ALBERTA UTILITIES COMMISSION

APPLICATION 1607868
PROCEEDING ID 1553

Market Surveillance Administrator Application for Approval of a Settlement Agreement Between the Market Surveillance Administrator and TransAlta Energy Marketing Corp.

Rebuttal Evidence and Submissions of the Market Surveillance Administrator

Filed March 5, 2012

Introduction

1. The Market Surveillance Administrator (MSA) is hereby filing rebuttal evidence and submissions in accordance with the notice issued by the Alberta Utilities Commission (Commission) on February 7, 2012.

2. The rebuttal evidence and submissions will address some areas or issues generally and in other instances will, as applicable, address the evidence and submissions of the interveners individually.

3. The mandate of the MSA requires it to act in a fair and responsible manner, as set out in section 40 of the *Alberta Utilities Commission Act* (AUCA)[1]. It is clear from the legislation that the MSA is required to consider the interests of all market participants in carrying out its mandate, including those on the load side as well as on the supply side. The MSA has sought to take account of those varied interests during its monitoring, investigation and enforcement actions in respect of the matters captured in the proposed settlement in this proceeding.

4. The MSA acknowledges the concerns highlighted by others in this proceeding to the effect that the settlement must appropriately penalize any misconduct and deter future such misconduct. We agree with that aim. We submit that the proposed settlement agreement will achieve that aim.

[1] Statutes of Alberta, 2007, Chapter A-37.2

5. The MSA looks to foster compliance by market participants with applicable legislation, rules, standards and other conduct requirements. Such compliance ultimately helps to foster the fair, efficient and openly competitive (FEOC) operation of the market, and thereby to further the public interest.

6. The focus on fostering compliance is not unique to the MSA. The United States Federal Energy Regulatory Commission (FERC) has made clear in its Penalty Guidelines that while civil penalties are an important tool to achieve compliance, achieving compliance, not assessing penalties, is the central goal of its enforcement efforts.[2]

7. Concepts of deterrence are relevant. A market participant should not see non-compliance as a viable strategy. Depending on the circumstances, an administrative penalty will help to cause the market participant to focus necessary efforts and resources toward ensuring that it will be compliant in future. The same is true for other market participants generally.

8. Deterrence also flows from other effects on the market participant, such as the effect on corporate reputation. Notwithstanding that vigorous competition is encouraged, it is reasonable to assume that market participants generally seek to conduct themselves appropriately. Being subject to an enforcement action can significantly harm the reputation of a market participant.

[2] FERC Penalty Guidelines, Chapter 1, Part A, General Application Principles, section 1A1.1.2, http://www.ferc.gov/whats-new/comm-meet/2010/091610/M-1.pdf

9. Reliance on compliance programs and undertakings is also reasonable, both in respect of assessing what amount of administrative penalty would be appropriate and in relation to assurances that future misconduct will be avoided. This is made clear in AUC Rule 013.[3]

10. It is also noteworthy that ID 1553 is in fact a proceeding relating to a proposed settlement agreement rather than a fully contested proceeding. Accepting responsibility for misconduct, like cooperation, is creditworthy. This view was explicitly adopted by FERC, for example.[4] Furthermore, it is consistent with the legislative scheme in Alberta, including s. 44 of the AUCA, that market participants should be encouraged to resolve issues without litigation.

11. The proposed settlement agreement reflects a situation where an issue was identified and contained quickly, including because of compliance efforts by TransAlta Energy Marketing Corp. (TransAlta). The transparency around the issue has caused significant media and stakeholder interest, with attendant effects on reputation. TransAlta has made clear commitments to further improve its compliance program. There is no evidence that the alleged misconduct has continued or will be repeated. TransAlta will, under the terms of the settlement agreement, pay a significant administrative penalty. All of this goes to a significant deterrent effect.

[3] AUC Rule 013, Criteria Relating to the Imposition of Administrative Penalties, http://www.auc.ab.ca/acts-regulations-and-auc-rules/rules/Documents/Rule013.pdf

[4] Ibid, FERC Revised Policy Statement on Penalty Guidelines, paras. 140 - 144

12. The interveners do not contest the approach proposed in the settlement agreement for the calculation of economic benefit allegedly received by TransAlta, which would be paid as part of the administrative penalty.

13. The interveners have largely focused in their evidence on the amount of the proposed administrative penalty when arguing that the settlement agreement is inadequate to penalize and deter the alleged misconduct. In particular, the $125,000.00 penalty proposed to be added to the disgorgement of 'economic benefit' attributed to TransAlta.

14. The MSA submits that the interveners have overlooked several other relevant factors, including those set out above.

Calculation of Estimated Economic Benefit

15. Appendix 2, including Table 1, in the proposed settlement agreement sets out the simulation methodology used to arrive at an estimate of what TransAlta could have gained from the alleged conduct ('economic benefit').

16. The estimating methodology makes a number of assumptions: first, that imports deemed to have been impeded would actually have been scheduled (flowed into the Alberta market); secondly, that no other changes would have occurred to offers or available supply, or demand.[5]

[5] Appendix 2, Calculation of Estimated Economic Benefit, para. 2(ii)

17. Using an assumption that, all other things being equal, the impeded import would show up was a necessary approach. An estimate of what might have happened absent the 'late' e-tag (i.e. the "adjusted pool price") is critical to an estimate of possible economic benefit.

18. The other assumptions made by the MSA in the methodology (holding offers, supply and demand steady) effectively remove those variables for the purpose of the estimation of possible economic benefit. This is reasonable, as there is no way to accurately show how any of those factors would have actually changed, or not, in a given hour relevant to this proposed settlement agreement.

19. The assumptions can be significant. For example, a reduction in demand would, all other things being equal, tend to mean a lower pool price and therefore a lower actual 'economic benefit'. Some load customers may reduce their demand in response to price. The methodology did not attempt to take this into account in estimating the possible economic benefit.

ADC Evidence and Submissions

20. ADC asserts in its evidence actual harm to ADC members in the specific amount of $215,911.34. This assertion is based on a "revised pool price had the misconduct not occurred".[6] That is, using the estimated "adjusted pool price".

[6] ADC Evidence, February 27, 2012, page 2, lines 11 through 20, and page 3 table

21. In relation to the description of the harm asserted, ADC seemingly treats each of its members as identical insofar as their commercial practices. In particular, ADC effectively characterizes them all as being fully exposed to pool price on a flow-through basis. The MSA submits that this is unlikely, and in any event should have been made explicit in the ADC evidence.

22. There are various commercial scenarios under which a load participant such as an ADC member may hedge or otherwise mitigate its portfolio impact from changes in pool price, apart from reducing its consumption, including:

(a) a forward contract, power purchase arrangement or other agreement that would mean paying some amount other than pool price flow-through in a given hour; or

(b) selling contingency reserves to create an income stream which would benefit from a higher pool price in a given hour, thus offsetting costs associated to a higher pool price.

23. ADC asserts a loss of production by some of its members as a result of instituting demand response in two of the hours in which imports were alleged to have been impeded.[7]

[7] ADC Evidence, February 27, 2012, page 3, lines 6 through 7 and page 4, lines 1 through 4

24. ADC notes that relatively few MW of demand response can significantly impact pool price and that other load participants can benefit from the resulting lower pool price. ADC concludes that if there had been no demand response during certain hours, TransAlta would have reaped a larger economic benefit. ADC notes that it is difficult to prove what the pool price outcome absent the demand response behaviour would be.[8]

25. The MSA submits, for the reasons set out in paragraphs 18 and 19 above, that ADC's conclusion regarding a higher 'economic benefit' if there had been no demand response is already taken into account in the methodology (by holding demand steady). Further, it is noteworthy that ADC does not attempt to reconcile in its claim of monetary harm ("$215,911.34") that its calculation using the estimate of "adjusted pool price" does not take account of: (i) the effect of any demand response on that same estimated price; or (ii) the beneficial effect on any of its members from a lower pool price resulting from such demand response. This weakens its assertion regarding specific economic harm, given that ADC itself acknowledged that those factors are relevant and given that ADC seeks to prove actual harm in the specific amount claimed.

26. ADC asserts in its evidence that the practice of scheduling near to gate closure may have been ongoing for some time, without being detected or penalized.[9]

[8] ADC Evidence, February 27, 2012, page 4, lines 5 through 14
[9] ADC Evidence, February 27, 2012, page 4, lines 16 through 23

27. The settlement agreement notes that the conduct at issue in this proceeding was noticed by the MSA as part of its monitoring and also by a market participant who separately brought it to the attention of the MSA. The settlement agreement also describes the extensive assessment done by the MSA for the months of November and December, 2010, and the resulting conclusion about the scope of the conduct.[10]

28. It is reasonable to assume that such conduct, either past or future, would be readily identifiable, even if a market participant was attempting to conceal it. The settlement agreement before the Commission in this proceeding confirms that the MSA considers such conduct to be worthy of enforcement where determined to be material. We therefore submit that the assertion by ADC about past misconduct is not well founded.

29. The MSA further submits that there is, in any event, no basis in this proceeding to consider allegations about conduct not detailed or attributed to any particular market participant, and not relevant to this settlement agreement.

30. The final assertion by ADC is that economic benefit potentially realized by other market participants is significantly greater than the amount realized by TransAlta, and those other participants will get to keep the benefit of the misconduct while Alberta consumers, including ADC members, have to pay for

[10] Appendix 1, Agreed Statement of Facts, paras 18 through 24

it. ADC alleges that this outcome frustrates consumers and creates tremendous mistrust and skepticism around the market.[11]

31. ADC appears in part to express a concern that there is some inequity in having other parties benefiting from a change in pool price caused by misconduct, and not somehow capturing that benefit in the penalty against TransAlta.

32. The MSA submits that such an approach would not be consistent with the model adopted by the Alberta legislature in sections 56 and 63 of the *Alberta Utilities Commission Act*, which focuses on economic benefit seen to have been gained by the contravener, not others.[12]

33. Furthermore, the concept of increasing the penalty against TransAlta by virtue of indeterminate economic benefits potentially realized by other market participants would add significant uncertainty, and by that tend to undermine the fair, efficient and openly competitive operation of the market rather than enhance it.

34. ADC also appears to advocate for the notion that less frustration, mistrust and skepticism will result if (and, it seems, only if) the penalty for causing a change in pool price is severe. The MSA submits that the basis for such a conclusion is not clear. Fostering confidence in the market is very important, but

[11] ADC Evidence, February 27, 2012, page 5, lines 1 through 6
[12] ibid

we submit that there are ways to do that beyond simply imposing huge penalties on market participants.

35. By focusing its advocacy on severe penalties, ADC ignores other consequences and factors which also go to deter and address misconduct. The MSA submits that it is unreasonable to ignore such other factors.

36. The MSA submits that it is both reasonable and appropriate to consider harm to reputation from the enforcement action as part of the 'penalty' relating to a contravention. Further, to consider the speed and effectiveness of the enforcement action in the specific case here, as well as the ability to detect like misconduct in future, when assessing whether adequate deterrence has been created. Beyond that, to consider the efforts taken by the market participant to identify, acknowledge and address misconduct, and compliance efforts toward avoiding future misconduct. It is not just about the quantum of the monetary penalty.

IPCAA Evidence and Submissions

37. Some of the evidence filed by IPCAA is similar in nature to that of ADC. Accordingly, for brevity the MSA will not expressly repeat our evidence and submissions set out above. However, our evidence and submissions are incorporated here by reference and as applicable.

38. The MSA also notes that by choosing to not expressly address any particular assertion in the evidence or submissions of IPCAA or the other interveners, the MSA is not acknowledging the correctness, relevance or applicability of such assertion.

39. IPCAA has included in its evidence a table which purports to show a "settlement difference" and a "settlement impact" on IPCAA members from the alleged conduct at issue in this proceeding.[13]

40. IPCAA asserts a "settlement impact" on its members of "approximately $2 million".[14] It is not made clear what the relationship between "settlement impact" and any actual harm is.

41. The "$2 million" figure is asserted by IPCAA as an "indicative value", based upon an estimate using simplifying assumptions, itself based on another estimate which used simplifying assumptions (the latter being the estimate of "adjusted pool price" used to attribute possible economic gain to TransAlta).

42. IPCAA does not provide any data regarding the actual load for its members during the hours at issue.

43. Further, as is the case with the ADC evidence, the IPCAA evidence does not specify the extent to which each of its members was exposed to pool price on

[13] IPCAA Evidence, February 27, 2012, part 2.0 and part 8.0, Table 1
[14] IPCAA Evidence, February 27, 2012, part 2.0

a flow-through basis and whether the member(s) had commercial arrangements or other applicable factors which would mean their particular "settlement impact" was not actually as described by IPCAA in its generalized approach. IPCAA does note that calculating the actual impact "would be onerous and would require load and contracting data for all members".[15] The failure by IPCAA to take account of such factors weakens its assertions about impact to its members arising from changes to pool price.

44. IPCAA asserts harm to market confidence from the alleged conduct, citing claims made earlier in its submissions regarding standing.[16] However, the MSA submits that IPCAA has overlooked or failed to take account of other factors which would serve to enhance market confidence in relation to the alleged misconduct. Among those factors: that the conduct was relatively limited; that the conduct was identified and stopped relatively quickly, including by the compliance efforts of TransAlta itself; that significant enforcement action ensued; that the conduct is readily identifiable; and that there is no evidence of such conduct continuing.

45. IPCAA asserts that the proposed settlement is inadequate, for a variety of reasons.[17] Its views are based in part on its calculation of total "settlement difference", and thus are challengeable for the reasons set out above. Further, in claiming that the proposed administrative penalty is insignificant for a company

[15] IPCAA Evidence, February 27, 2012, part 2.0
[16] IPCAA Evidence, February 27, 2012, part 3.0
[17] IPCAA Evidence, February 27, 2012, part 4.0

the size of TransAlta, IPCAA ignores the punitive and deterrent effects of other factors, including harm to corporate reputation.

46. IPCAA asserts that it, along with other groups such as the UCA and ADC should have been consulted in the course of the settlement negotiations. This appears to suggest that the MSA should ignore requirements for confidentiality around investigations, should ignore the fact that settlement negotiations are generally also privileged, in order to consult with competitors of a market participant regarding how to address an alleged contravention by that market participant. The MSA submits that such a concept cannot be appropriate, acceptable or viable.

47. The MSA also disputes the assertion that there has not been reasonable transparency around the calculation of the proposed settlement, given the materials filed with the Commission and the public access to such materials in general.

48. IPCAA asserts harm from impact to forward markets from the conduct at issue.[18] The MSA would here repeat its submissions above, including that IPCAA has overlooked or neglected to mention factors which would serve to foster market confidence, including: that the conduct was relatively limited; that the conduct was identified and stopped relatively quickly; that significant

[18] IPCAA Evidence, February 27, 2012, part 5.0

enforcement action ensued; that the conduct is readily identifiable; and that there is no evidence of such conduct continuing.

49. IPCAA asserts unfairness from that fact that the proposed settlement agreement does not require TransAlta to pay the costs of the MSA investigation.[19]

50. Application for such costs in relation to an enforcement proceeding is at the discretion of the MSA and subject then to adjudication by the Commission. The proposed settlement agreement reflects a negotiation in which there is give and take on both sides. It is not surprising that costs may be part of that negotiation.

51. The MSA negotiated the settlement agreement taking account of a variety of factors, including: the significance of the precedent, including the administrative penalty; the steps taken by TransAlta of its own accord to stop the conduct at issue; the compliance commitments given by TransAlta; the speed and efficiency of reaching an outcome; the relative costs associated to a contested proceeding versus a settlement proceeding.

52. A proposed settlement agreement such as the one before the Commission in this proceeding is by nature intended to conclude outstanding matters and thereby give certainty. An unresolved and uncertain exposure to costs claims

[19] IPCAA Evidence, February 27, 2012, part 6.0

would tend to make settlement agreements less likely in general. The MSA seeks to foster the possibility of negotiated outcomes, consistent with the legislative scheme and the public interest.

UCA Submissions

53. The UCA submits that there was harm to the consumers that it represents, but that it is unable now to make a definitive financial calculation of the impact of TransAlta's actions on those consumers.[20]

54. The MSA submits that, as with assertions made by ADC and IPCAA, it would be important to know in any such calculation the extent to which such consumers were exposed to pool price on a flow-through basis. That is, consumers on contract would not pay pool price on that basis. Further, consumers on the regulated rate option for electricity would pay a rate based upon a forward month price.

55. The UCA notes that it has not provided evidence but instead has made submissions which can be dealt with during argument, and also possibly addressed during the oral hearing. The MSA reserves that right.

56. To the extent that the UCA has made submissions going to factors relevant to assessments regarding the proposed administrative penalty and the

[20] UCA Submission, February 27, 2012, para. 6

settlement agreement overall, evidence and submissions by the MSA elsewhere herein may be applicable.

Summary

57. The conduct at issue in this proceeding allegedly restricted competition or competitive response. The conduct therefore was seen as inconsistent with the obligation of market participants to support the fair, efficient and openly competitive operation of the market (FEOC).

58. The MSA has been clear regarding its enforcement strategy, including in its *Offer Behaviour Enforcement Guidelines*, that attempts to restrict or prevent competition or competitive response will be treated very seriously.[21]

59. Given that the market is premised on fair, efficient and open competition, it is reasonable to predict that a lessening of competition may impact on the market price. The greater the lessening of competition, the longer it takes place, the greater the potential impact.

60. The simulation methodology used in the settlement agreement to estimate the potential economic benefit recognizes that by restricting competition a market participant may expect some possibility of gain.

[21] *Offer Behaviour Enforcement Guidelines* January 14, 2011 http://albertamsa.ca/uploads/pdf/Consultations/Market%20Participant%20Offer%20Behaviour/Decide%20-%20Step%205/Offer%20Behaviour%20Enforcement%20Guidelines%20011411.pdf

61. The actual extent of the possible gain is not certain, in advance or after the fact, because the market is dynamic. What is certain is that if the strategy is successful the market participant will tend thereby to be better off, and others worse off.

62. The MSA submits that assessment in this proceeding of the proposed settlement agreement is therefore properly focused on the scale of the potential impact to FEOC, including the risk of impact to the market price. Efforts by the interveners to calculate an actual price impact are less helpful, for the reasons set out above.

63. The administrative penalty proposed in the settlement agreement is not nominal or inadequate. It is significant and reasonable, under the circumstances at issue, and also in the context of existing Commission rules and decisions.

64. AUC Rule 027, which deals with specified penalties for contravention of Alberta reliability standards, is relevant and instructive.[22] For a variety of reliability standards AUC Rule 027 authorizes the MSA to assess the severity of a contravention, and therefore the amount of a specified penalty, based upon "*…the impact, the risk or the scope of the contravention on the safe, reliable and economic operation of the interconnected electric system…*".[23]

[22] http://www.auc.ab.ca/acts-regulations-and-auc-rules/rules/Documents/Rule027.pdf

[23] AUC Rule 027, section 4(2)

65. The assessment of severity uses four grading descriptions: "Low", "Moderate", "High" and "Severe". The most severe contravention faces a specified penalty of $25,000.00. The *Alberta Utilities Commission Act* authorizes the Commission to prescribe specified penalties up to a maximum of $100,000.00 per day.[24]

66. AUC Rule 027 requires the MSA to then reduce the amount of the specified penalty in the Penalty Table by 25% where a mitigation plan has been accepted. A similar reduction is made where a contravention has been self-reported by the market participant.

67. The MSA submits that this reflects an intention by the Commission to give credit for compliance efforts and for cooperation.

68. AUC Rule 027 recognizes that circumstances involving contravention of a reliability standard can have severe impacts on the safe, reliable and economic operation of the interconnected electric system, with resulting severe economic and other impacts.

69. The fair, efficient and open operation of the market is dependent to a significant degree on the functioning of the interconnected electric system. This

[24] ibid, subsection 52(7)

point is made clear in, for example, subsections 2(g) and 2(i) of the *Fair, Efficient and Open Competition Regulation* (FEOC Regulation).[25]

70. As made clear in AUC Rule 027, specified penalties are seen by the Commission to be applicable in situations involving severe risk and severe contraventions, and give useful guidance regarding assessment of penalty amounts. This is true notwithstanding that the proposed settlement agreement alleges restriction of competition or competitive response rather than contravention of a reliability standard.

71. The proposed settlement agreement would see TransAlta pay an administrative penalty of $370,073.34, including two components. The circumstances alleged involve a significant restriction of competition, creating a significant risk of impact to FEOC. The administrative penalty as proposed is reasonable and well within the range of outcomes available to the Commission.

72. Furthermore, the monetary penalty is only part of the overall picture here. Harm to corporate reputation is relevant. Further, the willingness to conclude this dispute by negotiation, the extent of other cooperation shown and efforts toward compliance are also significant factors which go toward approval of the settlement agreement as proposed.

[25] Alberta Regulation 169/2009, as amended

73. The proposed settlement agreement will, if approved, send a clear and important signal regarding the obligation on market participants to support FEOC. The nature of that obligation, as enunciated in subsection 2(h) of the FEOC Regulation, has not to date been specifically addressed by the Commission. The balancing of administrative penalty and other factors in settlement agreements will also, through the Commission's decision, provide important precedent for all stakeholders.