

19 May 2021

James Stevenson-Wallace  
Chief Executive  
Electricity Authority  
Wellington

By e-mail: [UTS@ea.govt.nz](mailto:UTS@ea.govt.nz)

Dear James,

## **The UTS remedy submissions reinforce our position that the UTS correction should fully compensate for over-pricing**

Ecotricity, Electric Kiwi, Flick Electric, Haast Energy Trading (Haast), Oji Fibre Solutions, and Vocus (the independents) welcome the opportunity to cross-submit in response to the Electricity Authority's Proposed Actions to Correct Undesirable Trading Situation 2019, dated 11 March 2021.

While Meridian, Neil Walbran Consulting (NWC) and Nova advocated the offer price cap be set above \$13.70/MWh, they did not offer any reasonable explanation why this would better correct the undesirable trading situation (UTS) than a \$13.70/MWh or lower cap.

We reiterate: "Our expectation of what an appropriate UTS correction looks like is minimisation of the harm caused by the unnecessary spill/excessively high spot prices during the UTS period to affected participants and end-consumers" and "The remedy can go further in correcting the harm caused by the excessively high spot prices than the draft remedy". We also reiterate we agree with Meridian that "the remedy should not punish end users ...".<sup>1</sup>

The Authority should ensure any remedy it adopts minimises or avoids harm to wholesale purchasers and end-consumers.

### **Process matters: use of cross-submissions to late submit**

Genesis provided a cursory submission on the UTS remedy, stating it was still evaluating the remedy and would "offer a substantive views at the conclusion of the cross-submissions period on or about 18 May":

"Genesis Energy continues to evaluate the complex circumstances surrounding the 2019 Undesirable Trading Situation and the Electricity Authority's proposed actions to correct. Given the potentially material transfer of values involved, Genesis reserves its position on the most appropriate course pending review of participants' submissions. We intend to offer a substantive view at the conclusion of the cross-submissions period on or about 18 May."

The Authority provided more than ample time for submissions.

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<sup>1</sup> Meridian, Proposed Actions regarding 26 March 2011 UTS, 21 June 2011.

Genesis is a large and well resourced organisation. Genesis should understand the distinction between submissions and cross-submissions, and it is not open to submitters to use cross-submissions to submit late. If Genesis submits a 'cross-submission' which is of the nature of a late submission the Authority should either: reject the submission (preferable) or provide opportunity for other stakeholders to cross-submit in response (which would delay the process).<sup>2</sup>

### **Fonterra provided a consumer-perspective on the UTS remedy**

We agree with Fonterra, for example, that:

- "... the proposed actions to correct the spot price, do not go far enough to restore confidence in the market. This is particularly the case given the EA have also concluded that there was no breach of the High Standards of Trading Conduct due to safe harbour provisions."
- "... we believe actions to correct should attempt to provide compensation for some of the downstream impacts which the market has to date paid for, such as the cost of emissions as a result of additional thermal dispatch, and the impact of reduced security of supply for North Island hydro (even if estimated)."
- "The EA has considerable latitude under clause 5.2 of the Code to take any action it deems necessary to correct the UTS, yet we note that the EA has described its preferred method to reset offer prices at \$13.70/MWh as "conservative". From our perspective this leaves transgressing parties in a net positive position and reinforces the advantage of such conduct. In the financial markets when the penalties for market manipulation are no longer effective in deterring manipulative behaviour, the risk that participants choose to exercise market power increases."

### **Unintended consequences and Meridian's present warning about creating an "anything goes" regime**

One consequence of the Authority decision not to explicitly determine fault in the UTS decision, and "Meridian and Contact did not breach the high standard of trading conduct on the basis that the conduct during the period was sheltered by the safe harbour provisions" [emphasis added], is both parties continue to deny they did anything wrong. For example, Contact claimed "In the UTS, the Authority identified the confluence of events during the flood period that included spilling by Meridian to manage the HVDC constraint, and Contact managing plant safety and the operation of its automated flood gates". Despite the Authority's clear findings, Contact talks dismissively of "perceived high prices" and Meridian of "supposed lack of competitive pressure".<sup>3</sup>

This undermines the precedent value of the Authority's UTS decision, in terms of what market conduct is acceptable or not, and the extent to which confidence in the market is restored/the UTS is corrected.

The lack of direction from the Authority about what conduct during the UTS was undesirable and should not be repeated is particularly regrettable given Meridian has stated its conduct is part of its normal trading strategy and it does not consider there is anything wrong with unnecessary spill e.g.

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<sup>2</sup> This matter has been raised directly with the Authority in e-mail, 30 April 2021.

<sup>3</sup> The Meridian comment about "supposed lack of competitive pressure" contradicts its own consultant, The Brattle Group, observation: "The concentrated structure of the New Zealand market means that many generators are potentially price-setting, resulting in prices deviating from SRMC depending on prevailing market circumstances and economic trading strategies".

“Spilling and making non-zero price offers is consistent with the normal operation of the wholesale market ...Throughout the last decade there have been many times in which a hydro generator has been spilling but offering at non-zero prices”<sup>4</sup>

It is also particularly regrettable given, as Electric Kiwi and Haast pointed out in their remedy submission, the Authority effectively found there was market manipulation (Authority decision wording mirrored the ACCC definition of market manipulation) and abuse of market power (mirroring Authority definition) but was not explicit in terms of using this terminology when describing conduct.

We reiterate in order “to correct”, the Authority should provide clear direction about what behaviour that contributed to the “confluence of factors” was undesirable and not what is expected in a normal workably competitive market e.g. any market manipulation, use of market power or other specific conduct that directly caused the UTS: “We consider that making right includes mitigating against repeat of similar outcomes. By way of an analogy, we do not consider that a plumber would have corrected a fault if the same fault reoccurs on a repeated basis”.

### **Offer prices needed to be below \$13.70 to avoid unnecessary spill in the real world**

We agree with Contact that “... the Authority’s modelling ... does not adequately reflect ... imperfect information in real-time wholesale market operation”, “ex-post theoretical modelling assumes perfect information”, and “As a result, the theoretical model determines an outcome that would be practically unachievable in real-time”.

We made overlapping submission points, noting the \$13.70/MWh offer price was an ex post estimate and “based on trial and error of the vSPD modelling using data that was not available in real-time. The highest offer price that would enable dispatch/avoid unnecessary spill cannot be known with certainty ex ante. More specifically, the Authority’s modelling is specific to determining the maximum price that would ensure Benmore did not spill and not other hydro plant”.

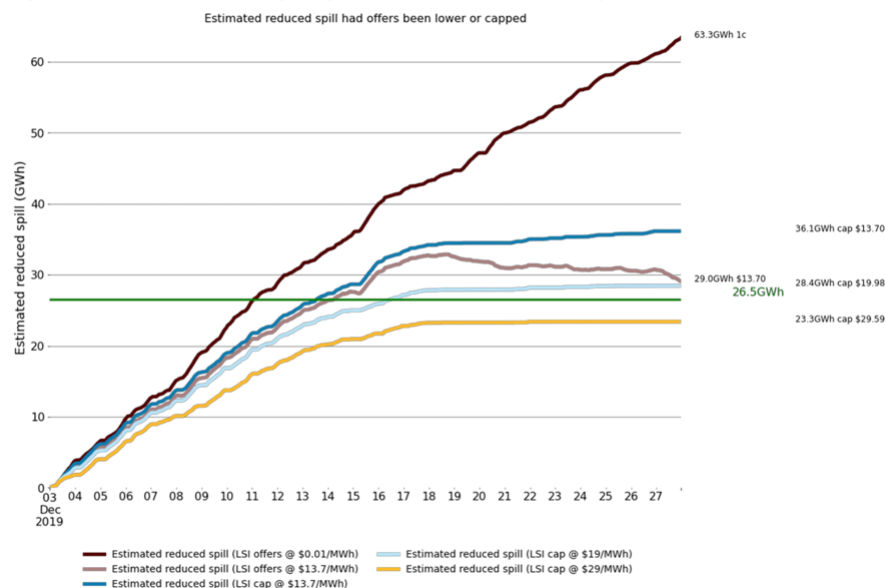
We also noted “If Contact or Meridian based their actual offer behaviour on estimates of this price, they would inevitably get the price wrong and there would be inefficient dispatch/unnecessary spill. Even if they knew the \$13.70/MWh price in advance and applied it they would have unnecessarily spilled water. This is a risk with any offer prices above SRMC”.

Our submission that “setting offer prices at or below SRMC would have been the safest and most reliable way for Contact and Meridian to ensure they did not needlessly spill water” is illustrated by the following Meridian graphic. This analysis clearly demonstrates that the maximum amount of spill is avoided when offers are \$0.01/MWh. This is consistent with a workably competitive market.

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<sup>4</sup> Meridian, Preliminary decision on claim of an undesirable trading situation, 18 August 2020.

**Figure 1: Volume of additional hydro generation with different offer adjustments**



The Contact and Meridian submission points reinforce that a \$13.70/MWh offer cap is too high and the Authority should consider the prices Contact and Meridian would have needed to have offered, based on information in real-time, to ensure they did not unnecessarily or deliberately spill water.

**Contact and Meridian are trying to relitigate aspects of the UTS decision**

Contact is trying to relitigate the UTS decision by saying that its prices should not be corrected on the basis that it considers that it didn't do anything wrong e.g.: "Contact questions whether its hydro generation at Clyde and Roxburgh spot prices should be reset. As explained during the UTS, Contact offer prices reflected the need to minimise marginal operation, safe operation of its spill gates and managing consent requirements. We do not agree with the draft conclusion that "[t]hese offers were also inconsistent with the abundance of water available for generation and contributed to the reduction in competitive pressure in the South Island"."

The UTS decision reflects that both Contact and Meridian unnecessarily spilt water resulting in higher prices (as reflected in relation to the above quote which related to the offers for stations on the Clutha/Mata-Au River).

Regardless, the Authority decision that there was a UTS was made based on a "confluence of factors" which included Contact's management of its spill gates and was not contingent on determining who was blameworthy.

By way of example also, "Meridian also notes that despite the confluence of events and supposed lack of competitive pressure between 19 and 27 December 2019, there was minimal incremental reduced spill after 18 December 2019. This is unsurprising given the daily average South Island prices between 19 and 27 December 2019 ranged from \$2.33 up to \$19.78 / MWh. This may suggest that there is little if any case for actions to correct the UTS identified after 18 December 2019 as the outcomes in the market very closely reflect the normal operation of the market."

The Authority's UTS determination was that the trading situation threatened or may have threatened confidence in, or the integrity of, the wholesale market over the entire 3-27 December period. This is a high threshold and very distant from Meridian's depiction of 18 December onwards as a period where "the outcomes in the market very closely reflect the normal operation of the

market". Meridian is essentially saying the Authority should not correct 18 December onwards because Meridian does not agree there was a UTS at that time.

Whether or not the harm caused during one part of the UTS period may have been less than in other parts of the UTS does not provide any basis for not bothering to remedy the UTS. The UTS remedy provisions do not include any such thresholds and apply to the entire period of the UTS as determined by the Authority.

### **Distinction between the decision that there was a UTS and the remedy**

Meridian was critical of the UTS remedy for purportedly not matching the UTS determination. We disagree with Meridian's assessment and do not consider they have provided a sound basis for criticising the Authority's draft UTS remedy and not setting the cap higher than \$13.70/MWh.

For example, Meridian submitted "Any offer cap must be consistent with the Authority's assessment of hydrology" in its earlier decision paper, and relied on this as basis for the offer price cap being set at \$19.98/MWh:

"The Authority's analysis shows that a \$19.98 / MWh offer cap would deliver an average offer price of \$13.70 / MWh and would result in the dispatch 28 GWh of additional hydro generation. To the extent the Authority wants to correct for this physical outcome, Meridian accepts that a \$19.98 / MWh offer cap would achieve that result."

The Meridian submission is internally inconsistent and contradictory on this point:

- It would appear to be a misrepresentation or misunderstanding of the Authority's UTS decision for Meridian to claim: "The rationale for the \$13.70 / MWh offer cap is that it is the level necessary to achieve the hydrological outcome sought by the Authority – elimination of the 28 GWh of "excess spill" the Authority found took place over the UTS period". The Authority's simplified and conservative modelling produced an offer price of \$13.70/MWh and the 28 GWh of "excess spill" was a byproduct of the modelling approach, not the other way round. As Meridian should be aware, the Authority adopted a simplified approach where it calculated the maximum offer price in which Meridian could have avoided spilling at Benmore.<sup>5</sup>
- The UTS determination was based on modelling which applied a \$13.70/MWh offer price cap. If Meridian's position was upheld it would result in a circular outcome that because the UTS determination was based on a \$13.70/MWh offer price cap then it is axiomatic the remedy should also set a \$13.70/MWh offer price cap.
- Meridian contradicts its own stance by advocating that "rather than back solving the offer cap or level which would achieve the 28 GWh of additional South Island hydro generation, it would be preferable to adjust offers based on the offers made during similar hydrological conditions". The Authority's application of the safe-harbour provisions in the related HSOTC investigation highlights well the problems with Meridian's proposal – in particular, that a market participant's behaviour may cause a UTS in certain circumstances (including when there is a "confluence of factors" but they may have behaved in the same way in other periods. If Meridian had set its offer prices to target a \$29.59/MWh average price in

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<sup>5</sup> The Authority noted in its UTS determination that "Using this lower bound of excess spill, the Authority estimated that during of the UTS period between 3 December and 27 December: ... (a) 704 out of 1200 trading periods could have resulted in less spill and more generation at Benmore (59%) ... (b) During these 704 trading periods the average amount of extra generation possible at Benmore was 82MW (or an average of 46.7MW/28.0GWh over the UTS period)."

December 2019 there would still have been substantial excess spill and a UTS (as reflected in Meridian's Figure 1 provided above).

- Meridian has also contradicted itself by stating the UTS remedy must match the UTS determination, but also that the Authority should deviate from its UTS determination that there was a UTS between 3-27 December and only apply a remedy up to 18 December.
- The Authority UTS determination was clear its estimate of unnecessary spill was conservative. Meridian has noted this in its submission. Clause 5.2 of the Electricity Industry Participation Code states "If the Authority finds that an undesirable trading situation is developing or has developed, it may take any action that— (a) the Authority considers is necessary to correct the undesirable trading situation". It is entirely within the bounds of the UTS Code provisions that the Authority would take into account the UTS determination was based on conservative estimates of spill and price outcomes when making its remedy determination.
- It is counter-intuitive and wrong application of "to correct" to suggest a \$13.70/MWh is too low on the basis it would have reduced spill by 36 GWh rather than 28 GWh. The offer price cap should be set at a level that, in real-time, would have avoided unnecessary spill.
- Meridian's statements about the level of unnecessary spill have gone from 12.2 GWh (UTS determination consultations) to 26.5 GWh (remedy consultation). Meridian's commentary on the Authority's 28 GWh estimate of unnecessary spill ignores it is an estimate of Benmore only.

All we can conclude from the Meridian commentary on offer price/spill levels is that the Authority UTS remedy should be based on the offer prices required to avoid unnecessary spill at all South Island hydro stations and not just Benmore.

### **The offer price cap should not be set above \$13.70/MWh and should not be based on LRMC**

As noted above, while Meridian, NWC and Nova advocated the offer price cap be set above \$13.70/MWh, we consider the respective submissions provided no reasonable basis why this would better correct the undesirable trading situation than a \$13.70 or lower cap.

For example, NWC suggested there should be a link between short-run pricing in periods of excess capacity and the long-run prices needed for future generation investment: "It is difficult to balance productive, allocative and dynamic efficiency in any decision, but because dynamic efficiency will have larger longer term benefits I suggest the EA consider the slightly higher offer cap option. Particularly given the need for significant renewable generation investment in the medium term to meet our climate change objectives".

The Meridian SRMC v LRMC submissions we have cited on multiple occasions highlight the NWC position is unsound as a matter of economics and workably competitive electricity market operation.<sup>6</sup> It is clearly inefficient for prices to be set at LRMC when there is surplus capacity and SRMC is very low. If generators can receive LRMC prices when there is a surplus this would inefficiently bring forward generation investment and raise electricity prices.

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<sup>6</sup> It does not follow from the need for prices to average LRMC to enable additional investment that there should be a floor on prices at LRMC, including when there is excess capacity and SRMC is very low, but this is what NWC's response to question 12 effectively recommends.

The Authority SRMC v LRMC bus analogy is directly applicable: “It is like charging peak fares when the bus is only half-full so there is no need to encourage passengers to travel off-peak, or having a road congestion charge in areas without grid-lock issues”.<sup>7</sup> The Authority has detailed why it considers SRMC-based nodal pricing to be more efficient than reliance on LRMC pricing e.g. “as Borenstein recently put it, the presence of lumpy investments does not change the efficiency of short run marginal pricing, given the investments that are in place. An LRMC charge sets the price too high when there is plenty of unused capacity and too low when the system is stressed”.<sup>8</sup>

### **The UTS remedy should not compensate for market participants commercial offer strategies**

Contact Energy has submitted the Authority has not considered “the operational limitations on thermal plant where volume is frequently offered at \$0.01/MWh to allow dispatch above minimum operating levels. Contact relies on forecast pricing when committing units such as TCC as some volume is always offered well below the marginal cost. Given the revised spot prices, it is unlikely that Contact would have generated with thermal over the UTS period. The proposed constrained payment mechanism does not suitably allow for cost recovery”.<sup>9</sup>

We do not support Contact’s view.

Any decision to offer below SRMC is a commercial one that trades-off risk of getting dispatched below cost against surety of dispatch. It is reasonable to expect if the market is operating consistent with workably competitive outcomes, in situations where there is surplus capacity, low prices should be expected. Presumably a generator that adopts a pricing strategy of offering below SRMC will, on average, receive prices equal to or above SRMC, with the generator making a commercial decision it is willing to accept prices below SRMC on occasion. There is nothing for the Authority to correct.

We reiterate “The remedy should not reward market participants who contributed to and/or caused the UTS and should not penalise consumers: A key principle we consider should be applied when determining the remedy for a UTS is that no party, whose actions contributed to a UTS and/or was responsible for a UTS, should be compensated, financially gain or profit, from the UTS”.

Relatedly, we also reiterate we agree with the Authority “only generators that did not have their offers reset would be eligible for constrained on payments” and our position is “this should mean no generation plant owner who has had any of its offers reset would be eligible for constrained on payments for any of its other generation stations”.

### **Potential for a ‘split’ market**

After a review of submissions it is clear many participants are concerned for the potential for a split market if ASX is not directed to resettle the futures market as part of the UTS remedy.

We understand the perspectives offered by these submitters, but ASX reset is not an appropriate option as it could in turn undermine confidence in the ASX futures markets. Traders act on information available to them in the now and have taken actions based on the spot prices at the time. It is not possible or practical to reset the ASX (as reflected in the ASX submission) without significant unintended consequences to traders that have reasonably and prudently taken action

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<sup>7</sup> <https://www.ea.govt.nz/assets/dms-assets/26/26542Peak-charges-under-proposed-TPM-guidelines-information-paper-and-next-steps-March-2020.pdf>

<sup>8</sup> <https://www.ea.govt.nz/assets/dms-assets/26/26542Peak-charges-under-proposed-TPM-guidelines-information-paper-and-next-steps-March-2020.pdf>

<sup>9</sup> Nova made similar comment.

based on spot market signals at the time. We note “The Authority’s current view is that hedge markets should be allowed to fully carry out their role of managing risk”.

We do not support further undermining of confidence in the ASX futures market and therefore a different mechanism is required that purely compensates buyers in the spot market.

If the Authority decides to address this matter in the remedy, our preferred alternative is an off market wash-up with the following features:

1. Only generators whose offers are reset are payers.
2. Payer amount set as difference between actual revenue over the UTS period and simulated revenue with offers reset.
3. All load are receivers.
4. Receiver amount set as difference between actual purchases and simulated purchasers after offers are reset, with a scaling factor to account for the shortfall.

This approach may avoid further erosion in confidence in New Zealand's wholesale markets which could be caused by a split market.

### **Concluding remarks**






We agree with Fonterra that: “The Undesirable Trading Situation (UTS) which occurred in late 2019 provided the market with considerable evidence of market power being used to drive prices ahead of normal competitive pressures. Sustained high prices alongside spilling occurred in such a way as to be relatively transparent to the market. In our view this was an example of the extreme end of a not uncommon practice (exercise of market power), but one which afforded a clearer set of evidence in what is a complex and often opaque market” and “the EA’s decision in regard to this UTS is critical in defining the trading approach for the supply side of the industry. If the EA maintains its “conservative approach” it is reinforcing acceptance of the behaviour that leads to the supply side freely raising prices above competitive levels”.

We reiterate the Authority should not prefer simplicity and convenience over precision and robustness in its determination of how much prices need to be reduced by to correct the undesirable trading situation if to do so makes consumers worse off and means they are not compensated as fully as they could be. The remedy should not reward market participants who contributed to and/or caused the UTS and should not penalise consumers.

If the Authority wants to adopt a simplified approach due to “material computational burden” etc it needs to ensure it does not result in a bias which under-corrects for the UTS.



Yours sincerely,

<p>Al Yates Chief Executive <a href="mailto:alyates@ecotricity.co.nz">alyates@ecotricity.co.nz</a></p> 	<p>Luke Blincoe Chief Executive <a href="mailto:luke.blincoe@electrickiwi.co.nz">luke.blincoe@electrickiwi.co.nz</a></p> 	<p>Steve O'Connor Chief Executive Officer <a href="mailto:steve.oconnor@flickelectric.co.nz">steve.oconnor@flickelectric.co.nz</a></p> 
<p>Phillip Anderson Managing Director <a href="mailto:phill@haastenergy.com">phill@haastenergy.com</a></p> 	<p>Terry Skiffington Chief Operating Officer <a href="mailto:terry.skiffington@oifs.com">terry.skiffington@oifs.com</a></p> 	<p>Emily Acland General Counsel and Regulatory GM <a href="mailto:emily.acland@vocusgroup.co.nz">emily.acland@vocusgroup.co.nz</a></p> 