

## Corporate Risk Management

### Middle Office Compliance Report

#### Related Merchant Transactions

Three Month Period January - March 2008

#### Related merchant transactions - Management Control Plan<sup>1</sup>

*Resale of power purchased from third parties and which either flows over transmission owned or reserved by/for Manitoba Hydro or was purchased for Manitoba Hydro system requirements and has subsequently been deemed surplus.*

	JANUARY		FEBRUARY		MARCH	
Number Deals	324		358		395	
Duration	1 Day		1 Day		1 Day	
	Total MWh	Total Settlement	Total MWh	Total Settlement	Total MWh	Total Settlement
<b>CDN Market</b>						
Purchases <sup>2</sup>	80,586	\$3,873,155	100,218	\$5,390,083	149,369	8,846,344
Sales	80,586	\$5,080,057	100,218	\$7,142,846	149,349	10,660,052
Total Trading Gains/(Losses) <sup>3</sup>		\$1,206,903		\$1,752,763	(20)	1,813,708
Profit Share to Third Party						
<b>Other<sup>4</sup></b>						
Purchases	10,083	407,793	6,180	265,205	4,863	248,204
Sales	10,083	324,167	6,180	252,153	4,863	189,167
Total Trading Gains/(Losses)						
Profit Share to Third Party						
% Total Deals with Losses	13.3%		8.7%		9.9%	
Transaction Limits	Compliant		Compliant		Compliant	
Approval Authority	pending		pending		pending	

<sup>1</sup> Approved by the Board of Directors November 22, 2007

<sup>2</sup> US dollar purchases converted to CDN at Webtrader monthly rate

<sup>3</sup> Before transmission and scheduling costs

<sup>4</sup> Purchases not accepted by CDN market and sold back into US

---

**Transaction Limits**

- Maximum net power position of 1000 GWh
- Fixed price to fixed price transactions may be entered into only if there is a positive profit margin
- All other transactions may be entered into only if there is a positive expected value and with a term no more than three days in duration.
- Maximum duration six months

**Approval Authority**

- Merchant Energy Products Day Ahead, Real Time, Products up to and including 14 calendar days in duration:
  - Day Ahead Power Trader/Financial Trading Supervisor/Physical Trading Supervisor
  - Confirmation Oral, Fax or Approved Electronic Platform

**Comments**

- Compliance with approval authority is pending while we try to determinate an effective, efficient method to assess compliance, given the transaction volume and oral or electronic platform (instant messaging) confirmation method.
- Related merchant transactions are captured in very large spreadsheets maintained by the traders and then entered into Webtrader. Purchases not accepted by CDN market are sold back into US by Third Party. These transactions are not captured in webTrader. Relevant details must be copied from these spreadsheets and analyzed for compliance. This process is very time consuming.

Middle office requested PS&O to review the feasibility of entering these transactions into webTrader. PS&O has agreed to screen the possibility.

- Middle Office also notes that trading limits for related merchant transactions are not set in webTrader to enable easy identification of violations.
- The maximum net power position of 1000 GWh defined in the Management Control Plan may not be appropriate for current trading activity. Limits reflected in risk policies should be clearly aligned to the type of transactions.
- Exposure of this position (depending on price) for example, would be \$50,000,000 at an assumed price of \$50 MWh.

The rationale for the net power position of 1000 GWh supports transactions purchased for Hydro system requirements and subsequently deemed surplus.

---

For example, this could apply to a possible drought situation where the corporation found itself in a long position due to changes in circumstances and did not need the power to meet its commitments.

The related merchant transactions (facilitated by Third Party) is arbitrage energy trading (taking advantage of price differentials between two or more different markets).

Arbitrage trading occurs when equivalent assets or combinations of assets sell for different prices creating an opportunity to profit. It can be defined as a set of positions, long and short, such that the net position is zero. If executed simultaneously at a profit would be considered risk free.

Risks associated with the trading activity include the risk that the energy may not be accepted by CDN market, pricing may change in the CDN market between the time energy is purchased in the day ahead market in US and delivery of the sale into CDN market at hourly or pre-dispatch price). In addition, a net position other than zero (purchases net of sale) may result in the risk of financial exposure and be considered a pure merchant transaction which has not been approved at this time.

Buying energy for delivery tomorrow to sell in the real time market tomorrow with a net zero position has significantly less risk.

- The energy is purchased, not generated by the corporation. Though, the volume of transactions are currently limited by the capacity of the related transmission positions, the Management Control Plan does not address volume limits in relation to transmission associated with these trading activities.
- The net position is important in arbitrage positions regarding risk exposure.
- As Middle Office continues its compliance work, other transactions that are considered to be of an arbitrage nature by current standards will be identified and reviewed to determine if existing controls and limits outlined in the Management Control Plan are appropriate.

### **Recommendations**

- Middle Office recommends that the EPRMC consider future revisions to the Management Control Plan that set risk parameters and limits related to the arbitrage transactions that are consistent with the Committee's risk tolerance.

- 
- Define transaction limits (such as the 1000 GWh) for transactions that are purchased to meet system requirements and later considered surplus separate from arbitrage transactions.
  - Transaction limits for the arbitrage trading include an intended zero net position.
  - Defining/clarifying volume limits related to transmission of these trading activities.