

GLOBAL COMPETITION REVIEW

The Guide to Energy Market Manipulation

Editor

Gordon Kaiser, JAMS

Stikeman Elliott

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Gordon Kaiser

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This article was first published in February 2018
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GLOBAL COMPETITION REVIEW

Published in the United Kingdom
by Global Competition Review

Law Business Research Ltd
87 Lancaster Road, London, W11 1QQ, UK
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www.globalcompetitionreview.com

First edition

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ISBN 978-1-78915-092-6

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

Acknowledgements

The publisher acknowledges and thanks the following contributors' for their learned assistance throughout the preparation of this book:

AKIN GUMP STRAUSS HAUER & FELD LLP

ALBERTA UTILITIES COMMISSION

ALLEN & OVERY LLP

AUSTRALIAN ENERGY REGULATOR

BIRD & BIRD LLP

BLAKE, CASSELS & GRAYDON LLP

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STIKEMAN ELLIOTT LLP

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Part I

Legislation & Jurisprudence

3

Compliance and Enforcement in the Ontario Electricity Sector

Glenn Zacher¹

Introduction

The purpose of this chapter is to explain how Ontario regulatory agencies have addressed compliance and enforcement in the Ontario wholesale electricity market, including more recent enforcement initiatives targeted at market manipulation and gaming. However, before addressing this topic directly, it is useful to start with a brief history of the restructuring of the Ontario electricity sector. Understanding how restructuring unfolded is a necessary backdrop to explaining and analysing the current enforcement and compliance regimes. As further explained herein, Ontario's transition from vertically integrated utility structure to short-lived experiment with a merchant power market and the sector's subsequent evolution to the current 'hybrid market' has shaped the regulation of compliance and enforcement in Ontario.

Restructuring of the Ontario electricity sector

For over a century, electricity supply in Ontario was centrally managed. The Hydro Electric Power Commission of Ontario (Ontario Hydro) was established in 1906 as a provincial commission tasked with building a transmission grid to deliver power from privately owned hydro-electric generators to various municipal distribution systems in Southwestern Ontario. This mandate soon expanded to acquiring and building generation and by the early 1970s the Commission, renamed Ontario Hydro, had evolved into a vertically integrated utility with a virtual monopoly on the generation and transmission of power in Ontario.²

¹ Glenn Zacher is a partner at Stikeman Elliott LLP.

² Glenn Zacher & Patrick Duffy, *Energy Regulation in Ontario*, ed. (Toronto: Thomson Reuters Canada Limited, 2016), p. 1:110. (Energy Regulation in Ontario).

In the early 1990s, Ontario Hydro's structure came under immense pressure. Based on rising demand expectations, Ontario Hydro undertook a substantial expansion of its nuclear facilities in the 1980s and early 1990s. With the recession of the 1990s, demand growth did not materialise and Ontario Hydro found itself with significant excess capacity. The cost pressure resulting from large expenditures on nuclear facilities pushed Ontario Hydro's power rates up by almost 40 per cent between 1990 and 1994³ and customers experienced annual rate increases ranging from 8 to 12 per cent. In 1993, the corporation incurred a net loss, after restructuring charges, of over C\$3.6 billion, the largest corporate loss in Canadian history. Ontario Hydro's debt also climbed dramatically.⁴

The Macdonald Commission and Bill 35

In November 1995, in response to increasing political pressure, the Conservative provincial government created the Advisory Committee on Competition in Ontario's Electricity System, otherwise known as the Macdonald Commission, to consider sector reform. Less than a year later in May 1996, the Macdonald Commission recommended the break-up of Ontario Hydro and creation of a competitive wholesale market.⁵

The Macdonald Commission report led to the promulgation in 1998 of Bill 35, the Energy Competition Act.⁶ The Energy Competition Act broke up Ontario Hydro into five organisations that closely tracked its major functions:

- the Independent Market Operator (later renamed the Independent Electricity System Operator (IESO)) to maintain reliability of the provincial transmission grid and administer the new wholesale power market;
- Ontario Hydro Services Company (later renamed Hydro One Inc) to own and operate the provincial transmission grid (and some distribution);
- Ontario Power Generation (OPG) to own and operate Ontario Hydro's former generation assets;
- Electrical Safety Authority to control the safety of electricity products sold in Ontario; and
- Ontario Electricity Financial Corporation, to assume Ontario Hydro's debt and general financial obligations.⁷

Notably, the government rejected the Macdonald Commission's recommendation to eliminate Ontario Hydro's market power in generation by breaking it up into a number of competing entities. Instead the government directed the Ontario Energy Board (OEB) to include conditions in OPG's licence that required it reduce its ownership and control of generation within 10 years to 35 per cent of provincial generation capacity. In the

3 Donald MacDonald, 'A Framework for Competition: The Report of the Advisory Committee on Competition in Ontario's Electricity System to the Ontario Minister of Environment and Energy' (Toronto: Queen's Printer, 1996), p. 28. (the MacDonald Commission Report).

4 R.J. Daniels and M.J. Trebilcock, 'The Future of Ontario Hydro: A Review of Structural and Regulatory Options', in R.J. Daniels, ed., *Ontario Hydro at the Millennium: Has Monopoly's Moment Passed?* (Montreal: McGill-Queen's University Press, 1996), pp. 4,6.

5 MacDonald Commission Report, p. viii (Summary of Recommendations).

6 S.O. 1998, Chapter 15.

7 Being Schedule A of the Energy Competition Act, 1998, S.O. 1998, Chapter 15.

interim, OPG's wholesale trading activities were subject to a market power mitigation rebate mechanism under which OPG was required to rebate that portion of its wholesale market revenues that exceeded a prescribed weighted average price. As things turned out, OPG did not divest its generation assets and in 2005, through the Electricity Restructuring Act 2004 and subsequent regulations, the market power mitigation mechanism was effectively replaced with OEB rate regulation under which the OEB sets 'payment amounts' (i.e., rates) for almost all of OPG's generation.

Another notable feature of Ontario's wholesale market design was that it did not – again contrary to recommendations by many experts and advisers – include locational pricing. Instead, the wholesale market includes a two-schedule system whereby offers and bids are initially scheduled in order of economic merit and a uniform market clearing price is determined, as if the transmission system is free of constraints; but, for purposes of dispatch, the system generates a second schedule that constrains-off or constrains-on bids or offers based on transmission limitations. Market participants who are constrained on or off are then entitled to congestion management settlement credit (CMSC) payments to compensate them for the difference between their offer and bid price and the market clearing price in respect of the quantity of bids or offers that are constrained. The costs of CMSC payments are socialised through uplift charges. The Ontario Market Design Committee had recommended the two-schedule system, including CMSC, as an interim measure pending the introduction of locational pricing.⁸ However, as with many market design features that were intended as transitional – maintenance by OPG of its generation fleet being another – the transitional has thus far proved permanent.

Market opening

After a number of unanticipated delays, Ontario's competitive electricity market opened on 1 May 2002. Ironically – in a development that paralleled the cost increases that were the impetus for competitive restructuring of the sector – market opening was a victim to bad timing. Nuclear units on outage were late in returning to service and the summer of 2002 was one of the hottest on record, creating unanticipated spikes in demand and skyrocketing electricity rates. The government responded with rate freezes and price ceilings in December 2002,⁹ which had a chilling effect on the private investment needed to address Ontario's generation shortage.¹⁰ Ontario's generation shortage and the government's precipitous decision to cap retail prices proved to be both a signal and a catalyst for the end of the merchant market and the inception of a new electricity sector model, the 'hybrid market'.

The hybrid market

In 2005, Ontario was faced with a looming supply shortage. At the same time, the capping of retail prices coupled with the lack of a capacity market and other structural issues,

8 Ronald Daniels, 'Final Report of the Market Design Committee: To the Honourable Jim Wilson, Minister of Energy, Science and Technology' (Toronto: Queen's Printer, 1999), part. 2-5.

9 Electricity Pricing, Conservation and Supply Act 2002, S.O. 2002, Chapter 23.

10 Michael J. Trebilcock and Roy Hrab, 'What will Keep the Lights on in Ontario: Responses to a Policy Short-Circuit', (C.D. Howe, Toronto 2003), p. 14.

depressed merchant generation investment. Faced with this predicament, the government created a new agency, the Ontario Power Authority (OPA), again ostensibly as an interim measure, to procure needed generation; but again the temporary became more permanent. While the OPA merged with the IESO in 2015, the IESO retains all of the former OPA's procurement powers and government-sponsored procurement currently remains central to developing new generation in Ontario, although the IESO is currently developing new market mechanisms, including a capacity market.¹¹

Since 2005, the OPA/IESO has procured over 39,000MW¹² of gas-fired generation, refurbished nuclear generation and, pursuant to the Green Energy and Economy Act and its Feed-in Tariff Program, various forms of renewable generation. While the IESO wholesale market remains, almost all generation is contracted and largely insulated from the wholesale market price through out of market contract payments. The terms of procurement contracts vary, but most provide for a form of contractual top-up payment where monthly IESO wholesale market revenues earned by generators based on the hourly Ontario energy price (HOEP) are less than the contract revenues payable based on the contract price. These out-of-market contract payments are collected from Ontario ratepayers as a 'global adjustment' charge. As the World Trade Organization stated in a 2012 decision relating to Ontario's feed-in tariff programme:

It follows from the above that the price offers attached to a generator's supply bids in the IESO-administered wholesale market are not motivated by the need to cover marginal costs of production (as would typically be the case in a competitive wholesale electricity market such as that which existed in Ontario in 2002), but rather by the need for each generator to be chosen to supply electricity into the Ontario grid in order to receive its contracted or regulated prices.

[. . .]

. . . the IESO-administered wholesale market clearing mechanism is perhaps best characterized as a tool for the IESO to make the dispatch decisions needed to balance physical supply and demand for electricity.¹³

Government procurement of generation and rate regulation of OPG generation, has invariably impacted market participant bid or offer behaviour, although not always in clearly discernible ways. The complexity and differences among procurement contracts and the various market programmes and forms of revenue that characterise Ontario's hybrid market (e.g., CMSC payments, various forms of generator standby and revenue sufficiency

11 It should be noted that the IESO, as part of its current Market Renewal programme and other market initiatives, is seeking to develop new market mechanisms to attract necessary resources, including capacity, storage and other demand management resources. See, for example, the IESO's summary on Generation Procurement at: IESO Generation Procurement (2016), online: <http://www.ieso.ca/Pages/Participate/Generation-Procurement/default.aspx>, and its call for stakeholder engagement on Market Renewal at: Market Renewal-Stakeholder Engagement, online: <http://www.ieso.ca/Documents/consult/ME/ME-20160321-Draft-Stakeholder-Engagement-Plan.pdf>.

12 Ministry of Energy, Planning Ontario's Energy Future: A Discussion Guide to Start the Conversation (Toronto: Ministry of Energy, 2016), pp. 8-9.

13 World Trade Organization, Canada – Certain Measures Affecting the Renewable Energy Generation Sector, Canada – Measures Relating to the Feed-In Tariff Program, Reports of the Panels (19 December 2012), p. 126.

guarantee payments, etc.) can sometimes make determining the reasons and motivations for bid or offer behaviour difficult to assess. This of course has implications for market monitoring and compliance and enforcement.

Compliance and enforcement

It is against this complex and unique backdrop that Ontario's compliance and enforcement regimes have evolved.

Broadly, the key agencies with authority over monitoring, compliance and enforcement are the IESO, the OEB and the Market Surveillance Panel (MSP). The latter was at the time of market opening a panel of the IESO. In 2004, pursuant to the Electricity Restructuring Act, the MSP was made a panel of the OEB,¹⁴ although, the MSP continues to be supported by IESO employees.¹⁵

Also, while the Competition Bureau formally has authority to prosecute unlawful conduct falling within the purview of the Competition Act, in 2002 the Competition Bureau, the OEB and the IESO entered into a memorandum of understanding under which the Competition Bureau agreed that where there was overlap between the jurisdiction of the Bureau, the OEB and the IESO in respect of anticompetitive behaviour, the Bureau's policy would be to defer to the OEB and the IESO in taking enforcement action.¹⁶ The memorandum of understanding has remained in place since 2002 and the Bureau has deferred to the IESO, OEB and MSP. Each of these bodies and their investigation, compliance and enforcement mandates are described below.

The OEB

The OEB is the principal regulator of the Ontario gas and electricity sectors. The OEB is a quasi-judicial tribunal and is supported by professional staff.

The OEB was initially authorised to set rates for the sale and storage of gas and to make orders granting leave to construct pipelines for the transmission of oil or gas. The mandate of the OEB expanded with the passage of the Energy Competition Act 1998, which gave the OEB broad new powers over the electricity sector. The OEB's objectives in regard to electricity include:

- to protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service;
- to promote economic efficiency and cost-effectiveness in the generation, transmission, distribution, sale and demand management of electricity and to facilitate the maintenance of a financially viable electricity industry; and

14 S.O. 2004, Chapter 23.

15 Ontario Energy Board Act, 1998 (being Schedule B of the Energy Competition Act, 1998, S.O. 1998, Chapter 15), Section 4.3.1(5). (the OEB Act).

16 Joint Statement of Competition Bureau, Independent Electricity Market Operator and Ontario Energy Board, Competitive Oversight of the Ontario Electricity Market, at Anticompetitive Practices – Overview. This joint statement provides that the Competition Bureau will not enforce the Competition Act with respect to practices that are subject to enforcement action by either the IESO or the OEB.

- to promote electricity conservation and demand management in a manner consistent with the policies of the government of Ontario, including having regard to the consumer's economic circumstances.¹⁷

The OEB's core responsibility is to set the rates for Ontario's regulated electric utilities. This includes Ontario's transmitters (principally Hydro One) and Ontario's numerous electricity distribution companies. The OEB also approves the fees and charges levied by the IESO (and previously, the OPA); and, as noted above, since 2005, the OEB has been responsible for setting 'payment amounts' (i.e., rates) for almost all of OPG's generation facilities.¹⁸ The OEB's responsibilities also include licensing sector participants, hearing applications for leave to construct transmission and distribution facilities and considering and approving utility amalgamations and other changes in ownership and control of regulated entities. The OEB also has an important role in developing electricity policy through codes, rules and other regulatory instruments.

With regard to compliance and enforcement, the OEB monitors, investigates and enforces compliance by licensed entities with their statutory and regulatory obligations and licence conditions. The OEB Act equips the board with broad inspection and investigation powers to monitor compliance and to investigate potential breaches of statutory or regulatory and licence conditions. These include powers to compel disclosure of documents, undertake searches and seize evidence. The Act also grants the board significant sanctioning powers, including the power to suspend or revoke licences and to impose administrative financial penalties.¹⁹ Notably, while the board's compliance and enforcement powers are broad, the board itself has exercised little oversight of the wholesale market. The OEB has focused its compliance and enforcement resources on the electricity and gas retail sectors and general.²⁰

The OEB may also hear appeals from decisions by the IESO, including appeals concerning compliance and enforcement matters. Moreover, and as further discussed below, as part of the IESO's recent adoption of the General Conduct Rule, the OEB may adjudicate IESO prosecutions for market manipulation and other anticompetitive behaviour.²¹

The MSP

The MSP monitors, investigates and reports on IESO market design and structural issues and on activities and behaviour of market participants. The MSP records its findings and recommendations in semi-annual reports published by the OEB.²² The MSP's recommendations often include broad proposals for remedying market design flaws and inefficiencies

17 OEB Act, Section 1(1); What We Do, online: <http://www.ontarioenergyboard.ca/OEB/Industry/About+the+OEB/What+We+Do>.

18 OEB Act, Section 78.1(2).

19 OEB Act, Section 112.5(1).

20 Ontario Energy Board, Compliance and Enforcement Policy and Process, online: <http://www.ontarioenergyboard.ca/oeb/Industry/Rules%20and%20Requirements/Compliance%20and%20Enforcement/Compliance%20Process>.

21 Independent Electricity System Operator, Market Rules for the Ontario Electricity Market, (the Market Rules), Chapter 1, Section 10A.

22 Ontario Energy Board By-Law 3 (OEB By-Law 3).

and curbing inappropriate or anomalous behaviour; the MSP's reports may also address investigations and findings with regard to specific market participants.²³ As noted, while originally an IESO body, the MSP was transferred to the OEB pursuant to the Electricity Restructuring Act of 2004.²⁴ The MSP is supported by the Market Assessment Unit (MAU), which is staffed by IESO employees, and the responsibilities of the MAU are detailed in a protocol between the IESO and OEB dated 25 April 2013.²⁵ The mandate of the MSP is specifically outlined in the OEB By-Law as:

4.1.1 The Panel shall monitor, evaluate and analyze activities related to the IESO-administered markets and the conduct of market participants with a view to:

- *identifying inappropriate or anomalous market conduct by a market participant, including unilateral or interdependent behaviour resulting in gaming or in abuses or possible abuses of market power;*
- *identifying activities of the IESO that may have an impact on market efficiencies or effective competition;*
- *identifying actual or potential design or other flaws and inefficiencies in the Market Rules and in the rules and procedures of the IESO;*
- *identifying actual or potential design or other flaws in the overall structure of the IESO-administered markets and assessing whether any one or more specific aspects of the underlying structure of the IESO-administered markets is consistent with the efficient and fair operation of a competitive market; and*
- *recommending remedial actions to mitigate the conduct, flaws and inefficiencies referred to in paragraphs (a) to (d).*²⁶

The MAU and MSP have access to confidential IESO operating data and market participant information, specifically a sophisticated surveillance data repository, which it uses to monitor activities and market participant conduct. The data includes specific confidential information that market participants are required to provide to the MAU specifically for the purpose of market monitoring.²⁷

The MSP may commence an investigation on its own initiative, at the request of the OEB or by request or report from another party.²⁸ Any party investigated by the MSP must be notified of the commencement of the investigation, unless this could prejudice the investigation, and an investigated participant has the right to respond and have its views addressed prior to the MSP making an adverse finding.²⁹

²³ OEB By-Law 3, Article 5.

²⁴ Electricity Act, 1998, S.O. 1998, Chapter 15, Schedule A (the Electricity Act).

²⁵ Independent Electricity System Operator and Ontario Energy Board, Protocol Relating to Market Surveillance Panel (25 April 2005).

²⁶ OEB By-Law 3, Article 3 (4.1.1.).

²⁷ Independent Electricity Market Operator, Market Manual 2: Market Administration: Part 2.5: Maintaining Surveillance Data and Amending the Data Catalogue (25 September 2002), at 1.3.2. (the Market Manual 2.5); Market Rules, Chapter 3, Section 3.3.5A.

²⁸ OEB By-Law 3, Article 5 (5.1.1-5.1.3).

²⁹ OEB By-Law 3, Section 5.1.9, 7.2.2.

Where the MSP requires additional information prior to conducting an investigation, it may request such information from market participants. Where a formal investigation has been commenced, however, the MSP has broad investigatory powers that allow it to issue subpoenas for document production, compel testimony, inspect physical locations and directly request search and seizure warrants from a court.³⁰

The MSP has addressed market manipulation and gaming, within the context of its mandate, to identify inappropriate or anomalous conduct, in several investigations. It has articulated its investigative focus as one of ascertaining whether gaming has taken place. In October 2009 the MSP issued a guidance report on monitoring offers and bids, which focused on how it intended to identify and analyse possible exercises of market power. In this document, it identified gaming as distinct from an exercise of market power, describing it as conduct where a market participant exploits a market defect for its benefit and to the disadvantage of the market. The MSP further noted that gaming could include fraud, deceit or manipulation of market prices or uplift payments.³¹ The MSP subsequently undertook two ‘gaming investigations’ in which it proposed the following analytical framework:

Framework for a gaming investigation – The Panel’s mandate includes investigations in relation to conduct that may constitute an abuse of market power or gaming. In the course of providing a framework for analyzing market power issues, the Panel has noted that gaming is a separate concept (which may or may not overlap with market power concerns) that encompasses, among others, market manipulation and conduct that involves the following four elements:

- *a defect in the market design, poorly specified rules or procedures or a gap in the Market Rules or procedures (collectively referred to as a Market Defect);*
- *exploitation of the Market Defect by the market participant;*
- *profit or other benefit to the market participant; and,*
- *expense or disadvantage to the market.*³²

Since 2009, the MSP has undertaken and publicly reported on two other gaming investigations.³³

It is notable that while the MSP has extremely broad and substantial monitoring and investigatory powers, including as noted subpoena and search and seizure authority, the MSP has no sanctioning authority. Its remedial powers are principally limited to making recommendations to the OEB, IESO and government – although the OEB or IESO may take enforcement or other remedial action based on MSP reports or recommendations.

The MSP’s semi-annual monitoring reports have also resulted in significant market rule changes aimed at rectifying market design flaws and inefficiencies and stemming inappropriate market conduct and behaviour. The MSP has also identified inappropriate conduct

30 OEB By-Law 3, Article 5 (5.1.1-1); Section 37 of the Electricity Act 1998.

31 Neil Campbell, ‘Gaming of Electricity Markets – The Ontario Experience’ (2014) *Energy Regulation Quarterly*.

32 Market Surveillance Panel, Report on an Investigation into Possible Gaming Behaviour Related to Congestion Management Settlement Credit Payments by Abitibi–Consolidated Company of Canada and Bowater Canadian Forest Products Inc. (Investigation No. 2010-2 February 2015), pp. 27-28.

33 Ontario Energy Board, Market Surveillance Panel Reports, online: <http://www.ontarioenergyboard.ca/oeb/Industry/About+the+OEB/Electricity+Market+Surveillance/Market+Surveillance+Panel+Reports>.

and behaviour by market participants that triggered enforcement actions by the IESO's Market Assessment and Compliance Division for related market rule breaches. In some cases, these enforcement actions resulted in remedial orders, including repayments to the market and financial penalties.

This all being said, the MSP's broad powers to investigate inappropriate market behaviour, including market manipulation and gaming, but its lack of any corresponding sanctioning authority – coupled with the IESO's broad sanctioning authority, but lack of market rules clearly proscribing market manipulation and gaming – contributed to the perception of a gap in Ontario's enforcement regime. This perceived gap was a factor in the development of the IESO's General Conduct Rule, which is addressed in further detail below.

The IESO and the Market Assessment and Compliance Division

The IESO is a non-profit corporation that is mandated by the Electricity Act to maintain the reliability of Ontario's bulk electricity system and to administer the IESO markets. Since its amalgamation with the OPA in 2015, the IESO has also been charged with planning for the province's medium and long-term energy needs and, as directed by government, procuring electricity supply to meet those needs. The IESO draws its authority from the Electricity Act and the Market Rules for the Ontario Electricity Market (the Market Rules); the Electricity Act gives the IESO broad authority to make market rules relating to reliability and administration of the IESO's wholesale electricity markets,³⁴ and impose financial penalties on market participants for breach of the Market Rules.³⁵

The balance of this chapter will focus on the IESO's compliance and enforcement powers and how it has addressed proscribed market conduct, including market manipulation, in the IESO markets.

The Market Assessment and Compliance Division

The IESO discharges its compliance and enforcement responsibilities through its Market Assessment and Compliance Division (MACD), which pursuant to the Market Rules monitors the operation of the market and compliance with applicable reliability standards. MACD does this through prevention, monitoring, auditing, investigation and enforcement activities. The IESO's authority to enforce compliance with the Market Rules was delegated by the IESO's CEO to the director of MACD. The IESO's authority to monitor, investigate and enforce compliance with the Market Rules is codified in Chapter 3 of the IESO Market Rules.³⁶ Notably MACD is authorised to investigate and enforce compliance by not only market participants, but also by the IESO, which is bound by the Market Rules and its OEB licence to comply with the Market Rules.

There has been some criticism by market participants and other observers concerning the perceived conflict and lack of independence arising from MACD being a part of the IESO. MACD, while formally a division of the IESO, operates as a ring-fenced group within the IESO. It operates out of separate office space, has its own dedicated staff and is

³⁴ Electricity Act, Section 32(1).

³⁵ Electricity Act, Section 32(2)(e)(i).

³⁶ Market Rules, Chapter 3, Section 6.2, 6.6.

functionally separated from the IESO's general business operations.³⁷ MACD has on several occasions taken enforcement action against the IESO, including financially sanctioning the IESO in 2014 relating to the IESO's failure to comply with North American Electric Reliability Corporation (NERC) standards.³⁸

MACD monitoring and investigation

MACD, like the MSP, has access to confidential operational data and sophisticated monitoring tools that it uses to identify market conduct that may constitute market rule breaches. Potential breaches are also brought to MACD's attention through reports from other IESO business units and by third parties, including market participants and the MSP. Where MACD is made aware of a potential breach of the Market Rules, it performs an initial assessment. To that end, MACD may issue requests for information to market participants.³⁹

Where MACD believes that a sanctionable breach of the Market Rules may have occurred, MACD issues a notice of alleged breach. This notice, which is addressed to the market participant who has allegedly committed the breach, outlines the details of the alleged breach; details of the evidence upon which MACD has relied to this stage of its review; details of potential sanctions that may be imposed; and right of the market participant to request a meeting with MACD to discuss the alleged breach within an acceptable time frame.⁴⁰

Following the issuance of a notice of alleged breach, MACD investigates the alleged breach – which may include requesting that the market participant provide further information in relation to the alleged breach.⁴¹

Following its investigation and consideration of any representations by the market participant, where MACD determines that the market participant has breached the Market Rules, it may order that the participant take steps necessary to comply, undertake additional or more stringent record-keeping, or issue a notice of non-compliance and the imposition of a financial penalty.⁴²

MACD financial penalties

The Market Rules provide for penalties for ordinary breaches in bands ranging up to C\$10,000. The rules prescribe factors that MACD is to consider in fixing penalty amounts within these bands. These factors include: the severity of the breach; the extent to which the breach was inadvertent, negligent or deliberate; the length of time the breach remained unresolved; the actions of the market participant on becoming aware of the breach and whether the market participant voluntarily disclosed the breach; and the actual or potential

37 Independent Electricity System Operator, Market Manual 2: Market Administration: Part 2.6: Treatment of Compliance Issues (6 March 2013), at 1.3.1. (the Market Manual 2.6).

38 Market Assessment and Compliance Division, Enforcement Sanctions, 2014, online: <http://www.ieso.ca/en/sector-participants/market-oversight/rule-compliance/compliance-enforcement/sanctions>.

39 Market Manual 2.6, at 1.3.2.

40 Market Manual 2.6, at 1.3.3; Market Rules, Ch. 3, Section 6.2.3.

41 Market Rules, Chapter 3, Section 6.2.4.

42 Market Rules, Chapter 3, Section 6.2.7.

impact of the breach on other market participants, the IESO markets or the reliability of the power system.⁴³

MACD may impose larger penalties of up to C\$1 million per occurrence in extraordinary circumstances, including where the IESO board determines that the impact of the breach on the IESO markets or the reliability of the power system is particularly severe, or where MACD determines that the rate of recurrence of noncompliance with the Market Rules by the participant is of such frequency or duration as to warrant a higher financial penalty.⁴⁴ In fixing financial penalties, MACD may consider the severity of the breach and harm to the market or market participants; MACD's authority to fully redress harm is formally limited by the penalty cap of C\$1 million per occurrence;⁴⁵ however, MACD has, as part of several recent enforcement actions, obtained voluntary disgorgement of ill-gotten gains (as well as imposed financial penalties). In some recent cases, disgorgement or penalties have ranged as high as C\$10 million, which is substantially higher than past enforcement results.

Lastly, the Market Rules authorise the IESO to issue suspension, termination or disconnection orders for persistent breaches of the rules (as well as unremedied events of default – e.g., failure to make payment in full, failure to provide required prudential support, insolvency events, etc.).⁴⁶

The dispute resolution process

In the case of all market rules with the exception of the General Conduct Rule, MACD may, subject to providing a participant with notice and the opportunity to respond to an alleged breach and a proposed penalty assessment, make a finding of non-compliance and impose a sanction, including imposing financial penalties of up to C\$1 million per occurrence.⁴⁷ This aspect of the IESO's enforcement regime has been criticised by some market participants and observers who argue that it improperly has MACD exercising investigative and adjudicative functions and raises issues of procedural fairness. As explained below, this was in part the impetus for the adoption of different processes for the General Conduct Rule.

Market participants who are found to be in breach and sanctioned by MACD may avail themselves of the IESO's dispute resolution process and, where they do, any financial sanction is stayed pending the outcome of the dispute resolution process.⁴⁸ The dispute resolution process – which applies to most other market rule disputes – includes good faith negotiations, mediation and, if necessary, arbitration. Arbitration is governed by the Arbitration Act, subject to certain overriding provisions of the Market Rules, and arbitral awards are final and binding on market participants, unless they result in financial penalties

43 Market Rules, Chapter 3, Section 6.6.7.

44 Market Rules, Chapter 3, Section 6.2.6A.

45 Market Rules, Chapter 3, Section 6.6.6A.

46 Market Rules, Chapter 3, Section 6.4.1.

47 The one other exception to this is the IESO's authority to order suspension, termination or disconnection orders which is subject to the market participant's right to request a hearing before a panel of the IESO board of directors: Market Rules, Chapter 3, Section 6.2A.2.4.

48 Market Rules, Chapter 3, Section 6.2.3.3.

in excess of C\$10,000 or termination, suspension or disconnection orders, in which case there is a right of appeal to the OEB.⁴⁹

MACD historical sanctions

The available data indicates that over the last 14 years, MACD has issued approximately 330 financial penalties against market participants, totalling an aggregate amount in the tens of millions of dollars. These sanctions have ranged in size from C\$500 to C\$10 million, although the vast majority of penalties are less than C\$100,000, with most in the C\$2,000 to C\$20,000 range.⁵⁰

Historically, most MACD sanctions have related to technical matters such as reliability standards infractions, metering issues and failures to comply and with dispatch instructions. The reported data indicates there have been relatively few enforcement actions taken for breaches relating to market manipulation, gaming, abuse of market power or other such conduct. As explained herein, this may in part due to the nature of the Ontario hybrid market and the absence until recently of Market Rules proscribing such conduct. Until recently, MACD has only been able to take enforcement action for conduct that concerns manipulation, gaming or other such behaviour where the impugned conduct also violates other specific Market Rules. For instance, on 22 August 2016, pursuant to a settlement agreement between the parties, a non-compliance letter was issued to a market participant for breach of a number of Market Rules associated with bidding and dispatch. As part of the settlement, the participant made repayment to the IESO of C\$8.75 million, in addition to approximately C\$1.8 million already repaid. The market participant also committed to developing and implementing an internal compliance programme to help ensure against future breach of the Market Rules. Notably, the enforcement action taken in this case followed an MSP gaming investigation and report that detailed much of the conduct which was the subject of MACD's enforcement action.⁵¹ This case predated the IESO's adoption of the General Conduct Rule (discussed below) and the market participant's conduct, in addition to constituting gaming, also raised potential violations of a number of Market Rules, which provided authority to take compliance and enforcement action.

Another settlement in late 2015 included the imposition of a significant financial penalty, in addition to issuance of a non-compliance letter and a repayment. On 15 December 2015 MACD entered into a settlement with a generator market participant regarding cost submissions made under generation cost guarantee programmes that were found to have resulted in C\$12 million in overpayments to the generator over approximately four years. Pursuant to the settlement, MACD determined that the participant had breached its obligation to provide true, correct and complete information. It was also determined that the participant failed to exercise sufficient due diligence regarding its cost submissions, and thus failed in its obligation to correct the flawed information as quickly as it could and ought to have done. The generator agreed to repay approximately C\$100 million

49 Market Rules, Chapter 3, Section 2.2.4.

50 Independent Electricity System Operator, Compliance Enforcement – Sanctions, online: <http://www.ieso.ca/en/sector-participants/market-oversight/rule-compliance/compliance-enforcement/sanctions>.

51 Independent Electricity System Operator, Compliance Enforcement – Sanctions, online: <http://www.ieso.ca/en/sector-participants/market-oversight/rule-compliance/compliance-enforcement/sanctions>.

in overpayments and to pay a financial penalty of C\$10 million. The unprecedented magnitude of the financial penalty reflects the seriousness of the rule breaches.⁵²

In a more recent matter resolved by way of negotiated settlement in 2017, MACD terminated an investigation in return for a payment of C\$9.6 million by the market participant. The investigation alleged violations of specific energy offer rules, as well as alleging that the offers were ‘misleading’ and in violation of a general information provisions under Chapter 1 of the Market Rules. The market participant was also alleged to have not answered all questions as part of the investigation. These three matters settled in the 2015–2017 time frame resulted in settlements substantially in excess of those obtained in earlier MACD enforcement proceedings and they reflect the serious treatment MACD accords to matters concerning market manipulation.

It may be noted that while MACD’s enforcement action and recoveries in the aforementioned three cases predated the General Conduct Rule, and thereby required MACD to link any enforcement action to breaches of specific Market Rules, two of these cases implicated the information requirements prescribed by the Market Rules. These requirements are broad and, among other things, prohibit market participants from providing misleading or deceptive information and obligate market participants, where they become aware that information previously provided is incorrect, incomplete or misleading, to correct such information. These information requirements even following the adoption of the General Conduct Rule, provides MACD with a powerful tool to take enforcement action against participants who have engaged in deliberate, fraudulent or deceptive practices.

The General Conduct Rule: A Hybrid Rule For A Hybrid Market

In many ways the development of the General Conduct Rule (GCR) reveals and reflects the unique nature of the Ontario electricity market and the challenges in regulating it. The GCR was initially conceived and proposed as a more conventional analogue to FERC’s Prohibition of Energy Market Manipulation Regulation and Alberta’s Fair, Efficient and Open Competition Regulation (FEOC Regulation), the latter which is premised on the positive obligation imposed on market participants under Section 6 of the Electric Utilities Act to ‘conduct themselves in a manner that supports the fair, efficient and openly competitive operation of the market’.⁵³ However, through an extensive stakeholdering and market rule amendment process, the initial concept was substantially modified and was ultimately tailored to address the peculiarities of Ontario’s electricity market – in many ways what emerged was a ‘hybrid rule’ specially designed for Ontario’s ‘hybrid market’.

The IESO initially proposed the GCR as a positive obligation on participants to support and act in accordance with the IESO’s competitive wholesale market and as an enforcement mechanism for addressing the sort of behaviour – market manipulation, circumvention, exploitation and anticompetitive conduct – that the MSP has authority to monitor, investigate and report on, but not sanction. The IESO argued that given the complexity of electricity markets and the inability to specifically codify and proscribe all manner of unlawful conduct, it was necessary to enact a principle-based general conduct

52 Independent Electricity System Operator, Compliance Enforcement – Sanctions, online: <http://www.ieso.ca/en/sector-participants/market-oversight/rule-compliance/compliance-enforcement/sanctions>.

53 Electric Utilities Act, SA 2003, Chapter E-5.1, Section 6.

rule. The IESO premised the GCR on conduct rules in other contexts – i.e., the General Anti-Avoidance Rule under the Canadian Income Tax Act⁵⁴ – as well as general behavioural rules employed by other energy regulators, specifically, FERC and Alberta Utility Commission regulations noted above.

In the course of the IESO stakeholdering and market rule amendment process, market participants raised the unorthodox nature of Ontario's market and MACD's enforcement regime as grounds for opposing the GCR, as proposed. In particular, market participants argued the following.

- Complexity of the Ontario market: the IESO's real-time market, unlike other North American wholesale electricity markets, was a relatively insignificant driver of market behaviour as compared to the multiplicity of other regulatory and policy instruments, notably IESO power purchase agreements and OEB rate regulation. Market participants therefore argued that it was inappropriate to impose a positive obligation on them to conduct themselves in a manner that supported the competitiveness and efficiency of the IESO market and to thereby proscribe market participant behaviour aimed at maximising revenue under the various other non-market incentives.
- Adjudicative framework: market participants argued that conduct rules that centre on allegations of deliberate or fraudulent behaviour should not be prosecuted and adjudicated pursuant to the current Market Rules framework whereby MACD investigates, charges and makes determinations of breach without having to satisfy an independent adjudicator. Market participants contended that the Market Rules dispute resolution process, which was more geared towards commercial arbitration-type disputes, was inappropriate for prosecution and adjudication of serious conduct violations.
- Jurisdiction: some market participants, as part of recommending that general conduct rule violations be brought within the purview of the OEB, went so far as to argue that the IESO's authority under the Electricity Act to make rules governing the IESO grid and markets did not give the IESO authority to make and enforce general conduct rules, which they argued only the OEB had jurisdiction over.
- Clarification of proscribed conduct: market participants argued that while general conduct rules are necessarily less prescriptive than other rules, the IESO needed to clarify what behaviour would be non-compliant with such a rule and which outcomes the rule was specifically intended to prohibit, e.g., manipulating prices, artificially causing congestion, etc. Market participants argued that violations should only be caught by the rule where the behaviour was both unlawful and led to a prohibited outcome.

The IESO ultimately agreed with much of the input from market participants. The IESO did not agree that only conduct that caused prohibited outcomes would attract liability; although the impact of a breach of the GCR, as with all other market rule breaches, remains a relevant factor for determining the appropriate sanction. The IESO also rejected the argument of some participants that the IESO did not have the jurisdiction to regulate conduct, general or specific, and that all authority for adjudicating GCR breaches should be transferred to the OEB. On the other hand, the IESO accepted that for purposes of prosecuting serious allegations of deliberate misconduct, such as gaming and manipulation,

54 Income Tax Act, RSC 1985, Chapter 1 (5th Supp), Section 245.

that participants ought to be able to elect to have the matter adjudicated by the OEB, in which case MACD would have the evidentiary burden of establishing a breach before a panel of the OEB. Alternatively, the GCR still allows market participants to opt to contest the alleged breach through the current Market Rules dispute resolution procedure. In cases where the OEB determines that there has been a breach of the GCR, the matter is then returned to MACD for the fixing of a financial penalty.

The IESO also removed from the rule any positive obligation to support the IESO market and revised the GCR as a negative prohibition on conduct aimed at undermining, manipulating, interfering with or exploiting the market. The rule, as adopted, states:

10A.1 Market participants and the IESO shall not directly or indirectly engage or attempt to engage in conduct, alone or with another person, that they know, or ought reasonably to know:

10A.1.1 exploits the IESO-administered markets, including by, without limitation, exploiting any gap or defect in the market rules;

10A.1.2 circumvents any of the market rules;

10A.1.3 manipulates any of the IESO-administered markets, including by, without limitation, manipulating the determination of a settlement amount;

10A.1.4 undermines through any means the ability of the IESO to carry out its powers, duties or functions under the Electricity Act, 1998 or the market rules; or

10A.1.5 interferes with the determination of a market price or dispatch outcome by competitive market forces.

The construction of the GCR accordingly recognises the realities of Ontario's hybrid market in a manner that distinguishes it from more conventional market-driven rules, such as Alberta's FEOC regulation. In this regard, it addresses both traditional anticompetitive market conduct as well as out-of-market conduct. With respect to the latter, the rule acknowledges defences that would be available to participants based on out-of-market incentives. Specifically, the rule notes that market participants will not be found to have violated the GCR where they demonstrate that their conduct was entirely or predominately caused by a procurement contract with the IESO or an OEB rate order.⁵⁵

While the GCR is in its infancy and has not yet been vigorously tested, the substantial work undertaken by MACD in developing the rule, with important contributions from market participants and other stakeholders, has produced an enforcement mechanism that addresses a significant gap in Ontario's compliance and enforcement regime, yet does so in a manner that fairly takes into account the unique structure of Ontario's market.

55 Market Rules, Chapter 1, Section 10A.2.

Appendix 4

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Glenn is a partner in the energy and litigation sections in Stikeman Elliott's Toronto office and is co-chair of the firm's energy group. He regularly acts as counsel in complex court proceedings and before various regulatory tribunals, including the Ontario Energy Board and the National Energy Board. Glenn also frequently represents clients in review and appeal proceedings before the Ontario Divisional Court, Court of Appeal and Supreme Court of Canada. Glenn is co-author of *Energy Regulation in Ontario*, a leading Ontario text on energy regulatory law. He was recently recognised as Benchmark Litigation's 2016 Energy/Resources Litigator of the Year for Canada and has been recognised in other publications including *Chambers Global* and *Chambers Canada* guides as a Leading/Band 1 ranked lawyer in Energy: Power (Regulatory), *The Legal 500 Canada* as Leading Individual in Energy: Power, *The Best Lawyers in Canada* for energy regulatory law; Legal Media Group's *Guide to the World's Leading Energy Lawyers* and *Chambers Global: The World's Leading Lawyers for Business* as a recommended lawyer in energy: power (regulatory).

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The Guide to Energy Market Manipulation is a survey of the law on market manipulation in the energy sector across nations that reflects the collective wisdom and real-life experiences of 30 distinguished practitioners from 18 different organisations.

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ISBN 978-1-78915-092-6