consistent with the agreed facts in the Settlement Agreement, as described above, it is alleged that the timing chosen for export e-tags by TransAlta prevented other market participants from competing through import counter-flow and thereby lowering the Alberta market price. This is seen by the MSA to be conduct restricting or preventing competition or competitive response, and to be inconsistent with the obligation on TransAlta to support the fair, efficient and openly competitive operation of the market (or "FEOC").

25. In construing the conduct, it is appropriate to start with the words in subsection 2(h) of the FEOC Regulation as well as in section 6 of the EUA. Principles of statutory interpretation are of assistance.

26. As stated in *Sullivan on the Construction of Statutes*, the so called "modern principle" of statutory interpretation holds that "…*the words of an Act are to be read harmoniously in their entire context, in their grammatical and ordinary sense*

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[7] Ex. 004, Settlement Agreement, Joint Settlement Recommendation, para 4.

harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament".[8]

27. Applying the modern principle entails consideration of other rules of statutory interpretation, including the presumption in favour of ordinary meaning.

28. "*As understood and applied by modern courts, the ordinary meaning rule consists of the following propositions:*

1. *It is presumed that the ordinary meaning of a legislative text is the meaning intended by the legislature. In the absence of a reason to reject it, the ordinary meaning prevails.*
2. *Even if the ordinary meaning is plain, courts must consider the purpose and scheme of the legislation; they must consider the entire context.*
3. *In light of these considerations, the court may adopt an interpretation that modifies or departs from the ordinary meaning, provided the interpretation adopted is plausible and the reasons for adopting it are sufficient to justify the departure from ordinary meaning."*[9]

29. "*Although judges often purport to establish the ordinary meaning of words by looking them up in dictionaries, in fact the definitions found in dictionaries say very little about the meaning of a word as used in a particular context."*[10]

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[8] Ruth Sullivan, *Sullivan on the Construction of Statutes*, 5th ed. (Toronto: LexisNexis Canada, 2008) at p. 1

[9] Ibid, at page 24

[10] Ibid at page 27

30. "*An interpreter who wants to determine which sense of a word is intended and what it is meant to refer to must rely on the immediate context.*"[11]

31. The legislative context for the words found in the FEOC Regulation is formed by the AUCA and the EUA, the directly related legislation. The context for subsection 2(h) of the FEOC Regulation is section 6 of the EUA, because 2(h) is part of a non-exclusive list describing conduct that does not support the fair, efficient and openly competitive operation of the market. The larger context is the deregulated electricity market in Alberta, reliant on competition by design, and with its unique market rules and other standards of conduct.

32. The term "market" is defined in the FEOC Regulation and the EUA to mean "…*any type of market through or under which an offer, purchase, sale, trade or exchange of electricity, electric energy, electricity services or ancillary services takes place in relation to the production or consumption of electricity, electric energy, electricity services or ancillary services*".[12] The term "electricity", as defined in those enactments, includes "electric energy".[13]

33. The definition of "market" is broad and thereby captures the various types of markets relating to electricity in Alberta, including the wholesale market or power pool operated by the Independent System Operator (also referred to as the "ISO" or "AESO"). The term "power pool" is defined in the FEOC Regulation and the EUA to mean "…*the scheme operated by the Independent System*

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[11] Ibid at page 28

[12] EUA ss. 1(1)(dd), FEOC Regulation ss. 1(2)(m)

[13] EUA ss. 1(1)(p), FEOC Regulation ss. 1(2)(h)

Operator for (i) the exchange of electric energy, and (ii) financial settlement for the exchange of electric energy".[14]

34. From a practical perspective, as described in the proposed settlement agreement, the power pool is the relevant market insofar as the conduct that is at issue in this proceeding, since exports and imports form part of the offers in the power pool through which the Alberta wholesale market price is set. Subject to certain limited exceptions not raised in this proceeding, all electric energy entering or leaving the Alberta interconnected electric system must be exchanged through the power pool.[15]

35. It is instructive here to again consider the purposes of the EUA, including as set out in section 5(b) of that enactment:

> (b) "*to provide for a competitive power pool so that an efficient market for electricity based on fair and open competition can develop, where all persons wishing to exchange electric energy through the power pool may do so on non-discriminatory terms…*".

36. A reading of the various provisions in section 2 of the FEOC Regulation highlights words such as "*misrepresenting*", "*disrupting or impairing*". Further, there are concepts such as carrying out actions or transactions to "*circumvent*" any enactment and "*creating or increasing congestion*" for the purpose of being paid to relieve that congestion. Of particular relevance in this proceeding,

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[14] EUA ss. 1(1)(mm), FEOC Regulation ss. 1(2)(q)

[15] EUA ss. 18(2)

subsection 2(h) invokes the concept of "*restricting or preventing*" competition or competitive response.

37. As is made clear by its opening sentence, the non-excusive list set out in section 2 describes conduct that does not support FEOC. In this context, the ordinary meaning of the word "support" can reasonably be interpreted as '*not actively impeding or undermining*', at a minimum. For example, with reference to subsection 2(h) of the FEOC Regulation, one cannot "support" FEOC by preventing competition.

38. Thus, by their ordinary meaning the words chosen by the legislature in section 6 of the EUA and subsection 2(h) of the FEOC Regulation make clear that the conduct at issue cannot reasonably be seen as supporting FEOC. Accordingly, the conduct of TransAlta contravened section 6 of the EUA. This interpretation is complemented by established principles within the competition and antitrust law, and concepts of competitive harm, as set out below.[16]

B. Relevant Competition/Antitrust Principles

39. This part of the argument will undertake the following:

(i) describe the characteristics of markets for electric power and show how they differ from other markets;

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[16] In a different context, AUC Decision 2011-226 included discussion of principles associated to FEOC. http://www.auc.ab.ca/applications/decisions/Decisions/2011/2011-226.pdf

(ii) explain how the characteristics of electricity markets make them vulnerable to the exercise of market power;

(iii) explain why the structural indicators of the ability to exercise market power applied in other markets are less useful in electricity markets, and suggest appropriate alternatives;

(iv) explain why TransAlta's conduct is exclusionary and constitutes a wilful acquisition or extension of market power, rather than a mere exercise of existing market power; and

(v) explain why the proposed settlement provides a clear and necessary signal that this exclusionary conduct will not be tolerated in the future.

40. Markets for electric power can be defined at the retail and wholesale levels. Wholesale markets for electric power are characterized by suppliers in the form of generators and importers bidding against each other to supply power to customers including load serving entities and large users. Wholesale markets operate through the visible hand of a power exchange and/or a system operator who, among other things, determines the market-clearing price (the price at which supply is sufficient to satisfy load).

41. In Canada there are two deregulated wholesale electricity markets, one in Alberta and one in Ontario. Each has its own system operator that determines a single market-wide wholesale price (the pool price in Alberta). Both of these markets have limited connections (interties) to other jurisdictions with the consequence that the wholesale price that prevails in each of them is often materially different from that which prevails in adjacent jurisdictions. On the basis of their unique design and regulatory characteristics and of the limited

opportunities for inter-jurisdictional arbitrage each of these markets would qualify as relevant geographic markets for competition policy purposes.[17]

42. Markets for electric power differ from other markets in a number of important respects. First, the demand for electric power is price inelastic, at least in the short-term. That is, load is largely insensitive to all but major price changes. Most of the consumption in a given hour cannot easily be shifted and there are no good substitutes for electricity.[18] Second, generation capacity is fixed in the short-run and aggregate generating capacity in a geographic area is well known. Third, electric power is difficult to store, so it cannot be readily held in inventory to be used when prices rise. Fourth, transmission grids are subject to congestion, limiting the extent to which electric power can flow from areas of excess supply to areas of excess demand in order to mitigate price increases in the latter. Fifth, supply must be equal to load at all times to avoid system failure. This requires complex sets of rules or standards designed for reliability purposes.

43. The characteristics of markets for electric power make them vulnerable to strategies of withholding supply under certain circumstances. For example, when local generation capacity is close to being fully used and transmission

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[17] For a more detailed consideration of the issues involved in product and geographic market definition see Severin Borenstein, James Bushnel, Edward Kahn and Steven Stoft, "Market Power in California Electricity Markets" (PWP-036, University of California Energy Institute, Berkeley California, March, 1996). http://www.ucei.berkeley.edu/ucei/PDF/pwp036.pdf

[18] By way of comparison, a good such as coffee can be stored, has substitutes, and to a large degree consumption can be shifted between periods.

congestion precludes further imports, the withholding of even a small amount of supply in the form of either local generation or imports can increase the market price significantly, given the limited options available to loads. In essence, the tight supply conditions give individual suppliers market power in the sense of being able to profit from raising their offer prices above their respective marginal costs, thereby restricting supply and raising the market price above the competitive level.[19] This market power is sustained in the sense that it exists whenever supply conditions are tight.

44. Structural indicators of market power, in particular historic capacity or output shares and concentration ratios, are less useful in electric power markets than they are in other markets.[20] Profitable exercise of market power under tight supply conditions requires the withholding or exclusion of a relatively small amount of capacity from the market in conjunction with the holding of a compensating long physical or financial position that is exposed to the market price.

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[19] More technical terms are sometimes used. A low elasticity of demand and the inability of other suppliers to increase their output combine to reduce the elasticity of residual demand faced by any one competitor. The market power of a supplier is inversely related to the elasticity of its residual demand. See Frank Wolak, "Measuring Unilateral Market Power in Wholesale Electricity Markets: The California Market 1998 - 2000" CSEM WP 114, Center for the Study of Energy Markets, University of California Energy Institute, UC Berkeley,(June, 2003) http://escholarship.org/uc/item/6dw241sv

[20] The limitations of market shares, concentration ratios and Herfindahl Indexes as indicators of the presence of market power are discussed in more detail by Borenstein et.al. *supra*, n.15. See also Severin Borenstein, James Bushnel and Christopher Knittel, "Market Power in Electricity Markets: Beyond Concentration Measures" PWP-059r (February,1999) http://www.ucei.berkeley.edu/ucei/PDF/pwp059r.pdf

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45. Generating assets are not required in order to create the necessary combination of motive and opportunity. As described above, such 'motive' may come from a financial position exposed to the spot market (pool price). The 'opportunity' comes from the ability to withhold or exclude supply, including by blocking the ability of others to import, for example. The implication is that the structural test for the ability to exercise market power in an electric power market such as the Alberta power pool must focus on aggregate supply conditions and on the net exposure to the spot market, in addition to factors such as historic market shares. In this, the structural test differs from that often applied in other markets.

46. Physical withholding in the Alberta wholesale electricity market is prohibited pursuant to subsection 2(f) of the FEOC Regulation and section 6 of the EUA.

47. In the view of the MSA, the exercise of market power in the form of economic withholding of supply is not by itself prohibited, as explained in the MSA *Offer Behaviour Enforcement Guidelines* ("OBEGs").[21] In this, the OBEGs reflect the Alberta legal framework and are consistent with Canadian and U.S. antitrust jurisprudence which hold that "the mere possession of monopoly power and the concomitant charging of monopoly prices is not only not unlawful, it is an important element of the free market system."[22]

48. What does run afoul of antitrust and competition statutes in the U.S., Canada and elsewhere is conduct that is termed variously as monopolization, abuse of dominance or, more generally, abuse of market power. Abuse of market power

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[21] *Offer Behaviour Enforcement Guidelines*, January 14, 2011, Ex. 0040-35

[22] Verizon Communications Inc., Petitioner v. Law Offices of Curtis V. Trinko, LLP 540 U.S. 398, 407 (2004), at page 7

is conduct that is predatory, disciplinary or exclusionary.[23] It is wilful conduct intended to entrench or extend market power.

49. Similarly, the MSA *Offer Behaviour Enforcement Guidelines* label the "extension of market power" as conduct that does not support the fair, efficient and openly competitive operation of the market. This is defined in the OBEGs to include conduct that impedes competitive responses in the market; that is, exclusionary conduct.

50. TransAlta acknowledges that it could have filed its e-tags earlier and that it knew that the effect of delaying their filing until just before the gate closed would be to preclude responding and offsetting import transactions and thus to preserve the pool price-increasing effect of its export transactions. TransAlta exported power from Alberta, choosing timing that forestalled the entry of competing imports by delaying the filing of the e-tag on each export transaction until just before the gate closed, leaving the importers no time to respond. In essence, TransAlta made strategic use of the market rules to give it the power to reduce supply and raise the pool price; that is, to acquire market power it would not otherwise have had. Viewed through a competition/antitrust lens, TransAlta engaged in a strategy of entry deterrence (exclusionary conduct) to increase (extend) its market power.

51. Accordingly, on the basis of competition/antitrust law, the conduct would also not be seen as consistent with the obligation to support the fair, efficient and

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[23] Commissioner of Competition v. Canada Pipe Company Ltd./Tuyauteries Canada Ltée, 2006 FCA 233 at para.77, Canada Pipe.

openly competitive operation of the market. Further, as set out below, there is no reason to believe that the market itself would have adequately corrected or disciplined this type of conduct.

52. According to the evidence in this proceeding, views expressed by the MSA during its consultation regarding the *Offer Behaviour Enforcement Guidelines* caused TransAlta to cease the conduct at issue. In the absence of the actions of the MSA, TransAlta may have continued this exclusionary conduct and others might also have engaged in it. As described above, absent enforcement action, the conditions to profitably engage in this conduct could make the strategy available and appealing to an array of parties.

53. As set out in the calculation of economic benefit in the Settlement Agreement, it is estimated that TransAlta made a profit of $245,073.34 from the conduct at issue. In general terms, the profitability of this type of conduct depends on:

(i) the effect of the net reduction in supply on the pool price;

(ii) the net exposure of the market participant involved to the pool price; and

(iii) the loss, if any, on the export transaction – being the difference between the price received for the exports and the price those MW would have received had they not been exported (the pool price in the absence of the export transaction concerned).

54. There is no reason to believe that the market circumstances listed in paragraph 53 above are unlikely to be repeated or are even uncommon. There is also no competitive response that could offset this kind of conduct in the relevant period. In fact, other market participants could also file e-tags on exports just before gate closure, thereby further reducing imports and increasing the pool price. In the

face of such an export strategy importers would not be able to counter-flow with additional energy.

55. The export conduct (late e-tag) could only be frustrated by importers choosing, in circumstances of zero export available transfer capability ("ATC"), to engage in a similar late e-tag strategy so as to render new exports impossible, as a form of retaliation. In other words, replacing one type of impediment to competition with another. Clearly this would not be a desirable outcome.

56. TransAlta engaged in this conduct in 31 separate hours, stopping because of commentary expressed by the MSA as part of its OBEGs consultation. In the view of the MSA, the adverse effects of the conduct at issue were significant and would not have been mitigated over time by market forces alone.

57. Electricity markets have, of necessity, rules designed to ensure system reliability. These rules place restrictions on the timing of transactions, among other things. This can impact market efficiency to some degree; however, given inter-jurisdictional reliability imperatives that drive such rules, it may be unavoidable. The answer is therefore to cause market participants to conduct themselves appropriately, given the rules.

58. TransAlta has acknowledged that it could have filed the relevant e-tags earlier and that it delayed filing in full anticipation of the exclusionary effect this would have on potential imports. Other market participants may delay filing e-tags because they are indecisive or disorganized. Nevertheless, such disorganization or indecision can also have undue effects on competition. Further, market efficiency is undermined by impediments which restrict arbitrage between

markets.[24] Jurisprudence on abuse of dominance in Canada holds that parties are deemed to have intended the reasonably foreseeable effects of their actions.[25]

59. In approving the proposed Settlement Agreement and thereby rendering a view on the conduct at issue, the Commission can provide guidance that, in order to support the fair, efficient and openly competitive operation of the market, exporters and importers should make reasonable efforts to file their e-tags at their earliest opportunity. Further, as noted in the introductory submissions above, the Commission can reinforce the importance of the OBEGs and other such guidelines.

VII Considerations Going to Penalty

A. Relevant Factors and Considerations in AUC Rule 013

60. In determining the administrative penalty to be imposed, the Commission will consider the factors set out in AUC Rule 013 -- *Criteria Relating to the Imposition of Administrative Penalties* in order to ensure even-handed enforcement and to protect energy markets and consumers.

B. Relevant Principles Contained in the Case Law

61. It will also be useful for the Commission to look to the courts for guidance in determining whether the proposed administrative penalty is reasonable and fair. In particular, the courts have provided guidance on a number of general legal principles which are relevant to the determination of penalty, including:

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[24] Hearing Transcript, March 14, 2012, MSA Evidence, page 512, lines 13-25.

[25] Ibid, Canada Pipe, para. 72

(i) the role of the public interest;

(ii) specific and general deterrence;

(iii) the role of retribution; and

(v) the importance of context.

Those principles are discussed in greater detail below.

The public interest as a penalty consideration

62. The Supreme Court of Canada held that consideration of the public interest is guided by reference to the context and to the objects and purposes of the relevant legislation.[26] The relevant legislation here includes the AUCA and the EUA.

63. It is clear that in determining whether an administrative penalty is appropriate an adjudicator can consider the public interest. For example, in *Ironside v. Alberta (Securities Commission)*, 2009 ABCA 134 the Alberta Court of Appeal explained as follows:

> *It is the damage to the public interest arising from undermining confidence in the markets — a necessary consequence of the deliberate machinations and deceptions perpetrated by the appellant — that is a major concern of the SA. That was a centrepiece of the panel's concerns. In our view, the sanctions chosen were modest, even lenient, having regard to the scale of the events and the appellant's conduct.*

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[26] Memorial Gardens Assn. (Can.) Ltd. v. Colwood Cemetery Co., [1958] S.C.R. 353 (S.C.C.)

64. However, in considering whether a penalty is within the public interest, careful attention must be paid to the scope of the adjudicator's public interest jurisdiction. For example, in *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission) ("Asbestos")*, the Supreme Court of Canada considered the scope of the Ontario Securities Commission's jurisdiction to intervene in Ontario's capital markets, for purposes of protection and prevention, if in its opinion it is in the "*public interest*" to do so pursuant to s. 127(1) of the *Securities Act*, R.S.O. 1990, c. S.5.

At paras. 41 and 42 the court stated that:

> *… the public interest jurisdiction of the OSC is not unlimited. Its precise nature and scope should be assessed by considering s. 127 in context. Two aspects of the public interest jurisdiction are of particular importance in this regard. First, it is important to keep in mind that the OSC's public interest jurisdiction is animated in part by both of the purposes of the Act described in s. 1.1, namely "to provide protection to investors from unfair, improper or fraudulent practices" and "to foster fair and efficient capital markets and confidence in capital markets". Therefore, in considering an order in the public interest, it is an error to focus only on the fair treatment of investors. The effect of an intervention in the public interest on capital market efficiencies and public confidence in the capital markets should also be considered.*
>
> *Second, it is important to recognize that s. 127 is a regulatory provision. In this regard, I agree with Laskin J.A. that "[t]he purpose of the Commission's public interest jurisdiction is neither remedial nor punitive; it is protective and preventive, intended to be exercised to prevent likely future harm to*

> *Ontario's capital markets" (p. 272). This interpretation of s. 127 powers is consistent with the previous jurisprudence of the OSC in cases such as Canadian Tire, supra, aff'd (1987), 59 O.R. (2d) 79 (Div. Ct.); leave to appeal to C.A. denied (1987), 35 B.L.R. xx, in which it was held that no breach of the Act is required to trigger s. 127. It is also consistent with the objective of regulatory legislation in general. The focus of regulatory law is on the protection of societal interests, not punishment of an individual's moral faults: see R. v. Wholesale Travel Group Inc., [1991] 3 S.C.R. 154, at p. 219. (underlining added)*

Deterrence – specific and general

65. Another principle articulated by the courts is that an administrative penalty may be directed at specific and general deterrence. Specific deterrence contemplates setting a penalty which will deter the wrongdoer from repeating their breach. General deterrence contemplates that the penalty should send a message to other parties regarding the conduct, so as to also deter them from similar behaviour. Thus, the penalty should be meaningful not only to the wrongdoer but also to their peers.

For example, in *Cartaway Resources Corp. Re*, 2004 SCC 26, ("Cartaway), the Supreme Court of Canada was called upon to consider whether the British Columbia Securities Commission could properly impose monetary penalties with the goal of deterring people other than the wrongdoer from contravening securities legislation.

At paras. 60 and 61 of the court's decision, Lebel J., for a unanimous Court, stated that:

> *60 … it is reasonable to view general deterrence as an appropriate, and perhaps necessary, consideration in making orders that are both protective and preventative. Ryan J.A. recognized this in her dissent: "The notion of general deterrence is neither punitive nor remedial. A penalty that is meant to generally deter is a penalty designed to discourage or hinder like behaviour in others" (para. 125).*
>
> *61 The Oxford English Dictionary (2nd ed. 1989), vol. XII, defines "preventive" as "[t]hat anticipates in order to ward against; precautionary; that keeps from coming or taking place; that acts as a hindrance or obstacle". A penalty that is meant to deter generally is a penalty that is designed to keep an occurrence from happening; it discourages similar wrongdoing in others. In a word, a general deterrent is preventative. It is therefore reasonable to consider general deterrence as a factor, albeit not the only one, in imposing a sanction under s. 162. The respective importance of general deterrence as a factor will vary according to the breach of the Act and the circumstances of the person charged with breaching the Act. (underlining added)*

Retribution is not an appropriate penalty consideration

66. Retribution is not an appropriate factor to consider in setting an administrative penalty. In the British Columbia Court of Appeal case of *Thow v. British Columbia Securities Commission*, 2009 BCCA 46, the Court stated the *Asbestos* and *Cartaway* establish that:

> *… securities commissions, not being criminal courts, may not impose penalties that are "punitive" in the sense of being designed to punish an offender for past transgressions. They may, however, impose penalties that place burdens (even very heavy burdens) on offenders, as long as the penalties*

> *are designed to encourage compliance with regulations in the future. In essence, penalties may be directed at general or specific deterrence and at protection of the public; penalties that are purely retributive or denunciatory, however, are not appropriately imposed by administrative tribunals. (underlining added)*

Context – the circumstances of the breach

67. Courts have stated that in determining whether an administrative penalty is appropriate, an administrative tribunal may consider the context surrounding the breach which led to the penalty, and more generally, to all the circumstances of the case. For example, in *Cartaway*, the court concluded that:

> *On the facts of this case, the imposition of the maximum penalty is rationally connected to the conduct of Hartvikson and Johnson globally. Section 162 of the Act is triggered by a breach of the Act, but in formulating an order that protects the public interest, the Commission may take into account the context surrounding the breach. While settlement agreements between the Executive Director and the other brokers are a relevant factor, they are not dispositive or binding on the Commission, particularly where the conduct of the respondents and the other brokers is missing the required parity. In this case, Hartvikson and Johnson's deceitful conduct and leadership roles justified the imposition of a higher penalty than that imposed on their confederates. I therefore conclude that the $100,000 fine was reasonable in all the circumstances.*

68. To summarize, courts have explained that in determining whether an administrative penalty is appropriate, consideration may be given to the public interest, to specific or general deterrence, to the need to penalize the wrongdoer, to the context surrounding the breach which led to the penalty and, more

generally, to all the circumstances of the case. However, courts have cautioned an administrative penalty cannot be purely retributive or denunciatory.

VIII Argument as to the Reasonableness/Fairness of the Proposed Penalty

69. The proposed administrative penalty is reasonable and fair because it is in accordance with the criteria set out in AUC Rule 013 as well as the applicable legal principles, as discussed below.

A. The Penalty Removes all Financial Benefit for TransAlta

70. In accordance with AUC Rule 013, the administrative penalty includes a disgorgement of estimated economic benefit. The MSA notes that the reasonableness and fairness of this component of the overall administrative penalty is confirmed by the fact that it has not been challenged by any of the interveners.

B. The Penalty Will Serve as a Deterrent to TransAlta and Other Market Participants

71. Deterrence is an essential element and factor in the determination of a reasonable and fair penalty in the regulatory context. The interveners submit that in contemplating the size of a penalty: (1) the quantum must be significant enough to ensure that other market participants are deterred from engaging in similar unlawful conduct; and (2) it must be more than a mere "license fee" for unlawful conduct (i.e. more than 'the cost of doing business').

72. The MSA submits that the proposed administrative penalty meets both of these requirements. The proposed penalty is sufficiently large so as to deter other market participants from engaging in similar conduct. Further, it is more than a

mere "license fee" for TransAlta's conduct, especially given that TransAlta would also disgorge any profits associated to its conduct. $125,000.00 is a significant sum of money. That quantum of penalty sends a strong statement to TransAlta, to other market participants and to the general public, that TransAlta's conduct will not be tolerated.

73. At the same time, the proposed administrative penalty is not so large that it would create a disincentive to settlements. There is inherent give and take involved in negotiated outcomes. It would be unreasonable to expect a party to agree to settle a matter on the basis of a penalty equivalent to its worst case scenario if it chose instead to litigate. The avoidance of litigation, and its associated costs and uncertainty, is part of the reason for settlements.

74. The evidence in the proceeding shows that TransAlta has also sustained costs beyond the proposed penalty of $125,000.00. For example, TransAlta has incurred considerable expense in relation to the investigation, settlement negotiations and this proceeding. TransAlta has also suffered negative press coverage in relation to the conduct, and thereby suffered financial harm as well as harm to its reputation. Such costs also serve as a deterrent to TransAlta and to others.

75. The MSA has set out above reasons why the conduct at issue was a significant contravention of the obligation to support FEOC. The MSA would agree with those who would characterize the related impact or harm as significant.

76. The evidence in the proceeding reflects a debate about the amount of harm suffered by the customer groups represented by the interveners. The MSA acknowledges, however, that the conduct at issue had significant impacts on the

pool price and therefore would impact any person exposed to the pool price on a flow-through basis. In that sense the conduct had broad impacts.

77. As noted in the proceeding record, coming to an assessment of the exact market impact is not possible because changes to pool price from the conduct are estimates, not actual amounts. For that reason and others, calculations provided by the interveners were incomplete and inaccurate. Further, even if actual pool price changes were known with precision, determining the specific monetary impact across the market would be laborious exercise which would necessitate inquiry into the net position (vs. pool price) of every customer, generator and other market participant.

78. All of that said, getting a sense of the scale of the impact is feasible, based upon the estimates, and that is what the MSA did in coming to the amount of administrative penalty proposed in the Settlement Agreement.

79. The nature of the Alberta power pool is that many forms of conduct, including legitimate competitive offer strategies, have the potential to impact pool price to some degree. It therefore follows that many forms of conduct, even relatively small rule breaches, can cause relatively large impacts to the pool price.

80. From the perspective of FEOC, the trick is to deter anti-competitive conduct while at the same time encouraging pro-competitive conduct. The fidelity of the pool price rests on FEOC.

81. As submitted by the MSA during the oral hearing as well as in earlier written submissions, effective deterrence does not necessarily require imposition of a huge administrative penalty. The Commission has given useful guidance in its

rules respective specified penalties, taking into account circumstances where a contravention could have severe economic and other impacts.

82. By way of example, AUC Rule 019 would at the relevant time have allowed the MSA to issue a specified penalty to a maximum amount of $5,000.00 for contravention of ISO rule 6.3.3. That rule could, if contravened, cause a significant effect on pool price and thus a significant market impact not dissimilar in principle to the impact of pool price changes from the conduct at issue in this proceeding.

83. As a further example, AUC Rule 027 authorizes the MSA to assess a specified penalty based upon the severity level of the contravention of a reliability standard. That assessment must, in accordance with AUC Rule 027, take account of the impact, risk or scope of the contravention of a reliability standard on the safe, reliable and economic operation of the Alberta interconnected electric system. The rating scale goes from "Low" to "Severe", with the maximum specified penalty for the most severe circumstances set at $25,000.00.

C. The Penalty Penalizes TransAlta While Recognizing Mitigating Factors

84. The proposed administrative penalty, comprised of a disgorgement of economic benefit plus an additional administrative penalty, means that TransAlta would not only return all economic profits it earned unlawfully but also pay a proportion of the economic profits it earned lawfully through its legitimate business operations, solely as punishment for its unlawful conduct.

85. As noted above, AUC Rule 013 lists a number of factors and considerations going to an assessment of administrative penalty. It is noteworthy that the Commission has not assigned specific weighting to the criteria or a means

through which to explicitly calculate an increase or decrease in the penalty, a methodology used in other penalty setting contexts. For example, in AUC Rule 027 the Commission was explicit about penalty reduction for self-disclosure of facts and mitigation plans.

86. In relation to the criteria set out in AUC Rule 013, further to other submissions above relevant to those criteria, the MSA would add the following:

- The conduct did not cause physical harm to any person or property, or to the environment;
- There is no evidence that TransAlta previously engaged in such conduct;
- The conduct began and ended in November, 2010;
- TransAlta took steps itself to cease the conduct, upon issuance of a draft MSA guideline which identified the conduct as inconsistent with the obligation to support FEOC;
- There is no evidence that the conduct is recurring, by TransAlta or any other market participant;
- There is no evidence of an effort to cover up the conduct;
- TransAlta's conduct did not involve deceit or artifice;
- TransAlta has an established compliance program, and the evidence is that improvements have been undertaken;
- TransAlta's executive management has been proactively engaged in further improving compliance;

- TransAlta was in discussions with the MSA in relation to the conduct shortly after November, 2010, as part of work by the MSA in the area;
- TransAlta has acknowledged that its conduct was inconsistent with its obligation to support FEOC; and
- TransAlta assisted the MSA in coming to an assessment of the economic benefit attributed to the conduct.

87. In response to concerns that the proposed administrative penalty of $125,000.00 is too low in comparison to larger market impacts relating to changes in pool price, the MSA submits that the jurisdiction of the Commission is regulatory (i.e. protective and preventative), not compensatory and that a larger penalty in the context of this case could be viewed as retributive.

88. As argued during an earlier phase of this proceeding, the Commission has no jurisdiction to compensate interveners. Accordingly, this proceeding is not the means through which any intervener can seek to recoup losses alleged to have been suffered as a result of TransAlta's conduct.

D. Public Interest

89. The legislative context within which the Commission is considering the proposed Settlement Agreement includes the EUA, an enactment which makes clear in its stated purposes that the public interest is served by fair, efficient and open competition.

90. A finding by the Commission that timing intertie transactions so as to restrict or prevent the ability of competitors to respond is inconsistent with the obligation to support FEOC is appropriate, given the purposes of the EUA. Such a finding

is supported by the ordinary meaning of the words used in the EUA and the FEOC Regulation. Furthermore, such a finding is consistent with competition/antitrust law.

91. It is in the public interest that conduct which significantly undermines FEOC should be penalized. The purpose of the administrative penalty in this case is to help ensure support of FEOC going forward. Deterrent effects from the penalty are part of the answer. Another part of the answer rests in the compliance efforts of TransAlta.

IX Conclusion

92. The evidence in this proceeding is sufficient for the Commission to grant the relief requested in the Application.

93. The conduct of TransAlta was a clear contravention of its obligation under section 6 of the EUA to support the fair, efficient and openly competitive operation of the market, as further enunciated in subsection 2(h) of the FEOC Regulation. This view is consistent with the ordinary meaning of the words in those enactments. It is also consistent with principles established under competition/antitrust law.

94. The market affected by TransAlta's conduct was the Alberta power pool through which it was exporting electricity. The anti-competitive effects of its conduct on other market participants were understood by TransAlta at all relevant times.

95. The conduct was an exclusionary tactic which increased (extended) TransAlta's market power, thereby undermining FEOC. Such conduct was identified by the MSA as improper, in its *Offer Behaviour Enforcement Guidelines* ("OBEGs").

96. It is appropriate to impose a sanction against such conduct to help ensure that TransAlta and other market participants will be deterred from similar such conduct in future. The goal of this proceeding is promotion of FEOC.

97. The Settlement Agreement proposes a significant administrative penalty, through which TransAlta will disgorge all economic benefit attributed to the conduct and also pay a further penalty in the amount of $125,000.00. The reasonableness of the disgorgement amount has not been contested by any party in this proceeding. The further penalty ($125,000.00) is also reasonable under the circumstances.

98. An administrative penalty of $125,000.00 is consistent with guidance given by Commissions decisions and rules, as well as guidance given by the courts. It is neither trivial nor unduly harsh, given the relevant circumstances. Further, that monetary penalty is only part of the overall cost to TransAlta from its conduct. The evidence is clear that it has incurred other financial costs as well as reputational damage.

99. TransAlta stopped the conduct before the MSA took investigative or enforcement action. TransAlta has taken responsibility for its conduct and has committed itself to important compliance improvements in addition to the compliance program already in place.

100. The MSA has met the burden of proof in this proceeding, showing on a balance of probabilities that the proposed outcome is reasonable.

101. The governing legislation makes clear the view of the Alberta legislature that fair and responsible settlements are in the public interest. The Commission will by its decision in this proceeding send an important message about the use of

settlements to resolve significant conduct and enforcement matters. The Commission also has the opportunity to reinforce the responsibility of market participants to support the fair, efficient and openly competitive operation of the market, including attention to guidelines made in furtherance of FEOC.

102. The Settlement Agreement as proposed is a reasonable means through which FEOC will be supported going forward. It is in the public interest and should be approved accordingly.

All of which is respectfully submitted

"Original Signed"

Douglas Wilson
Senior Legal Counsel,
Market Surveillance Administrator.