IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

CIV-2011-485-1371
[2012] NZHC 238

UNDER	Section 64 of the Electricity Industry Act 2010
IN THE MATTER OF	an appeal of a decision of the Electricity Authority
BETWEEN	BAY OF PLENTY ENERGY LIMITED First Appellant
AND	TODD ENERGY LIMITED Second Appellant
AND	THE ELECTRICITY AUTHORITY First Respondent
AND	MERIDIAN ENERGY LIMITED Second Respondent
AND	MIGHTY RIVER POWER LIMITED Third Respondent
AND	NEW ZEALAND STEEL LIMITED Fourth Respondent
AND	NEW ZEALAND SUGAR COMPANY LIMITED Fifth Respondent
AND	POWERSHOP NEW ZEALAND LIMITED Sixth Respondent
AND	SWITCH UTILITIES LIMITED Seventh Respondent
AND	VODAFONE NEW ZEALAND LIMITED Eighth Respondent
AND	PULSE UTILITIES NEW ZEALAND LIMITED Intervenor

CIV-2011-485-1372

AND UNDER	the Electricity Industry Act 2010
IN THE MATTER OF	an appeal under section 64 of the Electricity Industry Act 2010 against a decision of the Electricity Authority that an undesirable trading situation developed on 26 March 2011
BETWEEN	CONTACT ENERGY LIMITED Appellant
AND	THE ELECTRICITY AUTHORITY First Respondent
AND	MERIDIAN ENERGY LIMITED Second Respondent
AND	MIGHTY RIVER POWER LIMITED Third Respondent
AND	NEW ZEALAND STEEL LIMITED Fourth Respondent
AND	NEW ZEALAND SUGAR COMPANY LIMITED Fifth Respondent
AND	POWERSHOP NEW ZEALAND LIMITED Sixth Respondent
AND	SWITCH UTILITIES LIMITED Seventh Respondent
AND	VODAFONE NEW ZEALAND LIMITED Eighth Respondent
AND	PULSE UTILITIES NEW ZEALAND LIMITED Intervenor

CIV-2011-485-1373

AND UNDER	the Electricity Industry Act 2010
IN THE MATTER OF	an appeal under section 64 of the Electricity Industry Act 2010 in respect of a final decision of the Electricity Authority that an undesirable trading situation developed on 26 March 2011
BETWEEN	GENESIS POWER LIMITED Appellant
AND	THE ELECTRICITY AUTHORITY First Respondent
AND	MERIDIAN ENERGY LIMITED Second Respondent
AND	MIGHTY RIVER POWER LIMITED Third Respondent
AND	NEW ZEALAND STEEL LIMITED Fourth Respondent
AND	NEW ZEALAND SUGAR COMPANY LIMITED Fifth Respondent
AND	POWERSHOP NEW ZEALAND LIMITED Sixth Respondent
AND	SWITCH UTILITIES LIMITED Seventh Respondent
AND	VODAFONE NEW ZEALAND LIMITED Eighth Respondent
AND	PULSE UTILITIES NEW ZEALAND LIMITED Intervenor

Hearing:	28 November 2012
Counsel:	A M Stevens and S B Kellett for Bay of Plenty Energy Limited and Todd Energy Limited J B M Smith and D A K Blacktop for Contact Energy Limited J A Farmer QC, M Dunning, A Simkiss and A Rawlings for Genesis Power Limited D J Goddard QC and L A O'Gorman for Electricity Authority J E Hodder SC and T D Smith for Meridian Energy Limited, NZ Steel Limited, NZ Sugar Company Limited, Powershop NZ Limited, Switch Utilities Limited M R Dean QC, J A Craig and G Holm-Hansen for Mighty River Power Limited J Scragg and O J Lund for Pulse Utilities New Zealand Limited (as intervenor)
Judgment:	27 February 2012

JUDGMENT OF RONALD YOUNG J

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Introduction

[1] At 10.30 a.m. on 26 March 2011 the interim wholesale price of electricity for Hamilton and regions north of Hamilton went from $367/MWh to over $19,000/MWh.[1] It stayed about level until 5.30 p.m. that day with a later upward adjustment of price from what is known as the spring washer effect (explained later in this judgment).[2] The wholesale prices during those seven hours on 26 March varied between $21,687/MWh to $23,047/MWh. After 5.30 p.m. on that day the wholesale price dropped initially to $2,373/MWh and by 8.00 p.m. it was $179/MWh.

[2] Thirty-five companies including generators, wholesalers, retailers and consumers of electricity complained to the Electricity Authority (the "Authority") that in terms of the Electricity Industry Participation Code 2010 (the "Code") an undesirable trading situation ("UTS") had arisen. They asked the Authority to reset the very high prices paid for electricity during that day.

[3] After an extensive enquiry the Authority concluded that a UTS had developed on 26 March and that the high interim prices should be reduced to $3,000/MWh for the relevant period on 26 March.[3]

[4] These appeals challenge that decision. Appeals from the Authority to this Court are appeals on questions of law.[4] A number of parties including Mighty River Power (MRP), Meridian, New Zealand Sugar and New Zealand Steel gave notice opposing the appeals and made submissions supporting the decision of the Authority on other grounds.

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1 MWh = mega watt per hour.
2 At [59].
3 Electricity Authority, Final Decision on the Undesirable Trading Situation of 26 March 2011 and Final Decision on actions to correct the Undesirable Trading Situation of 26 March 2011, 4 July 2011.
4 Electricity Industry Act 2010, s 64.

[5] This judgment firstly considers the background facts and electricity industry, then the Authority's decision, followed by the relevant law, and finally the grounds of appeal including the additional grounds of support relied upon by the respondents for the Authority's decision.

Background and facts

[6] The process undertaken by the Authority in establishing the facts is essentially inquisitorial. The Electricity Industry Act 2010 (the "EIA") established the Authority. Section 16(1)(a) includes, amongst the Authority's functions, the investigation and enforcement of compliance with relevant parts of the Act (there is also a Rulings Panel set up under the Act) and the Code. Section 46 empowers the Authority to obtain certain information from documents and interviews with "industry participants" for the purpose of an investigation for a breach of the Code.

[7] Industry participants are defined in s 7(1) of the Act in this way:

> **7 Industry participants**
>
> (1) The following are industry participants for the purposes of this Act:
>
> (a) a generator:
>
> (b) Transpower:
>
> (c) a distributor:
>
> (d) a retailer:
>
> (e) any other person who owns lines:
>
> (f) a person who consumes electricity that is conveyed to the person directly from the national grid:
>
> (g) a person, other than a generator, who generates electricity that is fed into a network:
>
> (h) a person who buys electricity from the clearing manager:
>
> (i) any industry service provider identified in subsection (2).

(2) The following industry service providers are industry participants:

(a) a market operation service provider:

(b) a metering equipment provider:

(c) a metering equipment owner:

(d) an ancillary service agent:

(e) a person that operates an approved test house:

(f) a load aggregator:

(g) a trader in electricity:

(h) any other industry service provider identified in regulations made under section 109.

The Electricity Industry

[8] Some background regarding the electricity industry is essential to understanding what occurred on the days preceding, and on, 26 March 2011. This summary of the background of the electricity industry primarily relies upon the submissions provided by Genesis and to a lesser degree other participants in the appeal.

[9] The five major generators of electricity in New Zealand are Contact Energy Limited, Genesis Energy Limited, Meridian Energy Limited, Mighty River Power Limited and TrustPower Limited. There are other smaller generators including one of the appellants in this case, Bay of Plenty Energy Limited.

[10] Electricity in New Zealand is primarily generated from hydroelectric stations (more than 50 per cent). Electricity is also generated by gas, thermal, geothermal, diesel and wind power. Hydroelectricity is the least expensive to produce. When the availability of hydroelectricity is reduced (for example, in a drought) then more expensive generating options are used to make up the deficit (for example, a thermal plant using gas or coal).

[11] The national grid, owned by Transpower, transmits this electricity directly to ten large industrial users and then to 28 local lines companies. When the electricity is delivered to the local distribution companies the voltage is reduced at substations. The lower voltage electricity is distributed through retailers to consumers, both business and domestic.

[12] The wholesale market consists of generators offering electricity for sale to large industrial companies and retailers (to onsell). The retail market involves the sale of electricity by retailers to end users including smaller businesses and domestic users.

[13] Transpower is the System Operator (as owner of the national grid) and is responsible for managing transmission of electricity around New Zealand. This involves the obligation to ensure that the high demand for electricity in the Auckland region is met, in part, from the production of electricity around New Zealand including the significant South Island electricity supply from the hydro lakes.

[14] The importation of electricity to Auckland is mainly through six 220kV[5] circuits from Whakamaru via Hamilton and Huntly to Auckland.

[15] The System Operator is responsible for ensuring that the demand for electricity around New Zealand is met on a second by second basis. Because electricity cannot be stored (or at least it is very expensive to do so) then supply must constantly meet a fluctuating demand. Physical supply and demand must always, therefore, be in balance to avoid a power "black out". As the Authority noted in its report on the System Operator:[6]

> ... determining the optimal combination of generating stations and reserve providers for each half hour trading period, instructing generators when and how much electricity to generate, and managing any contingent events that cause the supply demand balance to be disrupted. System Operations staff in Transpower's control rooms undertake this work using sophisticated modelling and communications technologies.

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5 kV = kilovolt.

6 Electricity Authority "System Operator Market Operation Service Provider" (2011) www.ea.govt.nz/industry/mo-service-providers/system-operator-market-operation-service-provider/.

[16] The electricity market in New Zealand involves trading in the wholesale and retail markets. The market has been regulated since 2004, with the more recent rules in the 2010 Act and Code. The wholesale market for electricity consists essentially of the spot market and the hedge market. Customers in the wholesale market can purchase electricity on the spot market or hedge market or in a combination of both.

Wholesale spot market

[17] Electricity is supplied by generators and taken by retailers and large industrial users at 225 nodes around New Zealand. Each node is simply a point within New Zealand where electricity is taken from or supplied to the national grid. Each day is divided into 48 trading periods of a half hour each. In each trading period a generator may offer to supply an identified quantity of electricity at an identified price or prices at a particular node or nodes. Prices are generally identified in bands of dollars per kilowatt.

[18] These offers may be submitted up to five days before supply through to 1.00 p.m. on the day before the supply is to take place. A generator can change or cancel a bid (for example, the amount of electricity offered or the price) up to two hours before the trading period to which the offer relates (for example, if the offer to supply is for the half hour period 10.00 a.m. to 10.30 a.m. then the offer to supply may be withdrawn or amended at any time up to 8.00 a.m. on the day of supply).

[19] As to the price, the offer may contain up to five bands per half hour trading period. There is no maximum offer price. The System Operator's function is, for any half hour period, to accept offers to supply electricity starting at the lowest offer and moving up the price bands of the offers until demand is met. This "demand" level of electricity is then dispatched to meet the demand.

[20] The highest generator's offer accepted in any trading period by the System Operator to meet demand then becomes the price paid for all the electricity offered and supplied in that trading period. And so although generator A may have offered to supply electricity at $10/MWh, if the last operator's offer, which is accepted to meet demand, is $1,000/MWh then the generator who offered $10/MWh will also

receive the $1,000/MWh. This highest price is called the "market clearing price". The generator whose price is the market clearing price is called the "marginal generator".

[21] Attached to this judgment is a bar graph (figure 1) showing a simplified version of how the system of offers and dispatches of electricity works.[7] Offer prices may vary between nodes. The System Operator will, therefore, want to send the lowest price electricity offered between nodes to satisfy demand at the lowest possible price. The capacity to send electricity around the system to satisfy demand at the lowest possible price is not unrestricted but is constrained by the electrical capacity of the lines carrying the electricity. The Code defines a constraint as:[8]

> **constraint** means a limitation in the capacity of the **grid** to convey electricity caused by limitations in capability of available **assets** forming the **grid** or limitations in the performance of the integrated power system.

[22] Thus, there will be different prices at different nodes known as price separation.

Information about wholesale market trading

[23] Industry participants on the wholesale market have a variety of information provided by the System Operator upon which they can assess both price and demand for electricity each day and indeed hourly or less.

[24] The basic information is provided through the Wholesale Information Trading System ("WITS"). Market participants provide information about their bids and offers to the WITS, which delivers pricing, scheduling and other market data using the System Operator's software model. Industry participants are entitled to the information within the system. Some information is publicly available.

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7 Genesis submissions, pg 18, fig 18.
8 Electricity Industry Participation Code 2010, 1.1(1).

[25] The first forecast information is the weekly dispatched schedule ("WDS"). This schedule is published each day at 1.30 p.m. It forecasts energy and reserved prices, whether there are any constraints (essentially restrictions on supply), known demand, electricity offered and scheduled generation outages for each trading period for the coming seven days.

[26] The second forecast document is the security dispatch schedule ("SDS"). It is published at 10.00 a.m. on the day before the trading day and is updated every two hours until dispatch. The forecast schedule is based on actual generation offers and the System Operator's forecast of demand. It gives estimates of half hourly prices. It includes information about constraints and a particular adjusted schedule for winter.

[27] The third forecast schedule is the pre-dispatch schedule ("PDS"). This is published at 1.00 p.m. on the day before trading and is then updated every two hours. It makes price forecasts for half hour periods for each given trading period. It is based on bids by wholesale electricity purchasers and not on forecast load. In addition, both the SDS and PDS forecast expected generation, any constraints, demand and prices.

[28] Every four hours before each given trading period a schedule of dispatched prices and quantities ("SDPQ") is produced. It is updated every 30 minutes at ten past, and twenty to, the hour. It shows forecast prices using the System Operator's demand forecast. It includes energy and reserve prices as well as an aggregate forecast of demand, energy offered and scheduled generation.

[29] The final indicator is five minute prices which are published five minutes after dispatch but prior to finalisation of the prices by the pricing manager. These are indicative prices only and can differ from the final prices which are not finally determined until two working days after the trading period.

[30] It is generally accepted that the price forecasts in the SDS and SDPQ are more accurate than those in the PDS. However, it is notoriously difficult to predict demand in electricity consumption.

[31] This is a volatile market. As Genesis noted in its submissions each node (225 of them) can have a different price for each half hour trading period (48 per day). The Pricing Manager, NZX, is responsible for calculating and publishing final prices for each node and for each trading period, potentially up to 14,000 different prices per day.

Wholesale hedge market

[32] A hedge contract allows a fixed price for electricity supplied thereby avoiding the volatility of spot market prices. Currently these are typically bilateral contracts between two market participants. They agree to fixed prices for an identified supply of electricity to avoid the volatility of spot market prices. Hedging, unsurprisingly, commands a premium above average spot prices essentially for the elimination or reduction of risk in the spot market. However, despite the higher prices such an arrangement suits those market participants who favour certainty over risk. Analysis indicates that over the course of a year, on average, spot prices will be lower than hedge prices.

[33] Thus, in a hedge a buyer agrees to buy and a generator agrees to sell a particular amount of electricity at a particular node for a particular time at a particular price irrespective of the market (spot) conditions. There are many variations to this described simple hedge contract.

Retail market

[34] At a retail level most contracts are for fixed price and variable supply. Some larger businesses, however, have contracts which also expose them to spot price risk. Such businesses do not have direct access to the information system accessible by the industry participants but often use agents who do have access to such information. This can involve the requirement for urgent price advice when spot prices exceed a particular level.

Events leading up to and on 26 March 2011

[35] In late 2009 Transpower gave notice to industry participants of the need for maintenance on the Whakamaru C transmission line between Whakamaru and Otahuhu. This maintenance was delayed on a number of occasions and was eventually planned for 26 March 2011. Other maintenance outages were also planned for the Arapuni/Otahuhu line during this time. As a result, on 26 March two of the six 220kV circuits between Whakamaru and Otahuhu were to be closed down between 5 a.m. and 5 p.m. and three 110kV circuits from Arapuni to Otahuhu were also to be closed during this time. This left four 220kV lines for the electricity supply to Auckland through Whakamaru and two 110kV lines also for the supply of electricity from north of the Waikato.

[36] These outages were known as early as December 2010 as to the 220kV outages and the 110kV outages by 9 March 2011. These outages on the 26 March, therefore, lowered the electricity that could be sent to Auckland from the South to meet Auckland's demand. Given the limitation imposed by these main demand outages (known as a constraint on supply) there were three generation plants which could supplement the "ordinary" supply and make up for the loss of capacity from maintenance: Genesis' Huntly plant; Contact's Otahuhu A and B plants; and MRP's Southdown plants.

[37] On 21 March Transpower requested Genesis provide 650MW of electricity from its Huntly power station for 26 March. Genesis replied that such generation would be available "if prices supported it". This request required Genesis to start a 250MW generator not otherwise required.

[38] By 22 March Transpower had entered the two maintenance outages in the WITS which notified all industry participants. After 22 March but before 25 March (but on a day uncertain) Genesis authorised the pricing of long volume electricity for 26 March at up to $20,000/MWh (this authorisation was required because of Genesis pricing policy).

[39] On 25 March at 9.51 a.m. Genesis moved 320kV of electricity from the Huntly Power Station which it had offered at less than $100/MWh to the $19,000/MWh band for the period of the constraint in supply (because of the loss of some transmission lines for maintenance between 5.00 a.m. and 5.00 p.m.) on 26 March.

[40] At 10.03 a.m. and 12.03 p.m. on 25 March the System Operator's information available to industry participants showed the Whakamaru/Otahuhu (Auckland) constraint binding with forecast prices at Otahuhu between $200/MWh and $500/MWh per trading periods on 26 March.

[41] At 12.58 p.m. Contact Energy withdrew 425MW previously offered for 26 March from its TCC plant at Stratford. It did so because its assessment was that prices would be low for 26 March and immediately thereafter and it was not economic, therefore, for it to run this station.

[42] Based on these changes the System Operator reassessed supply and demand. It included in the assessment the known constraint of transmission line maintenance and estimated demand. At 2.00 p.m. and 2.30 p.m. on 25 March the System Operator's SDS system forecast prices for the Auckland area during the trading period 9.30 a.m. to 2.00 p.m. on 26 March at $20,000/MWh.

[43] At 3.12 p.m. on 25 March, about an hour after these very high forecast prices, MRP offered an additional 125MW of electricity from its Southdown plant in Auckland at $0.01/MWh. This offer of very low priced electricity had the desired effect. It reduced the SDS forecast prices for Auckland for the following day, 26 March to a maximum of $150/MWh.

[44] During the course of the afternoon MRP sought hedge cover for 26 March from Genesis. Genesis offered two 50MW tranches of hedge cover to MRP at respectively $350/MWh and $750/MWh. The offer had a deadline of 5.00 p.m. for acceptance and related to a period after the constraint from transmission line maintenance had ended.

[45] Shortly afterwards the System Operator published the forecast prices for Auckland for 26 March reaching a maximum of $150/MWh. This reduction in forecast prices seems to have been in response to MRP's offer of very cheap electricity for 26 March.

[46] As a result of the drop in prices MRP decided not to accept the hedge price offers from Genesis and at 4.45 p.m. formally declined the offer. MRP did not seek hedge cover from Contact Energy. It believed that Contact did not have any spare capacity to offer as a hedge. At 5.00 a.m. on 26 March the transmission outages began.

[47] The System Operator seriously underestimated demand for 26 March, by as much as 120kV. This underestimate of demand for electricity played a pivotal part in the high prices for electricity on 26 March. If the level of demand for 26 March had been known on 25 March then it seems probable that the potential for high prices would have been predicted and probably avoided. Demand may have been able to be reduced and supply increased.

[48] The gate closes on offers to supply electricity two hours before each time period of the intended supply. Thus, an offer to supply, and the price and the amount, cannot be adjusted two hours or less from supply time. For example, for a supply for the half hour period commencing at 7.00 a.m. offers to supply a quantity and price of energy can only be adjusted prior to 5.00 a.m. that day.

[49] At 9.40 a.m. on 26 March, the SDPQ system indicated a price of $1,800/MWh for the trading period commencing at 10.30 a.m. By 10.10 a.m. the System Operator predicted a price of $20,000/MWh for 10.30 a.m., $6,000/MWh for 11.00 a.m. and $400/MWh for 11.30 a.m.

[50] The System Operator then reduced the limit for the Whakamaru/Otahuhu transmission lines reducing the capacity that the lines could carry from 404MW to ultimately 380MW on two occasions at 10.40 a.m. and 11.10 a.m. Part of the responsibility of the System Operator is to ensure that the transmission lines are not asked to carry an electrical load that may endanger the integrity of the lines. Part of

the System Operator's function, therefore, is to regularly assess and reassess the proper and safe capacity of the transmission lines, particularly where there are, as here, constraints on supply. This reduction in transmission line capacity on 26 March therefore further reduced the supply of electricity for Auckland.

[51] At 10.30 a.m. Genesis moved 20MW of Huntly generation from a low price band offer of $0.01/MWh to a high price band offer of $19,000/MWh for the trading periods 28 (2.00 p.m. to 2.30 p.m.) to 35 (5.30 p.m.).

[52] At about this time MRP moved 550MW of energy it had offered in the Waikato from a low to a high band price. MRP said its purpose was to reduce the transmission constraint across the Waikato and areas north of Hamilton. MRP said that its objective was to reduce price separation across the constraint to the north. The intention was to reduce the impact of the constraint binding by reversing the physical flow of electricity and to balance losses to MRP north of the constraint.

[53] I note the Authority's initial view was that MRP's "offer behaviour was consistent with an attempt to bring about a market squeeze affecting the rest of the North Island".[9] However, the Authority accepted MRP's explanation for their action as a "logical" reaction to the high prices brought about by Genesis Energy's high offer prices for its Huntly units.[10]

[54] At 1.00 p.m. Meridian contacted Genesis and requested hedge cover clearly in response to the high prices. Genesis advised that no hedge cover was available. Meridian asked Genesis again for a hedge and at 4.43 p.m. Genesis offered 30MW at $10,000/MWh from 7.00 p.m. to 8.00 p.m. on 26 March. This offer was declined by Meridian, unsurprisingly given the offer was outside when the constraint would end.

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9 Decision of Electricity Authority at [147].
10 Decision of Electricity Authority at [148].

[55] At about 3.00 p.m. Transpower advised industry users that the transmission outage due to end at 5.00 p.m. was being extended to 8.00 p.m. However, as it turned out the outage ended at 5.30 p.m. At 5.30 p.m., as the transmission line constraint ended, prices dropped remarkably.

[56] Apart from Meridian and MRP's reaction other industry participants also reacted to the high prices on 26 March. Some generators increased generation to benefit from the high prices. Some large industrial users reduced their use of electricity as they were able and thus reduced demand.

[57] The Authority subsequently received 35 complaints about the high prices on 26 March all claiming that the circumstances constituted a UTS. Losses by wholesalers, retailers and businesses from the high prices on 26 March were estimated to be around $45–$50 million.

[58] I have already detailed the interim prices for electricity during the seven hours between 10.30 a.m. and 5.00 p.m. that day. The ultimate prices charged for electricity for 26 March were subsequently published by NZX. They were typically higher than the interim offer prices that day because of the spring washer effect.

[59] The Authority in its submissions described the spring washer effect in this way:

> 4.1 As referred to in the note to Table 1 of the Consolidated decision at paragraph 123 (**R0125**), a high spring washer price is the most common mechanism by which a price higher than the offer price of the most expensive dispatched generation on the national transmission grid can occur. On 26 March 2011, a spring washer effect occurred between 10am and 5:30pm.
>
> 4.2 High spring washer prices occur at nodes where the SPD model has to replace multiple units of low-priced generation with high-priced generation so that an additional unit of generation can be delivered to those nodes whilst meeting the transmission constraints built into the SPD model.
>
> 4.3 The "spring washer" pricing effect occurs when there is a constraint within a transmission loop. For security, the transmission system includes many parallel paths. These parallel paths can form loops within the transmission system. The laws of physics determine how power flows from the transmission system. As a matter of physics, when there is a loop power cannot be made to flow only in one

direction. Rather, power flows will split across parallel paths according to the impedances on each side of the loop.

4.4 If one side of the loop is weaker than the other the system operator will need to re-dispatch generation to avoid overloading this weaker link. This weaker link is referred to as a transmission constraint and the re-dispatch of generation, to avoid overloading this link, will impact on the marginal price of supplying electricity at each point around the loop. In particular, price separation will occur either side of this transmission constraint.

4.5 Depending on whether a generator is a net seller or a net purchaser on each side of the constraint, such a generator can seek to influence whether a constraint binds:

(a) If it is a net seller on the high price side a party might want to cause a constraint to bind. By putting low price offers on the low price side, more energy will flow into the circuit that is constraining because of the incentive to get that low price generation into the high price region.

(b) If it is a net purchaser on the high price side it may want to remove the constraint. By putting high price offers on the low side, less will be generated there, and by putting low price offers on the high price side, more will be generated within the high price region, thereby reducing the import through the relevant constrained transmission circuit.

[60] As it turned out Genesis' Huntly electricity was needed to manage the demand on 26 March from about 10.30 a.m. through to the end of the outage at 5.30 p.m. Genesis was, during these seven hours, in what is known as a net pivotal position with respect to the supply of electricity north of Hamilton on 26 March. Essentially, therefore, electricity demand for that area required Genesis to supply additional electricity from its Huntly plant to match demand. A net pivotal position was described by the Authority in its decision in this way:[11]

Explanation of net pivotal

A generator is net pivotal when the quantity of generation required from it to prevent non-supply of some load in a region is greater than the generator's own load commitment in the region. Under these circumstances, it is profitable for a net pivotal generator to increase its offer prices as the additional revenue it earns will exceed its additional costs (from purchasing electricity from the wholesale market and meeting hedge contract commitments).

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[11] At [116].

> Generators are net pivotal in only rare circumstances, but pivotal situations, where the generator's load commitment is greater than its non-discretionary generation, are relatively common. A pivotal generator has no incentive to offer higher prices, as it would end up purchasing more electricity at the higher prices than it generated. For example, in the South Island, Meridian Energy is usually pivotal, but has only been net pivotal approximately 2.0% of the time since 1 January 2007, and this percentage will decrease significantly following the commissioning of Pole 3 of the high voltage direct current (HVDC) link between the North Island and the South Island.
>
> An analysis of the net pivotal status of Genesis Energy in the Auckland region from 2007 to 2011 has identified only five half hour trading periods when it might have been net pivotal (apart from 26 March 2011). This analysis was conducted by solving every trading period over the above time period with all offers of Genesis Energy's Huntly generation plant above $100/MWh increased to $20,000/MWh.

[61] Once Genesis knew or assessed it was probably in this position of control it could increase prices to reflect what was, in effect, its monopolistic position.

[62] On 2 April what is described by some parties to this litigation as a similar situation to 26 March arose. There were planned outages of transmission lines for 2 April 2011. However, the prices that resulted on 2 April were considerably lower than 26 March. Genesis had less electricity in the highest price band on 2 April compared with 26 March. Some firms who had been seriously affected by the events on 26 March hedged their price for 2 April, others reduced demand.[12]

The Authority's decision

[63] The Electricity Industry Participation Code 2010 defines an undesirable trading situation as:[13]

> **Undesirable trading situation** means any contingency or event–
>
> (a) that threatens, or may threaten, trading on the **wholesale market** for **electricity** and that would, or would be likely to, preclude the maintenance of orderly trading or proper settlement of trades; and
>
> (b) that, in the reasonable opinion of the **Authority**, cannot satisfactorily be resolved by any other mechanism available under this Code; and
>
> (c) includes, without limitation,–

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12 See [235] to [244] for a discussion on 2 April events.
13 At 1.1(1).

(i) manipulative or attempted manipulative trading activity; and

(ii) conduct in relation to trading that is misleading or deceptive, or likely to mislead or deceive; and

(iii) unwarranted speculation or an undesirable practice; and

(iv) material breach of any law; and

(v) any exceptional or unforeseen circumstance that is at variance with, or that threatens or may threaten, generally accepted principles of trading or the public interest

[64] Clause 5.1 of the Code empowers the Authority to investigate if it suspects a UTS. Clause 5.2 identifies the actions the Authority may take if it finds a UTS. It provides as follows:

5.2 Actions Authority may take to correct undesirable trading situation

(1) If the **Authority** finds that an **undesirable trading situation** is developing or has developed, it may take any of the steps listed in subclause (2) in relation to the **wholesale market** that the **Authority** considers are necessary to correct the **undesirable trading situation**.

(2) The steps that the **Authority** may take include any 1 or more of the following:

(a) suspending, or limiting or curtailing, an activity on the **wholesale market**, either generally or for a specified period:

(b) deferring completion of trades for a specified period:

(c) directing that any trades be closed out or settled at a specified price:

(d) giving directions to a **participant** to act in a manner (not inconsistent with this Code, the **Act**, or any other law) that will, in the **Authority's** opinion, correct or assist in overcoming the **undesirable trading situation**.

(3) The **participant** must comply promptly with a direction given to it in writing.

(4) Neither a **participant** nor the **Authority** is liable to any other **participant** in relation to the taking of an action, or an omission, that is reasonably necessary for compliance with an **Authority** direction under this clause.

[65] Subsequent to the receipt of the complaints of a UTS the Authority followed the process set out in its "Guidelines for Participants on Undesirable Trading Situations". Essentially this involved the gathering of information from complainants and those involved on 26 March, undertaking an analysis of the information, preparing and releasing a draft decision for comment from complainants and other participants, reconsidering the draft in view of the comments

made and reaching and publishing a final decision. It also reached a final view as to the appropriate remedial action.

[66] The Authority interpreted the definition of a UTS as always requiring that (a) and (b) are established. It concluded that although the examples in (c) can be a UTS they would only be a UTS if those factors in (a) and (b) were also present.[14]

[67] The Authority considered that s 15 of the EIA provided an economic context for its interpretation of a UDS.[15] Section 15 provides as follows:

> **15 Objective of Authority**
>
> The objective of the Authority is to promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers.

[68] And the Authority said:

> [29] The economic rationale for UTS provisions is to achieve operationally efficient and competitive markets. In voluntary marketplaces, market providers strive to attract buyers and sellers by adopting rules that promote operationally efficient trading and rules aimed at giving buyers and sellers confidence in the market.
>
> ...
>
> [31] UTS provisions are adopted by market providers because they cannot foresee all future eventualities and hence cater for these in the market's rules. Also, some practices are particularly difficult to specify in the rules, and so are better covered by generic UTS-type rules.
>
> [32] As market providers have strong incentives to enforce UTS provisions to further the efficient operation of the market and build confidence in it, UTS provisions often given broad discretion to market providers to deal with practices that threaten trading on the market in some manner, such as practices that disrupt orderly trading or the proper settlement of trades. Having the ability in certain circumstances to constrain the commercial decisions or actions of market participants is common to most organised markets.

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14 Decision of Electricity Authority at [15] to [19].
15 Decision of Electricity Authority at [25] to [26].

[69] And further, it said:

> [33] ... Based on the general economic rationale for UTS provisions given above, the UTS provisions in the Code are consistent with facilitating and encouraging competition (limb 1 of the Authority's statutory objective) and increasing the efficiency of the electricity industry (limb 3).

[70] In its decision the Authority summarised the various allegations made by the complainants and related the complaints to the definition of a UTS and the examples given in clause (c) of the definition.

[71] It rejected the allegation that there had been "a material breach of any law which constituted a UTS under the Code".[16]

[72] The allegation of manipulation or attempted manipulation of trading activity[17] by Genesis Energy was also rejected. As to the allegation of manipulative conduct, the Authority found that Genesis' strategy around 25, 26 March was consistent with managing its own risk of being able to supply all the electricity it had agreed to supply as well as (as it was entitled to) maximising the price it received for the electricity it generated.

[73] Further, the Authority considered whether Genesis had taken advantage of market power to achieve high prices and thereby engaged in manipulative behaviour. It said:

> [108] The UTS Committee notes there is no price cap on offers made in the wholesale market for electricity, and in its view offering generation at high prices is not *per se* evidence of manipulative or attempted manipulative trading activity. Moreover, Genesis Energy submitted its $20,000/MWh offers to the market the day before the transmission constraint occurred, rather than just before gate closure.

[74] As to misleading or deceptive conduct the Authority said:[18]

> [119] This limited ability of Genesis Energy to forewarn participants, coupled with the fact that Genesis Energy has made offers at $10,000/MWh over an extended period, does not support an allegation of misleading or deceptive conduct.

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16 Clause (c)(iv).
17 Clause (c)(i).
18 Clause (c)(ii).

[75] As to other conduct threatening orderly trading, it posed three questions for consideration:[19]

> [131] The UTS Committee considered:
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> (a) whether Genesis Energy was in a position to determine prices in a significant portion of the wholesale market for electricity on 26 March 2011;
>
> (b) whether parties exposed to those prices had time to seek supply from other sources or curtail their demand, and as a result;
>
> (c) whether those prices would be likely to undermine the wholesale market for electricity to such an extent that they satisfy the requirements of the definition of a UTS.

[76] It answered the three questions by concluding that Genesis was in a position to determine prices in a significant portion of the wholesale market for electricity on 26 March, that parties exposed to those prices did not have time to seek supply from other sources or curtail demand, and that in these circumstances:

> [150] The exceptionally high interim prices on 26 March 2011 are not the result of an underlying supply-demand imbalance, e.g. inadequate capacity or fuel, and they appear to bear no resemblance to any underlying or unavoidable cost. It is in the public interest to have an electricity market in which all participants can be confident prices are competitively determined. If participants observe that prices are greatly divorced from supply-demand conditions and are excessively higher than underlying costs, they will lose confidence in the integrity of the market arrangements and the incentive structures surrounding the wholesale market for electricity may be greatly damaged.
>
> ...
>
> [153] UTS claims in regard to 26 March 2011 and responses to the Authority's information requests in regard to 26 March 2011, indicate that buyer confidence in the wholesale market for electricity appears to have been seriously undermined through the combination of exceptionally high prices (in the absence of an underlying supply-demand imbalance) and buyers' lack of awareness of these prices until after the events had occurred.
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> ...

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[19] Clause (c)(iii) and (c)(v).

[156] The UTS Committee's view is that an exceptional and unforeseen circumstance occurred during trading periods 22 to 35 on 26 March 2011. The application of a squeeze in the wholesale market for electricity resulted in prices at exceptional levels in Hamilton and regions north of Hamilton. Counterparties trading in those regions had good reason to believe, until it was too late for them to take actions to avoid incurring liability to pay the prices, the exceptionally high offer prices at Huntly would not translate into market prices.

[157] In addition to the transmission outages and the absence of TCC generation offers in the market, a key contributing factor to the situation was the under-forecast of demand. This meant the exceptional prices were forecast only briefly on the afternoon of 25 March 2011, and then not until almost real time following Mighty River Power offering its Southdown generation into the market. This reduced the information available to participants and demand-side parties in the preceding 24 hours, and reduced the time for any response.

[158] The UTS Committee's view is that the exceptionally high interim prices on 26 March 2011 are the result of a market squeeze, which is an undesirable trading practice, rather than an underlying supply-demand imbalance. If these interim prices are allowed to become final prices, they threaten to undermine confidence in the wholesale market for electricity. The UTS Committee's view is that the events of 26 March 2011 may have threatened trading on the wholesale market for electricity and would be likely to have precluded the maintenance of orderly trading.

[159] The UTS Committee notes that, had the exceptionally high prices resulted from a genuine scarcity of electricity supply, and had the high offer prices been well signalled in advance, then the UTS Committee is unlikely to have found that the events of 26 March 2011 constituted a UTS, as it is important that price is used to signal scarcity to industry participants.

[77] And, in summary, it said:

[162] The reasons for this view may be summarised as follows:

(a) Genesis Energy's generation offers set the market prices for Hamilton and regions north of Hamilton during trading periods 22 to 35 on 26 March 2011 and parties exposed to prices in the wholesale market for electricity in those regions had good reason to believe the exceptionally high offer prices at Huntly for those trading periods would not translate into market prices, until it was too late for them to take actions to avoid incurring liability to pay the prices; and

(b) the high interim prices on 26 March 2011, if they are allowed to become final prices, threaten to undermine confidence in the wholesale market for electricity, and threaten to damage the integrity and reputation of the wholesale market for electricity.

[78] The Authority then considered what could or should be done to correct this UTS. They said:

> [165] To this end, the design of the remedy ought to be directed at restoring prices in the wholesale market for electricity to the level they would have been had buyers been aware that Genesis Energy would be net pivotal on 26 March 2011 and those buyers had had the opportunity to arrange an alternative source of supply or to curtail demand.

[79] They concluded that a $3000/MWh price cap for the seven hour period on 26 March was appropriate. In particular they said:

> [188] The $3,000/MWh offer price cap is intended to remove the effects of the market squeeze, while retaining incentives on participants that are aligned with those in a workably competitive market. In a situation where there is a willing buyer and a willing seller, a net pivotal generator should be able to price up to the economic alternative of the buyer, which would approximate the LRMC of a new entrant generation option or the opportunity cost of electricity for consumers (i.e. the price at which demand response occurs). As noted earlier, the Code restricts the remedies of a UTS to only those interventions necessary to correct the UTS. The UTS Committee considers that setting a cap on Huntly offer prices at SRMC would go further than just correcting the squeeze component of the UTS, while setting a cap on Huntly offer prices above $3,000/MWh would not go far enough to correct the squeeze.

Error of law

[80] This appeal is an appeal on a question of law. The Authority's function was to correctly interpret the meaning of the relevant provisions in the EIA and the Code and apply this law to the facts as they found them to be.

[81] The appellants' case is that the Authority made errors of law and reached an untenable conclusion. An error of law can occur if the Authority took into account an irrelevant matter, failed to take into account a relevant matter, misinterpreted a relevant statutory or Code provision or reached a conclusion, when applying the facts to the law, which is so untenable it cannot be allowed to stand.[20]

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[20] *Bryson v Three Foot Six Ltd* [2005] 3 NZLR 721 (SC); *Vodafone NZ Ltd v Telecom NZ Ltd* [2011] NZSC 138.

[82] It is important to keep in mind in making these assessments that the Authority is an expert body in the electricity industry and that this expertise plays an important part in its fact finding.[21] Many of the decisions in this area are judicial review decisions. There is a clear difference between review and, as here, appeal. Here, a direct challenge to the correctness of the decision is authorised. Having said that, however, Parliament has decided to use an expert body to oversee the electricity industry. Section 13 of the Electricity Industry Act requires the Minister, who recommends persons for membership of the Authority, to ensure that amongst its members the Authority has those who have knowledge and experience of the electricity industry, consumer issues and business generally.[22]

[83] The appellants' case is built on both types of error of law. They say the Authority's decision applied law to the facts as found by them but reached a clearly untenable conclusion. They also say that the Authority made a number of errors of interpretation in the meaning of the definition of the UTS which caused the application of the wrong legal test to the facts. Finally, the appellants submit the Authority misconstrued the extent or scope of its powers.

[84] In considering whether a decision is untenable it is not enough that an appellate Judge would have come to a different view on the facts as found by the Authority.[23] It requires a conclusion that the decision made by the Authority was not legitimately available on the facts found. The Supreme Court in *Bryson v Three Foot Six Limited* stated:[24]

> An ultimate conclusion of a fact-finding body can sometimes be so insupportable – so clearly untenable – as to amount of an error of law: proper application of the law requires a different answer. That will be the position only in the rare case in which there has been, in the well-known words of Lord Radcliffe in *Edwards v Bairstow*, a state of affairs "in which there is no evidence to support the determination" or "one in which the evidence is inconsistent with and contradictory of the determination" or "one in which the true and only reasonable conclusion contradicts the determination". Lord Radcliffe preferred the last of these three phrases but he said that each propounded the same test. In *Lee Ting Sang* itself the Privy

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21 *Major Electricity Users' Group Inc v Electricity Commission* [2008] NZCA 536 at [56].
22 Electricity Industry Act 2010, s 13(b).
23 *Vodafone NZ Ltd* (SC) at [53].
24 At [26].

> Council concluded that reliance upon dicta of Denning LJ in two cases "of a wholly dissimilar character" may have misled the Courts in Hong Kong in the assessment of the facts and amounted in the circumstances to an error of law justifying setting aside concurrent findings of fact. Their Lordships were of the opinion that the facts pointed so clearly to the existence of a contract of service that the finding that the applicant was working as an independent contractor was, quoting the words of Viscount Simonds in *Edwards v Bairstow*, "a view of the facts which could not reasonably be entertained", which was to be regarded as an error of law. In *Lee Ting Sang* the facts demonstrated so clearly that the applicant was an employee that it was the true and only reasonable conclusion.

[85] There was some discussion between counsel for the appellants and respondents about whether this Court should allow the Authority as an expert body a reasonable degree of tolerance or a margin of appreciation in considering such appeals. Unsurprisingly, those who supported the appeal sought to distinguish the margin of appreciation cases. Those who supported the Authority's decision endorsed that concept. In the end it does not seem to me to be helpful for me to embark upon a discussion either of the cases or the principles. In my view they simply do not in any significant way arise in this case.

[86] As the Supreme Court noted, the words of Lord Donaldson MR in *Piggott Brothers & Company Limited v Jackson* [1992] ICR 85 (CA):[25]

> What matters is whether the decision under appeal was a permissible option.

[87] I consider next the background to the definition of a UTS and the factors which will relevantly affect its interpretation. I then consider the appellants' alleged errors of law relating to the meaning of a UTS in the context of this case as they arise from a consideration of the appellants' submissions.

How to interpret the UTS statutory context

[88] At the beginning of its decision the Authority set out the basis upon which it interpreted the definition of a UTS. It said that, at cl 5.5 of the Code the Authority was required to "restore normal operation of the wholesale market as soon as

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[25] At 92.

possible" after a UTS. And so the inference was that a UTS could not constitute the "normal operation" of the market.

[89] The Authority noted s 15 of the EIA identified the statutory objectives of the Authority. That section provides as follows:

> **15 Objective of Authority**
>
> The objective of the Authority is to promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers.

[90] The Authority therefore considered how the statutory objectives relating to the UTS provision in the Code influenced the interpretation of a UTS. The Authority said:

> [29] The economic rationale for UTS provisions is to achieve operationally efficient and competitive markets. In voluntary marketplaces, market providers strive to attract buyers and sellers by adopting rules that promote operationally efficient trading and rules aimed at giving buyers and sellers confidence in the market.
>
> [30] In particular, market providers adopt rules aimed at giving buyers confidence that suppliers' goods and services are what they say they are, contract terms are transparent and prices are competitively determined. Likewise, market providers adopt rules aimed at giving sellers confidence that buyers are genuine and will meet their payment terms. Undesirable practices by a few buyers and sellers harm other market users, and they also harm the market provider by deterring some parties from using the market.
>
> [31] UTS provisions are adopted by market providers because they cannot foresee all future eventualities and hence cater for these in the market's rules. Also, some practices are particularly difficult to specify in the rules, and so are better covered by generic UTS-type rules.
>
> [32] As market providers have strong incentives to enforce UTS provisions to further the efficient operation of the market and build confidence in it, UTS provisions often give broad discretion to market providers to deal with practices that threaten trading on the market in some manner, such as practices that disrupt orderly trading or the proper settlement of trades. Having the ability in certain circumstances to constrain the commercial decisions or actions of market participants is common to most organised markets.

[91] And in summary, the Authority said:

> [33] As noted above, the overarching test contained in the Code's UTS provisions is that a UTS is "any contingency or event that threatens, or may threaten, trading on the wholesale market for electricity and that would, or would be likely to, preclude the maintenance of orderly trading or proper settlement of trades". Based on the general economic rationale for UTS provisions given above, the UTS provisions in the Code are consistent with facilitating and encouraging competition (limb 1 of the Authority's statutory objective) and increasing the efficiency of the electricity industry (limb 3).

[92] The thrust of the appellants' criticism of this analysis is that there was too little focus on the words of the definition of a UTS. This lack of focus on the words, together with the broad contextual analysis taken led the Authority to in fact apply a too broad a test to a UTS.

[93] Bay of Plenty Energy submitted, for example, that the proper interpretation of clause (a) of the definition of a UTS was:

> [49] In summary, the ordinary meaning of the Orderly Trading Element is that the contingency or event must be one that would, or is likely to, stop ongoing organised trading settlement of trades in accordance with the EIA and Code generally; or

[94] This submission suggests that the appropriate interpretation of clause (a) requires the likelihood that ongoing organised trading will stop as a result of the "event" which is said to be the UTS.

[95] Contact submits that the relevant context illustrates that the meaning of a UTS is not solely driven by competition issues but is related primarily to the smooth functioning "of markets and institutions within the electricity industry aside from competition issues". They stress that orderly trading is concerned with "inputs" not "outputs".

[96] I am satisfied the Authority's approach to the interpretation of the definition of a UTS contained no error of law. The Authority illustrated it was conscious that it was interpreting the meaning of the definition of a UTS and the words contained therein. It also understood there was a statutory context to be taken into account as

well as an assessment of the purpose of the UTS. No error has been identified in this approach which is clearly correct.

[97] The Authority approached the meaning of the word "orderly" as something more than the completion of trades as anticipated by the Code. In my view this was correct. "Orderly", in this context, is concerned with completion of trades as anticipated by the Code in a technical sense but is also concerned with a wider meaning of orderly, including the idea that orderly trading includes, for example, that all market participants would be trading on a level playing field. This is well illustrated by the examples in clause (c) of the definition of a UTS. They illustrate that trading which is not orderly could arise from manipulative conduct or illegal conduct or indeed from trading which threatens the public interest. Many of the examples in clause (c) have an aspect of ensuring that all trades are treated the same.

[98] And so a market which has been, for example, manipulated ((c)(i)), or misled or deceived ((c)(ii)), or where a relevant breach of the law has occurred ((c)(iv)), all involve an imbalance arising from the actions of the perpetrator of the event which will often result in an imbalance in knowledge about the market.

[99] And so to continue the level playing field example, "orderly" would require that market traders be equally well informed of market conditions. What is "orderly" in this context the Authority are uniquely qualified to assess.

[100] The idea of an orderly market can, as the Authority also recognised, be assessed against the Authority's statutory objectives. If the Authority's job, in part, is to ensure the functioning of the electricity market by promoting its statutory objectives,[26] then an assessment of the orderly trading element will inevitably involve an assessment of how the particular events under scrutiny affect these statutory criteria.

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[26] Electricity Industry Act 2010, s 15.

[101] And so, the preclusion of orderly trading does not require that trading is or is likely to halt. Trading may continue but orderly trading, that is orderly trading in the sense described by the Authority, will not continue. An event would have occurred which has so affected the market that if it is allowed to continue it means that trading will not, for example, be on a level playing field. To continue that example if market participants do not have equal access to relevant market information it is easy to see that orderly trading is likely to be precluded given an important aspect in orderly trading is equal access to market information.

[102] Trading might continue in that situation but it will not be orderly because it will not have one of the important ingredients of an orderly market, equal access to market information.

[103] I am satisfied that the Authority's analysis of the meaning of a UTS was correct and its analysis of what need be taken into account in assessing purpose in the meaning of the UTS was correct.

The appeal grounds

[104] Many of the appellants' allegations of Authority error can be grouped into the error of law category that the Authority applied the wrong legal test or misdirected itself as to the correct legal test.

[105] The second category of allegations by the appellants focus on claims that the Authority reached a clearly untenable decision. Some of the alleged errors of law in the first category are also relevant to this aspect of the appeal.

[106] Further, the appellants say that an error of law occurred, in part, because the Authority also took into account irrelevant matters and failed to take into account relevant matters.

[107] The appellants do not challenge the Authority's interpretation as to the status of clause (c) in relation to clauses (a) and (b). They agree with the Authority that to establish a UTS existed the Authority must be satisfied that clauses (a) and (b) are established. The respondents disagree with this interpretation.[27]

[108] The appellants' challenge focuses on the Authority's conclusions with respect to clauses (a) and (b) and whether the Authority applied the correct legal tests and also whether their conclusion was on the facts plainly wrong.

[109] Finally, the remedy of a reduction in price is challenged. The alleged error of law is said to arise from a misapprehension by the Authority of the scope of its powers. Individual appellants have identified particular claims of errors of law by the Authority including the application of wrong legal tests and considering irrelevant matters or failing to consider relevant matters in different categories.

[110] In the context of this case, where particular errors of law are placed in the analysis probably does not matter. If an error of law is made then its context in the decision making and its consequence for the decision will be relevant.[28] Some legal errors, if they occur, will be fundamental and so will inevitably result in a decision being set aside, for example, a misinterpretation of the definition of a UTS and so the wrong law, pivotal to the decision, would be applied to the facts.[29] Other errors may or may not matter and will likely require contextual analysis of the various appeal points to see how they relate to the ultimate decision of the Authority.

[111] When considering the appeal points I consider some discrete areas of challenge first. I then consider whether the decision is untenable. The challenge to the decision of the Authority as clearly untenable seemed to me, from the oral submissions made by the appellants and from their written submissions, to be at the heart of the appellants' case. I then consider the challenge to the remedy imposed by the Authority and other alleged misinterpretations by the Authority of the proper scope of its powers.

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27 See [129].

28 See *Peters v Davison* [1999] 2 NZLR 164 at 204; *Bryson v Three Foot Six Limited* [2005] NZSC 34 at [28].

29 For example see *Waiotahi Contractors Ltd v Murray & Ors* [1999] 3 NZLR 276 (CA).

[112] Some of the issues raised by the appellants are essentially questions of fact dressed up as questions of law. I have approached this analysis, however, by considering each appeal point raised by each of the appellants without initial concern as to whether they are questions of fact or law. If, however, an error is exposed then such exposure will require an analysis of whether the error is able to be challenged on appeal, that is, whether it is an error of law or not.

Discrete Errors of Law

Previous decisions of the Electricity Commission

[113] The appellants say that the Authority's misinterpretation of the UTS provisions arose in part because of its failure to take notice of and interpret the current UTS provision consistently with past decisions by the Electricity Commission and other regulatory bodies.

[114] In 2004 the electricity market ceased to be self regulating. The Electricity Commission was established to regulate the market. The Commission was disestablished on 31 October 2010 and replaced by the Authority. Prior to regulation the New Zealand Electricity Market was a voluntary competitive wholesale electricity spot market. The Metering and Reconciliation Information Agreement ("MARIA") provided for bilateral trading of electricity. The MARIA governance board and the NZEM Rules Committee oversaw the development of rules. The MARIA Conduct Committee and the New Zealand Electricity Surveillance Committee monitored and enforced compliance with the rules.

[115] Section 134(1)(g) of the EIA provides that anything done by the Electricity Commission is to be treated as having been done by the Authority. UTS decisions of the Commission are therefore deemed to be decisions of the Authority.

[116] The appellants say that the previous investigations and decisions provide a useful guide as to the circumstances that a UTS is designed to protect. Contact says that previous occasions where a UTS or its equivalent have been declared, or considered and rejected, have a common theme "in that they relate to fundamental

problems with the application of the market rules or an error in loading information underlying the market mechanism". None arise, the appellants say, from a perception of fairness or unfairness, high prices or adverse financial impact as the Authority found here.

[117] Genesis says that there are a series of factors in this case which previous Commissions have ruled on with which the Authority has effectively wrongly rejected by its decision. The failures by the Authority contributed to its misapprehension of what in law constitutes a UTS.

[118] Following are said to be (by the appellants) the key principles arising from the previous decisions but not adhered to by the Authority. I will respond to each of these propositions in turn.

(a) more than high prices are required for a UTS. The Authority both confirmed that was the position and, contrary to Genesis' claim, adhered to such a proposition in its analysis. At no time has the Authority ever said that "mere" high prices are sufficient alone for a UTS;

(b) the UTS regime is not an alternative recourse to the Rule "breach" provisions. It is difficult to understand the relevance of this proposition. None of the participants claimed that any Rule has been breached in this case;

(c) only an extraordinary Rule breach could constitute a UTS. Once again it is difficult to understand the relevance to this case. This is not a case involving a Rule breach and therefore whether a Rule breach is or is not required to be extraordinary before a UTS can be declared hardly arises in this case. In any event it is unhelpful to add further requirements to the definition of a UTS beyond the words actually used. And so it is unlikely to be helpful, for example, to say only extraordinary Rule breaches could ever be a UTS;

(d) the UTS provision is not an appropriate remedy where what is sought is a Rule change. It is not clear who Genesis say seeks a Rule change. But in any event, in this case, the complainants did not seek a Rule change and the Authority did not focus on Rule changes. It may or may not be the case that a change to the Rules is justified by the circumstances that arose on 26 March. But that fact by itself cannot dictate that a UTS therefore could not be declared on 26 March. Rather than be distracted by such propositions the Authority kept its eye on the definitional ball of what a UTS was. This was clearly the correct approach;

(e) for an event to be considered to threaten trading on the wholesale market the event must be such that the market is so significantly affected that daily trading is affected by withdrawal or likely withdrawal of participants or similar such circumstances. It is unwise to try and reach an exhaustive definition of what threatening trading on the wholesale market might be. It will inevitably depend on the particular facts of the particular case. This approach also favours adding further conditions to the wording of the definition of a UTS. The appellants attempt to identify the degree of threat by saying the event must be so threatening that market participants will or are likely to withdraw from trading. No such requirement is identified in the definition of a UTS;

(f) concerns about potential future manipulation do not justify a finding of a UTS. That proposition cannot be correct. A concern about potential future manipulation of the wholesale market by itself might be unlikely to justify a finding of a UTS. However, it would be relevant in assessing whether in terms of clause (a) of the definition of a UTS, there is an event which might threaten trading which would in turn be likely to preclude the maintenance of orderly trading. Subclause (a) is concerned, in part, with future events. And so the potential to manipulate a market is likely to be relevant in the assessment of whether or not the event which gave rise to the

potential might preclude the maintenance of orderly trading. In any event the Authority expressly found there was no attempt to manipulate the market and so in this case it was not concerned about future market manipulation;

(g) the Authority and its predecessors consistently declined to impose a price cap. It is legitimate to prize consistency highly in this area. The market should be reassured that similar situations are likely to give similar results should there be complaints to the Authority. However, I consider the Authority itself is not bound by previous decisions of the Authority and the Commission.[30] I agree with Meridian submissions that past decisions do not have a precedential effect as understood in law. The application of the UTS provisions are inherently fact dependent. The Authority, in any event, is free to disagree with, or take a different view of its own or the Commission's past decisions. More importantly none of the factual situations identified by the appellants are anything like the factual circumstances of 26 March and so it cannot credibly be maintained that the Authority has acted in a way which is inconsistent with previous decisions of the Authority/Commission.

Failure to identify a contingency or event

[119] The first error of law in relation to clause (a) alleged is that the Authority failed to identify the contingency or event which it alleged gave rise to the UTS. The definition of a UTS[31] is a "contingency or event" that has the ingredients of clauses (a) and (b) present. Contact submits that because contingency and event are expressed in the singular the Authority's function was to first identify a contingency or an event. That is, a single circumstance. I reject this submission. I am satisfied that both words can include a combination of factors and typically will do so. I note s 33 of the Interpretation Act 1999 provides that the singular includes the plural.

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30 *Telecom NZ v Commerce Commission* HC Wellington CIV-2004-485-2118, 6 October 2005.
31 At [63].

[120] The appellants say the Authority failed to identify the actual event which gave rise to the UTS. It submits that the judgment of the Authority is unclear as to whether the event was the high prices of 26 March, the alleged "squeeze" or a combination of events that occurred on that day. Genesis says this failure to define the "event" as the first part of the definition goes to the jurisdiction of the Authority to find a UTS.

[121] This seems to me a circular argument and in any event of no real moment in this case. The Authority made it clear the event being talked about in this case was the variety of circumstances that led to the high prices on 26 March. As Meridian identified, the circumstances that gave rise to the event are identified in summary at [159][32] of the Authority's decision.

[122] The events identified are: the fact that Genesis was in a net pivotal position during the relevant period on 26 March (this arose from a combination of circumstances including the transmission line outage and the withdrawal of electricity from the market (at Otahuhu)); that the high prices then offered by Genesis had not previously been offered when a generator was net pivotal; that the high prices were not able to be foreseen by industry participants, at least not in time to realistically reduce demand or hedge; finally, the prices were not related to an underlying supply and demand imbalance but a temporary situation, and as a result they had no relationship to the cost of supply of electricity.

[123] While the appellants challenge a number of these conclusions there can be no doubt that the Authority did identify a set of circumstances which it concluded gave rise to a UTS, namely the event or events proposed. I reject this ground of appeal.

Wrong standard of proof

[124] The second ground of appeal relates to the allegation that the Authority applied the wrong standard of proof to elements of the definition in clauses (a) and

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[32] At [76].

(c)(v). Subclause (a) is concerned with threats to trading on the wholesale market that (as relevant) "would be likely" to preclude the maintenance of orderly trading.

[125] Subclause (c)(v) is a potential example of a UTS and is concerned with an exceptional or an unforeseen circumstance which "may" threaten accepted principles of trading for the public interest.

[126] Before I directly deal with the standard of proof in clauses (a) and (c) of the definition, this appeal point inevitably raises the proper interpretation of the definition of a UTS and in particular the relationship between clauses (a) and (b) in relation to clause (c).

[127] The appellants (in contrast with Meridian and other respondents) agree with the Authority's conclusion regarding the definition of a UTS when it said it concluded that clause (c) may be illustrative of a UTS, but before a UTS can be said to have occurred, clauses (a) and (b) must be established.[33]

[128] The respondent submitted that clauses (a) and (c) each independently described a contingency or event which, if established, is a UTS. The requirements of clause (b) are, the respondents said, relevant only where the circumstances in clause (a) are found to exist, clauses (a) and (b) are therefore cumulative. Each circumstance described in clause (c) is, the respondents say, if established, a UTS. The respondents point to previous definitions of a UTS in the New Zealand Electricity Rule Book and Electricity Governance Regulations (r 2.36) and regulation 55 of the Electricity Governance Regulations as supporting this interpretation.

[129] The Authority said:

> [18] While paragraph (c) above suggests the types of situations in which a UTS may be considered to have occurred, it is not necessary that the contingency or event falls into one of the categories listed in paragraph (c).

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[33] Electricity Authority Decision at [15], [18]–[19].

> [19] Equally, a situation of the type listed in paragraph (c) will not automatically meet the requirements of the definition of a UTS. It is possible that such a situation could fall short of the thresholds in paragraphs (a) and (b) of the definition, and therefore not constitute a UTS.

[130] I also agree with the Authority's interpretation of the inter-relationship between clauses (a), (b) and (c). The definition of a UTS is not without its difficulties. However, I consider the only interpretation of the definition that makes sense requires those events described in clause (c) to also have the elements of clauses (a) and (b) established before a UTS can be declared.

[131] Firstly, that interpretation is favoured by history. The definition of a UTS is based on previous codes. Since the commencement of the wholesale electricity market in 1996 there has been continuity in the definition of a UTS in the three regimes that have operated since then. The UTS definition has not changed significantly. There was a rewrite in 2003 as part of the re-regulation process and the establishment of the Electricity Commission. Since 2003 the definition has remained unchanged and although reviewed no changes have been recommended.

[132] Rule 2.27 of the New Zealand Electricity Market Rules Voluntary Code described "an undesirable situation". This provided as follows:

> **2.27 Meaning of "Undesirable Situation"**
>
> For the purposes of these rules, an "Undesirable Situation" means any situation which threatens or may threaten fair, orderly or proper trading on NZEM, and without affecting the generality of the foregoing, includes the occurrence, threat or possible threat of:
>
> 2.27.1 any contingency or event which affects or has affected, or is capable of affecting trading on NZEM or any market, where the consequences of strict enforcement of the rules or Contract Specifications would, or would be likely to, preclude the maintenance of a fair or orderly market or fair or proper settlement of trades;
>
> 2.27.2 manipulative or attempted manipulative activity;
>
> 2.27.3 an excessive position;
>
> 2.27.4 unwarranted speculation or an undesirable practice;
>
> 2.27.5 a breach of any law; or

2.27.6 action or proposed action by a government, government instrumentality, futures exchange or stock exchange or any other body in New Zealand or elsewhere, or any exceptional or unforeseen circumstance, which is at variance with, or which threatens or may threaten, just and equitable principles of trading or the public interest.

[133] The Electricity Governance Regulations 2003, at regulation 55, prescribed the meaning of a UTS in this way:

> (1) An undesirable trading situation means any contingency or event–
>
> (a) that threatens, or may threaten, trading on the wholesale market for electricity and that would, or would be likely to, preclude the maintenance of orderly trading or proper settlement of the trade; and
>
> (b) that, in the reasonable opinion of the Board, cannot satisfactorily be resolved by any other mechanism available under the rules.
>
> (2) Without limiting subclause (1), an "undesirable trading situation" includes–
>
> (a) manipulative or attempted manipulative trading activity;
>
> (b) conduct in relation to trading that is misleading or deceptive, or likely to mislead or deceive;
>
> (c) unwarranted speculation or an undesirable practice;
>
> (d) material breach of any law;
>
> (e) any exceptional or unforeseen circumstance that is at variance with, or that threatens or may threaten, generally accepted principles of trading or the public interest.

[134] The primary differences between the Electricity Market Rules compared with the 2003 Regulations and the current regime are:

(a) that clause (b) was added;

(b) references to fair trading were removed;

(c) conduct which is misleading or deceptive was included as an undesirable situation; and

(d) reference to Government action threatening trading was omitted.

[135] I am satisfied that it is clear that the Commission has in the past taken a view that the situations described in clause (c) or the equivalent in regulation 55(2) are merely examples of what could be a UTS, but before they can be a UTS they must satisfy in the current Code clauses (a) and (b) and in the 2003 Regulations, regulation 55(1).

[136] This view was confirmed by the Authority in its 2008 paper "Issues and Indicative Options for the Spot Market Process and UTS provisions" at 9.4.6 and 9.4.7.

[137] If clause (c) is interpreted as a standalone provision (as Meridian asserts), then clause (c) would have to contain a fully comprehensive and exhaustive list of circumstances where clause (c) applies. Thus, the use of the word "includes" which indicates clauses (c)(i) to (v) are mere examples of a UTS and there are other possibilities makes no sense. There is no identification or guidance as to what other situations are included in clause (c) (and therefore, if established, a UTS based on Meridian's submissions) but not identified in clause (c).

[138] Further, if Meridian are correct once, for example, unwarranted speculation or a material breach of the law is established then whether these events could be resolved by any other mechanism available under the Code (clause (b)) would be irrelevant. It is difficult to understand why there would be such a fundamental difference between the requirements of clause (a) (which, if established, then requires clause (b) be established) and clause (c) (which does not). Given the relative similarity, for example, between clauses (a) and (c)(v) it is difficult to identify any rational reason for the difference. I am satisfied that before a UTS can be found to exist clauses (a) and (b) must be established and that clause (c) illustrates a UTS, but before it does so illustrate, clauses (a) and (b) must be established.

[139] Subclause (c)(v) is particularly problematic. It confusingly uses different terminology relating to trading than clause (a) ("orderly" in clause (a) and "accepted principles" in clause (c)). It is not clear whether they are intended to be equivalent

or different and if different, how. As I have previously noted, clause (c) uses the standard of proof "may" where clause (a) uses the standard "likely" in relation to assessing whether these trading standards (accepted principles or orderly) have been threatened or precluded.

[140] The Authority based much of its analysis on clause (c)(v). However, all of the ingredients in clause (c)(v) could be present but the event being considered will not be a UTS. The converse also applies. None of the ingredients in clause (c)(v) may be present, no exceptional or unforeseen circumstances, but a UTS can still be correctly found to have occurred. Given that conclusion, a better approach in the future may be for the Authority to focus solely on whether clauses (a) and (b) are established, accepting that the circumstances in clause (c) may give an indication to the market and the Authority about the types of circumstances that might be a UTS.

[141] I acknowledge that this interpretation of the meaning of the definitional provision does not give "public interest" in clause (c)(v) prominence. A threat to the public interest is not a direct part of the proof of a UTS given it is not expressly identified in clauses (a) or (b). However, all of the circumstances described in clause (c), including the public interest reference, can legitimately be used in the interpretation of clauses (a) and (b).

[142] The Authority focussed on clause (c)(v) as potentially covering the circumstances/events of 26 March. It found that the circumstances that arose on 26 March were exceptional and unforeseen (although the definition only requires one or the other). The vital point is, however, that the Authority then went on to consider whether the circumstances in (a) and (b) were met. It concluded they had.

[143] To return, therefore, to the question of law proposed relating to the standard of proof in clauses (a) and (c)(v). At para [155] the Authority said:

> [155] Finally, the indications are that, if the high prices of 26 March 2011 are allowed to stand, the reputation of the wholesale market for electricity *may* be damaged to the point where trading on the market *may* be threatened and the adverse financial impact on some parties *may* preclude the maintenance of orderly trading or the proper settlement of trades. (emphasis added)

[144] The appellants' complaint is that while the Authority correctly applied the clause (c)(v) test to the circumstances on 26 March when it considered whether trading might be threatened, it then applied the same standard "may" rather than the required standard of "likelihood" when it considered whether the maintenance of orderly trading was precluded (the clause (a) test).

[145] All parties agree that a standard of likelihood is higher than a standard of *may*. Although the parties could not agree on exactly what standard *may* and *likely* brought to the various tests, all were agreed that 'likely' or 'likelihood' or something 'would be likely' to occur is a higher standard than *may* which is mostly identified as something that is possible. Likelihood is agreed to be above something that is possible but self evidently not more likely than not. However, given my later conclusions it does not seem to me that in this case the difference matters.

[146] This confusion arose also at para [15] in a slightly different way when the Authority said:

> [15] A contingency or event must meet the criteria set out in paragraphs (a) and (b) of the definition above before it can be categorised as a UTS. That is, it *must, or may*, threaten trading on the wholesale market for electricity *and* preclude the maintenance of orderly trading or settlement, *and* it *must* not be able to be resolved by any other mechanism available under the Code. A UTS may exist in the absence of a breach of the Code. (emphasis added)

[147] Clause (c)(v) is concerned with an exceptional or unforeseen circumstance that affects the trading market. Clause (a) is also concerned with circumstances that affect trading. It is difficult to identify if the thrust of clause (c)(v) (save for the public interest aspect) is really any different than the focus in clause (a).

[148] Both are concerned with events which threaten trading on the wholesale market. It is difficult to see an obvious practical difference between conduct which threatens or may threaten accepted principles of trading and conduct which threatens trading and thereby is likely to preclude the maintenance of orderly trading. In clause (c)(v) the conduct may only threaten (endanger) accepted principles of trading. In clause (a) the conduct must be likely to preclude (prevent) orderly trading.

[149] Subclause (a) requires a threat to trading that is *likely* to prevent orderly trading. Subclause (c)(v) requires only that an exceptional or unforeseen circumstance *may* threaten accepted principles of trading. "May" typically involves a lesser level of certainty than would be required for "likely to". A likelihood of preventing orderly trading appears to be a rather higher standard than an exceptional circumstance which *may* threaten accepted principles of trading.

[150] However, where the Authority's analysis involves a consideration of clause (c)(v) then the higher standard of likelihood in clause (a) will, in any event, have to be met. After all, the Authority concluded (correctly) that clause (c) gave examples and that if a UTS was to be established the circumstances in clauses (a) and (b) would have to be established. So the real question is whether the Authority lowered the standard of proof from "likelihood" to "may" in clause (a) when it considered whether a UTS had occurred.

[151] Apart from the references in paras [155] and [15] where there is some confusion, the Authority has recorded the correct test throughout its decision. Some examples are:

(a) at [121] it correctly identifies the clause (c)(v) test;

(b) at [130](a) it correctly identifies the clause (a) test;

(c) at [131](c) it correctly identifies the clause (a) test; and

(d) again at [149] and [158] where the Authority's finding is that the events are not only "likely" to threaten orderly trading but will do so; and

(e) finally, the final sentence at para [158] where it says:

> The UTS Committee's view is that the events of 26 March 2011 may have threatened trading on the wholesale market for electricity and would be likely to have precluded the maintenance of orderly trading.

[152] I am satisfied, therefore, that although the Authority may have misdescribed the test at [155] and [15], overall it is clear that the Authority understood the standard of likelihood to be applied to the clause (a) test and in fact applied that standard. No error of law is shown, therefore.

Untenable decision

[153] The appellant says the Authority made a series of errors of law which ultimately resulted in an untenable decision. These errors include the application of the wrong legal test, making factual findings that were not open to it, and taking account of irrelevant matters and failing to take into account relevant matters.

[154] These allegations require a more detailed trace of the reasons for the Authority's decision, an analysis of their fact finding, and the application of this analysis to the claim of a clearly untenable decision.

[155] To return to the Authority's decision. I identify the Authority's conclusions and work back to identify its fact finding and, therefore, its reasoning.

[156] The Authority rejected the claims of manipulative trading and of a material breach of the law (clauses (c)(i) and (c)(iv)). In paras [120] to [161] it considered a combination of the circumstances in clauses (c)(v) and (c)(iii) and whether they met clauses (a) and (b) definitional circumstances. The Authority concluded there was an exceptional and unforeseen circumstance on 26 March. The very high prices were a result of an undesirable trading practice, that is, a market squeeze. The high prices had not arisen from scarcity of supply. The circumstances of the squeeze meant that other industry participants could not respond to the very high price in time to take avoiding action. These circumstances, the Authority concluded, threatened to undermine confidence and to damage the integrity and reputation of the wholesale electricity market. This, therefore, threatened trading and was, in the Authority's view, likely to have precluded the maintenance of orderly trading.

[157] The Authority said, in summary:

> [159] The UTS Committee notes that, had the exceptionally high prices resulted from a genuine scarcity of electricity supply, and had the high offer prices been well signalled in advance, then the UTS Committee is likely to have found that the events of 26 March 2011 constituted a UTS, as it is important that price is used to signal scarcity to industry participants.

[158] As to the second part, clause (b) of the definition, the Authority said:

> [160] The UTS Committee's view is that there are no other mechanisms under the Code to resolve the event.

[159] As to its factual findings to support this conclusion (beyond [120] to [161]) the Authority also made relevant factual findings when it considered and rejected other clause (c) circumstances.

[160] The essential relevant factual findings summarised throughout the judgment are:

(a) it is difficult to accurately estimate future demand for the wholesale electricity spot market;

(b) there was a transmission line constraint on 26 March well known to the market;

(c) there was a transmission line load constraint on 26 March which further constrained load but was not known before 26 March;

(d) if Contact Energy had not withdrawn 425MW of energy on 25 March then very high prices would not have eventuated on 26 March;

(e) Genesis Energy was in a position of transient market power on 26 March;

(f) Forecast prices on 25 March consistently failed to accurately predict prices for 26 March. There were some predictions on 25 March of very high prices on 26 March;

(g) the System Operator information underestimated demand on 26 March 2011 by 100MW to 120MW. If this underestimate of demand had not occurred, then high prices could have been predicted by industry participants ahead of 26 March;

(h) because Genesis Energy had only rarely been in a net pivotal position previously other market participants could not (based on history) predict Genesis Energy's intentions for 26 March thereby limiting the predictability of prices for 26 March;

(i) many thousands of offers over $10,000/MWh by Genesis Energy since March 2010 had been made. This was relevant because it provided a warning to industry participants of very high offered prices if Genesis Energy was in a net pivotal position;

(j) the warning in (i) above is softened by:

(i) there being only one actual price between 2007 and 2010 that was over $15,000/MWh for a trading period (half an hour); only two occasions from May 2004 to March 2011 where actual prices (for each half hour period) were above $10,000/MWh; $12,971/MWh on 21 August 2004 at 10.30 a.m. and $13,063/MWh on 19 June 2006;

(ii) none of the highest 20 prices from 2004 to 2011 related to Whakamaru/Otahuhu. The largest consecutive period of a high price before 26 March was three half hour periods (compared with the 14 half hour periods on 26 March);

(k) electricity prices are uncapped in New Zealand;

(l) high prices by themselves do not constitute a UTS per se;

(m) Genesis knew it was net pivotal when it received dispatch instructions for Huntly on 26 March. Only Genesis knew how much of its high price offers were being dispatched from Huntly and, therefore, the degree to which it was net pivotal that day;

(n) Genesis was in a position to determine interim prices for a significant part of the relevant wholesale market on 26 March. Industry participants exposed to the high prices did not have time to "seek supply from other sources or curtail demand". These circumstances were such that a "squeeze" occurred;

(o) the interim prices on 26 March did not bear any relationship to the cost of producing the electricity;

(p) exceptionally high prices for 26 March were not foreseen nor reasonably foreseeable before 26 March;

(q) after high prices for 26 March were predicted on 25 March, MRP offered 125MW of energy for 26 March at $0.01/MWh. Predicted prices for 26 March dropped and stayed low until near 10.30 a.m. on 26 March;

(r) no industry participant reacted to the possibility of high interim prices until actual high prices began on 26 March.

[161] Indicative prices are forecasts ahead of time by the System Operator using the SPD system (scheduling pricing and dispatch model). These forecasts take into account the expected state of the electricity system, generator offers and purchaser bids. These prices give participants valuable information on when and how to best use electricity. Five minute indicative prices, also called "real time" prices, are also calculated at the end of each five minute period in the half hour trading period for each node.

[162] Final prices are calculated ex post (normally 2 p.m. the day following the relevant trading period) using the offer prices as established two hours before the trading period begins and volumes as established during the trading period. Final prices are used for the settlement of trades between the generators and wholesale purchasers and affect the prices consumers pay for electricity. The difference between indicative and final prices can be significant.

Alleged errors

Exceptional and unforeseen circumstances

[163] The Authority concluded, therefore, that the prices were both exceptional and unforeseen (effectively unforeseeable before 10.30 a.m. on 26 March). They concluded that this combination of circumstances meant that if the interim prices for 26 March were to be the final trading prices then the wholesale market for electricity would be threatened such that it was likely to preclude orderly trading. They stressed:

(a) the very high prices in combination with Genesis in a net pivotal position; and

(b) that the prices were divorced from supply/demand conditions and that the market was informed too late of the potential for high prices to effectively react to the prices.

[164] This meant, the Authority said, that participants in the market would lose confidence in its integrity; the loss of confidence would result in inefficient investment signals and very high prices would likely continue where a generator was in a net pivotal position in the future if interim prices were to become final prices. Such prices could alter involvement in the spot market, participants turning to the hedge market instead.

[165] Finally, having considered the various responses to the Authority's information requests they thought buyer confidence in the market had been seriously undermined by these prices especially given the lack of awareness (before 26 March) of the possibility of such prices occurring on 26 March.

[166] The appellant says that the Authority's error was in applying too low a threshold in concluding the events were unforeseen and/or that they were outside normal operations of the market and therefore exceptional.

Exceptional situation?

[167] Genesis challenged the Authority's conclusion that this was an exceptional situation on 26 March. Genesis submitted that the very high prices were simply part of the electricity market. They said neither the Code nor the Act provided for a cap on prices and so the sky is the limit. Generator companies are regularly in a net pivotal position and high prices can then be expected. There have been high prices in the past with the almost $13,000 price in 2007 (being the equivalent of $16,000 in 2011's currency) near, the 26 March price. The electricity market is one of the most volatile markets. And so substantial price hikes can be expected. Very high prices may be no more than the normal operation of the market.

[168] Whether the situation on 26 March was or was not exceptional is not, in my view, pivotal to this case. In any event it is hardly a question of law. Genesis attempted to turn it into a question of law by alleging that it was an error of law to declare a price to be exceptional when the price produced arose as part of an "ordinary" market.

[169] The Authority's conclusion that the circumstances were exceptional was not based solely on the high price, although this was very high, and not just that the high price continued for 14 trading periods, although this was well beyond the previous maximum of three such periods of a previous high price. When the previous maximum of three trading periods occurred, the price was $5,434/MWh well below the $21,000/MWh to $23,000/MWh price band here. Although the high price and extended period on 26 March were exceptional (in that they had not occurred

previously to this extent) the other relevant factor was that these prices were not related to a supply/demand equation nor had they been predicted. All of these factors in combination led the Authority to conclude that this was an exceptional situation.

[170] I am satisfied the Authority made no error of law in reaching this conclusion. The Authority could not be said to have misunderstood the meaning of "exceptional". The Authority clearly considered whether what had happened was out of the ordinary in the sense it was exceptional.

[171] At [158] I observed that in any event whether the situation on 26 March was or was not exceptional was not pivotal to a consideration of whether a UTS existed. The word "exceptional" occurs in the clause (c)(v) example and is not repeated in clauses (a) and (b).

[172] An exceptional circumstance does not have to exist before a UTS can be declared. The circumstances described in clauses (a) and (b) have to exist before a UTS can be declared. Relevantly, what the analysis done by the Authority shows is that the circumstance was out of the ordinary or beyond normal trading.

Foreseen and foreseeability

[173] Whether the circumstances that gave rise to the UTS are or are not foreseen is not directly part of clauses (a) or (b) but is part of clause (c)(v). For the purpose of deciding whether there was a UTS I have concluded that whether the circumstances were or were not exceptional (the alternative to foreseen) is not vital (although I am satisfied they were). However, foreseen and foreseeability, and the circumstances that gave rise ultimately to the high prices was a factor which the Authority linked directly to their conclusions in clause (a) about orderly trading and threats to orderly trading.

[174] And so in the clause (a) and (b) context, whether the circumstances were or were not foreseen might not be vital. However, given the Authority linked forseeability to precluding ordinary trading, whether the events were foreseen and/or

foreseeable is a vital aspect of the Authority's decision declaring the UTS and the appellants challenge to it.

[175] The distinction between foreseen and foreseeable is important. A market participant who was not paying attention to the market would not have foreseen the events of 26 March. It is not suggested that such a circumstance could be relevant to the declaration of a UTS. However, whether a diligent market participant *could have* foreseen (i.e. whether they were foreseeable) the very high prices for 26 March is of real importance to the analysis of whether a UTS existed on 26 March.

[176] The appellants say that for a reasonably diligent market participant in the wholesale spot market the events of 26 March, including the high prices, were able to be foreseen. This is illustrated, Genesis says, by the action taken by industry participants to mitigate their risk in the market on 26 March. Simply because some in the market did not in fact foresee the high prices does not mean they were not able to be foreseen.

[177] The essence of Genesis' submission is summarised in their written submissions in this way:

> [220] If obscurity was caused, as seems to be suggested, by other contributing factors on 26 March 2011 (such as inaccurate demand scheduling, lack of sophistication in identifying and responding to market signals, or Contact's decision not to offer Stratford generation) then those are matters which should be addressed through revision of market design and not by finding a UTS. Circumstances arising out of the normal operation of the market, which are visible in the usual manner to its participants, and were in fact acted upon by many, cannot be "unforeseen". In finding otherwise, the Authority misdirected itself and erred in law.

[178] The Authority understood that the issue here was not whether those who were not monitoring the market had foreseen anything but whether those who were industry participants active in the market could or should reasonably have foreseen these high prices coming. They concluded that the circumstances that gave rise to the threat to trading were neither foreseen nor foreseeable by well informed industry participants.

[179] There was ample evidence to support the Authority's conclusion. Perhaps the most telling consideration is to look at what happened on 25/26 March and whether in fact the very high prices for 26 March were foreseen by any industry participants.

[180] After MRP offered its low price energy on 25 March[34] for 26 March no industry participant illustrated, by their actions, that they considered very high prices were a reasonable possibility for that day. MRP's actions on 25 March were seen as providing sufficient supply to substantially reduced prices as intended. While the transmission line maintenance outage was known, this was a common event. There was nothing to suggest this constraint would cause very high prices. Market participants did not know Genesis was in a net pivotal position on 26 March.

[181] There was no evidence of any attempt to hedge prices for 26 March except for MRP's request of Genesis arising from the concern about the high prices. When MRP offered its 125MW of energy on 25 March it also sought a hedge for the following day from Genesis. By the time Genesis responded to this request, offering a hedge at between $350/MWh and $750/MWh, the predicted price of electricity for 26 March had reduced to $150/MWh. Predictably MRP refused the hedge offer. Clearly MRP had concluded there was no or very little risk of very high prices for the next day.

[182] The only other hedge sought was after high prices had occurred on 26 March. Meridian's 26 March hedge request of Genesis was initially refused, although later a hedge offer was made by Genesis to Meridian albeit outside of the time of the transmission line constraint. There was no evidence of any reduced demand by any industry participants prior to the constraint biting at 10.30 a.m. on 26 March. And so there was no evidence before the Authority that in fact any industry participant anticipated the very high prices on 26 March. A failure to foresee very high prices by some industry participants could be explained by their own inadequate monitoring of the market. But a failure by all industry participants strongly suggests unforeseeability.

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[34] At [44].

[183] The other relevant factor is the limited information which in fact did accompany the $19,000/MWh price prediction published by the System Operator mid afternoon on 25 March for 26 March.

[184] The appellants placed some reliance on the 25 March $19,000/MWh prices as giving fair warning to the market that high prices were likely to follow the next day. I have already noted the subsequent reduction in predicted price for 26 March arising from MRP's actions.[35] This reduction in price confirmed market experience that such very high prices were very unlikely to be dispatch prices. However, the $19,000/MWh price on 25 March was in any event of limited value in predicting prices north of Hamilton for 26 March. The $19,000/MWh price offer would have been visible to industry participants on the System Operator's market information. However, it would not identify the location of the price beyond the fact that it would have been in the North Island.

[185] As I have noted many offers over $10,000/MWh have been made by generators and such prices predicted for the market. However, prior to this event only two half hour prices over $10,000/MWh have been reported in the last seven years.

[186] I consider, therefore, that Genesis cannot point to any industry participant who, by the end of trading on 25 March or until 10.30 a.m. on 26 March (when prices rose), predicted high prices for 26 March. In summary, the only participant who appears to have taken any action arising from the high predicted prices on 25 March was MRP. They took action to reduce prices for 26 March by providing additional electricity for that day. Their action on 25 March appeared to have been successful in substantially reducing prices.

[187] After 10.30 a.m. on 26 March and after it became apparent to industry participants that prices were high for 26 March some businesses tried to reduce demand, others tried to use their own generating capacity as a substitute for the high prices while others tried (unsuccessfully) to hedge prices. Given these actions

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[35] At [43].

typically occurred some hours after prices first climbed on 26 March they were of very limited use to the market participants involved.

[188] Their actions illustrated that these participants had not foreseen high prices for 26 March and given not one industry participant by the end of 25 March had acted expecting such high prices the reasonable inference in the circumstances is that such prices were not foreseeable.

[189] I am, therefore, satisfied that there was evidence available to the Authority upon which it was entitled to conclude that the events of 26 March were unforeseen and unforeseeable. Such a conclusion was not untenable nor was it based on any error of law.

The definition of a squeeze and the approach of the Authority

[190] The appellants also submit that the Authority having concluded that a "squeeze" had occurred on 26 March then observed that a squeeze is well known as an undesirable practice and then wrongly converted that view into the conclusion that there was an undesirable trading situation. This approach, the appellants say, was wrong because the situation on 26 March was not a squeeze as that term was known, and the Authority equated an undesirable practice with a UTS.

[191] The Authority defined what it meant by a squeeze in this context when it concluded that the situations in [131](a) and (b) could be answered yes as to clause (a) and no as to clause (b):

> [131] The UTS Committee considered:
>
> (a) whether Genesis Energy was in a position to determine prices in a significant portion of the wholesale market for electricity on 26 March 2011;
>
> (b) whether parties exposed to those prices had time to seek supply from other sources or curtail their demand, and as a result;
>
> ...

[192] This conclusion as to what a squeeze is may not, as the appellants maintain, equate with the definition of a squeeze used in other trading contexts when market manipulation is typically an essential ingredient (e.g. Commodity and Futures Markets). But those definitions do not matter in this case. Here, the Authority made clear the context in which it used the word "squeeze".

[193] The Authority defined a squeeze as occurring when Genesis knew or believed it was in a position to determine prices for a significant part of the wholesale electricity market on 26 March and parties exposed to the prices had no time to reduce demand or seek other supply or hedge.

[194] The Authority concluded that this "squeeze", together with the whole of the circumstances that occurred on 26 March, was an undesirable trading practice. This conclusion that prices were squeezed was hardly surprising. One generator was in a position to determine prices. Others could do little or nothing to avoid paying these prices. The generator could, therefore, effectively name its price.

[195] I am satisfied, therefore, that the Authority understood what a squeeze was because it defined the term itself. It then applied its definition of a squeeze to the facts of this case and its knowledge of the electricity industry and concluded this event was undesirable. It then used these facts together with other factual findings to test whether a UTS had occurred. No error of law has been identified in this approach nor was any conclusion by the Authority reached which was not available on the facts.

Was an abnormal situation required?

[196] The appellants' case was that the Authority erred in failing to appreciate that a threat to market trading had to be beyond a "normal" trading situation. The appellants say that the facts of this case illustrate that the events on 26 March, although unusual, were a normal market trading situation.

[197] The Authority's decision is based on a combination of circumstances giving rise to the UTS. Each factor considered alone may well not be sufficient for a UTS. Each factor considered alone might be within an "ordinary" market. As has been stressed high prices by themselves would not be enough. A generator in a net pivotal position (not an uncommon situation) by itself would not be enough. Market participants without access to vital market information, by itself, might not be enough.

[198] The appellants' analysis considers each issue in isolation from others, for example, it considers separately relevant issues (high prices, net pivotal position, inadequate access to vital information) and says each individually occurs in an ordinary market. Therefore, it says the Authority erred when it concluded the facts supported the UTS.

[199] However, that was not the Authority's approach. The Authority's approach was, correctly, to consider all in combination and decide if the combination of circumstances met the definition of a UTS. Any other approach would be artificial. Considering each factor individually, without acknowledging they form part of a whole, means that the Authority would have failed to reflect what was happening that day on 26 March.

[200] The Authority gathered all the relevant facts for 26 March. It then considered the definitional test of a UTS. The appellant has shown no error of law in this aspect of the case.

Why did the circumstances of 26 March threaten trading such that it would be likely to preclude orderly trading?

[201] As I have noted the Authority considered the definition of a UTS should be considered against the statutory objective of the Act. It noted that the contingency or event constituting the UTS must be "outside of the normal market operation of the wholesale market for electricity". It considered that clause (b) in the definition could only be fulfilled if it concluded the events of 26 March could not be resolved by any other mechanism. In particular it concluded that:

> [20] To be considered as "threatening" trading, an event must be such that participants' confidence in the wholesale market for electricity is significantly affected, or that daily trading is affected by withdrawal (or likely withdrawal) of participants, or similar.

[202] The Authority approached its task in this way:

> [20] To be considered as "threatening" trading, an event must be such that participants' confidence in the wholesale market for electricity is significantly affected, or that daily trading is affected by withdrawal (or likely withdrawal) of participants, or similar.

[203] The appellants submit that if what the Authority suggests in this passage is that a "threat" in this context is limited "to an assessment of the probability of lessening confidence in the market or withdrawal of participants ..." then that cannot be correct.[36]

[204] Further, the appellants say that if [20] of the Authority's judgment is interpreted as the Authority suggesting the withdrawal of a particular industry participant is sufficient to amount to a threat to trading then the appellants say that is wrong.

[205] As part of this error the Authority concentrated on whether market participants had threatened to withdraw from the market rather than the correct approach in focussing on whether such threats in fact threatened trading on the market.

[206] Both propositions identified by the appellants are effectively "straw-men". The Authority did not say that the threat was confined in the way the appellants suggest or that a threatened withdrawal is necessarily a threat to trading.

[207] In this situation, the Authority was faced with a large number of complainants, some of the largest electricity industry participants in New Zealand, many of whom were saying their confidence in the market had been undermined by these events. The Authority concluded there was a serious situation on 26 March. While the Authority did not have to accept what the complainants were saying, this

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[36] Contact's submissions at [113].

was powerful evidence of an actual loss of confidence (accepting many of the complainants had "lost" as a result of the events of 26 March).

[208] The Authority accepted by its findings of fact that market participants had been subject to very high prices in the circumstances described. It, therefore, logically followed that confidence in the market would be significantly lessened and a number of market participants would understandably not wish to trade in a market which allowed these events to occur. The Authority did not conclude that market participants were complaining about the ordinary functioning of the market but where, through their own failure, they had traded poorly.

[209] This point illustrates that, as Contact says, the threat to trading provision is not directed to the disgruntled trader who has done poorly in the market. It is directed at the disgruntled trader who, faced with an exceptional set of circumstances, which are unforeseen and unforeseeable, has done poorly in the market. This later situation is likely to threaten trading.

[210] I am satisfied, therefore, that the Authority applied the correct legal test to the facts found and no error of law is apparent.

[211] The second part of the clause (a) test is that the threat precludes orderly trading. The appellants' case is that "orderly" in this context means trading in accordance with the Rules for trading (here, the Code and Act).

[212] I am satisfied that "orderly" trading within the definition of a UTS is somewhat more than simply trading according to the Rules. The examples of a possible UTS in clause (c) illustrate the point. The examples show that what is intended by the definition of "orderly" is more than merely trading according to the Rules. The examples in clause (c) illustrate that beyond trading according to the Rules, orderly trading does not involve manipulative or illegal behaviour, unwarranted speculation or undesirable practices that are likely to result in disorderly trading.

[213] Circumstances that are exceptional and unforeseen (really unforeseeable) may also preclude orderly trading. These examples illustrate trading which is according to the Rules, which is not illegal, manipulative, deceptive or speculative, and trading which is according to accepted principles (for example, where all industry participants have access to the same information about trading) is unlikely to cause a UTS.

[214] Further, Bay of Plenty Energy complained that the Authority in its analysis of threats to trading conflated "confidence in" the market with the reputation of the market when the Authority said:

> [155] Finally, the indications are that, if the high prices of 26 March 2011 are allowed to stand, the reputation of the wholesale market for electricity may be damaged to the point where trading on the market may be threatened and the adverse financial impact on some parties may preclude the maintenance of orderly trading or the proper settlement of trades.
>
> *Conclusion*
>
> [156] The UTS Committee's view is that an exceptional and unforeseen circumstance occurred during trading periods 22 to 35 on 26 March 2011. The application of a squeeze in the wholesale market for electricity resulted in prices at exceptional levels in Hamilton and regions north of Hamilton. Counterparties trading in those regions had good reason to believe, until it was too late for them to take actions to avoid incurring liability to pay the prices, the exceptionally high offer prices at Huntly would not translate into market prices.
>
> [157] In addition to the transmission outages and the absence of TCC generation offers in the market, a key contributing factor to the situation was the under-forecast of demand. This meant the exceptional prices were forecast only briefly on the afternoon of 25 March 2011, and then not until almost real time following Mighty River Power offering its Southdown generation into the market. This reduced the information available to participants and demand-side parties in the preceding 24 hours, and reduced the time of any response.
>
> [158] The UTS Committee's view is that the exceptionally high interim prices on 26 March 2011 are the result of a market squeeze, which is an undesirable trading practice, rather than an underlying supply-demand imbalance. If these interim prices are allowed to become final prices, they threaten to undermine confidence in the wholesale market for electricity, and threaten to damage the integrity and reputation of the wholesale market for electricity. The UTS Committee's view is that the events of 26 March 2011 may have threatened trading on the wholesale market for electricity and would be likely to have precluded the maintenance of orderly trading.

[215] While the Authority may have been better to have used the language of the Code which involves a threat to confidence in the market, the idea behind paras [155] to [158] is clear. If reputation is seriously damaged, as the Authority found, then confidence in the market will obviously be threatened.

[216] The other issue raised by the appellants in this aspect of the challenge is the claim that trading continued on 26 March and the days following so how could it be said that orderly trading may be precluded. They submit that after the events of 26 March trading on the wholesale market continued. Trading was therefore not precluded because it continued.

[217] I reject the suggestion that as a matter of law trading must stop as a result of an event before orderly trading can be said to be precluded. There is nothing in the definition of a UTS which requires that trading stop or be likely to stop as a result of a UTS.

[218] As has been noted, New Zealand chose not to have a price cap for electricity on the wholesale market. What it does have is a power to deal with market abuse arising from threats to trading precluding orderly trading (the UTS). These events will typically be "one off" events of relatively short duration.

[219] In this case the events of 26 March occurred before many, although not all, market participants were aware. No doubt industry participants recognised this was a relatively rare event. They did not immediately stop trading. But they said if this is not fixed they would reconsider their involvement in the spot market. Wholesale departure from an already small and fragile market was likely to seriously undermine orderly trading. This is also an area on which the Authority's specialist knowledge of the industry is of real importance. The Authority's conclusions as to the market behaviour are in that specialist area of knowledge.

[220] I am satisfied that the Authority, therefore, correctly applied the law to the facts here.

Potential financial impact on industry participants not enough for a UTS

[221] When considering whether orderly trading is likely to have been precluded as part of its assessment of whether a UTS existed the Authority said:

> [155] Finally, the indications are that, if the high prices of 26 March 2011 are allowed to stand, the reputation of the wholesale market for electricity may be damaged to the point where trading on the market may be threatened and the adverse financial impact on some parties may preclude the maintenance of orderly trading or the proper settlement of trades.

[222] The appellants submit that based on past decisions from the Electricity Commission it is not enough that there is, or is the potential for, a financial impact on individuals for a UTS to occur. In particular the Electricity Commission in UTS Decision No. 5, 30 August 2006 at [48] said:

> In addition, the financial impact of the circumstance giving rise to the UTS claim is not so significant that it could realistically be regarded as likely to threaten trading (in the order of 0.05% of total purchases in the relevant month). The Commission does not consider that a market impact of this magnitude can generally be considered to threaten trading on the wholesale market for electricity. The market (and Genesis, the market participant that bore the brunt of the financial impact) has continued to trade and settle after the circumstances giving rise to the UTS claim occurred.

[223] Further, the Market Surveillance Committee in its report of 17 July 2001 relating to high spot prices in May/June 2001 said:

> ... while it is undoubtedly the case that certain Market Participants have been, or are being, placed under financial pressure (in some cases significant) by (singly or in combination) spot market prices, a thin financial hedge market and current retail prices, in the Committee's view, that financial strain does not, and does not seem likely to, "preclude the maintenance of a fair or orderly market or fair or proper settlement of trades". **In any case, in the Committee's view, the rules concerning "undesirable situation" are for the protection of an efficient and competitive spot market. Those rules should not be used to shield particular market participants from market forces unless, for example, the consequences of the failure of a market participant threaten trading and settlement on the spot market as a whole**. [emphasis added]

[224] Thus the appellants' case is that the Authority was wrong to take into account the possibility that prices on 26 March strained individual market industry participant solvency as relevant in finding a UTS. In fact the evidence established

that only one industry participant responded to an enquiry from the Authority indicating that such prices might test its solvency.

[225] Here the Authority concluded that in line with the Commission's 2006 Decision No. 5 the events which occurred did threaten trading on the spot market as part of the wholesale market. Where trading on the spot market simply reflects a competitive spot market functioning according to the rules of orderly trading then the fact an industry participant becomes financially vulnerable as a result of that trading is not relevant in considering whether a UTS has occurred. Market forces were operating and there are likely to be winners and losers from such a market.

[226] However, in this case the Authority found market forces were not operating and so financial vulnerability as a result was likely to have occurred in a market which did not involve orderly trading. Participants in such a market would hardly accept financial loss and thereby potential financial vulnerability arising from a market where there was no orderly trading. And so the Authority's Decision is consistent with the previous decisions of the Commission (although it need not be).[37]

[227] More importantly the Authority's observations about financial vulnerability were made given the facts as found by the Authority. In that context no valid criticism can be made of the Authority's observations. The observations about financial vulnerability were made after the conclusion reached by the Authority that this was an unforeseen or exceptional situation where trading was threatened which was likely to preclude orderly trading.

Demand forecast errors

[228] On 26 March actual demand for electricity turned out to be significantly greater than predicted demand. This fact contributed to the very high prices on 26 March. The appellants' complaint is that the Authority erred in accepting such a difference between actual and predicted demand was sufficient to give rise to an exceptional or unforeseen circumstance.

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[37] See discussion at [119].

[229] Further, the Authority erred in taking into account that actual demand was significantly greater than predicted demand in deciding a UTS had occurred. The appellants stress that there was nothing surprising about demand forecast differing significantly from actual demand.

[230] Contact submitted that there was no relevant error here. Forecasts are by their nature imprecise. And so to say that a forecast did not exactly match an actual demand is not to say there was an error in the forecast. This simply says that the forecast was not a perfect predictor of the actual demand. Thus, Contact submits that the low forecast on the 25th was not an error, it was simply different to the actual load on the 26th but within the normal bounds of how forecast load is expected to differ from actual load.

[231] It is common ground that forecasting electricity demand is very difficult and that demand forecasts are often wrong. The demand forecast on 25 March for 26 March was wrong. It significantly underestimated actual demand on 26 March. This underestimate played an important role in the ultimate high prices for 26 March. However, the Authority did not say that the demand errors by themselves were exceptional or unforeseen. The point made by the Authority was that inaccuracy of demand for 26 March explains why predicted prices were low but actual prices very high.

[232] As to this the Authority said:

> [153] UTS claims in regard to 26 March 2011 and responses to the Authority's information requests in regard to 26 March 2011, indicate that buyer confidence in the wholesale market for electricity appears to have been seriously undermined through the combination of exceptionally high prices (in the absence of any underlying supply-demand imbalance) and buyers' lack of awareness of these prices until after the events had occurred.

[233] And at [157] it said:

> In addition to the transmission outages and the absence of TCC generation offers in the market, a key contributing factor to the situation was the under-forecast of demand. This meant the exceptional prices were forecast only briefly on the afternoon of 25 March 2011, and then not until almost real time following Mighty River Power offering its Southdown generation into the market. This reduced the information available to participants and

> demand-side parties in the preceding 24 hours, and reduced the time for any response.

[234] The point made by the Authority, clearly correct, was that had the demand forecast been more accurate then industry participants would probably have been alerted to high prices earlier and may have been able to take remedial action. What the Authority did not do is conclude that the demand error was by itself exceptional or unforeseen or a UTS. It was, however, one of the factors that went into the set of circumstances that the Authority concluded gave rise to a UTS that day. As I have repeatedly said taking one factor, isolating it, and saying it is not a UTS sheds little light on whether a UTS existed on 26 March.

What is the significance of the events of 2 April for 26 March and the conclusion of the Authority that UTS occurred on 26 March?

[235] The appellants submit that the events of 2 April were broadly similar to 26 March. They say that what happened on 2 April illustrated that the events of 26 March were simply a market event from which market participants learned and adapted as illustrated by the market's reaction on 2 April. This supports the submission that the decision to declare a UTS on 26 March was untenable. The appellants say the events of 26 March were no more than market forces driving up prices.

[236] Thus, when the events of 2 April arose, given what had happened on 26 March, market participants were able to use their experience of the previous occasion and adapt their strategies accordingly.

[237] On 2 April further maintenance on transmission lines was required. The industry participants had notice of the maintenance. Further, on 1 April the Authority warned industry participants that very high prices were possible for the following day. On 1 April the Authority posted a bulletin on its website. In part, the Bulletin said:[38]

> In the interim the UTS Committee has received assurances from a number of participants that they had put in place sufficient hedge agreements to manage commercial risks regarding Saturday, 2 April when grid outages near Hamilton are scheduled to occur.
>
> Despite these assurances parties exposed to spot market prices must assess the risks for themselves and must not rely on the above statement for managing their own circumstances.

[238] Genesis and Contact offered prices near $20,000 for extended periods (12 hours) on 2 April. There was considerable hedging by market participants on that day and reduced demand by others. The very high prices offered by Genesis and Contact were not dispatched. As it turned out a quite different pattern of price and supply of electricity offered was apparent between 26 March and 2 April.

[239] The appellants' submissions are that what happened on 2 April is an example of how the market, working properly, and appropriately reacting to the signals of 26 March should function. And so, they submit, orderly trading could not be seen to be precluded by the events of 26 March (part of the definition of a UTS) given the events of 2 April.

[240] As to 2 April the Authority said:

> [93] Alternatively, had the demand forecasts been more accurate, the exceptionally high prices would have been more apparent to parties exposed to wholesale electricity spot prices and, based on their decisions for the following Saturday (2 April 2011), they are likely to have made different hedging decisions, curtailed their demand and/or increased generation from embedded generators. Hence, errors in the demand forecasts may have had a material impact on the actions of participants and resulting market prices.

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[38] Update on UTS and Market Performance Investigations, 1 April 2011. Available at www.ea-govt.nz/act-code-regs/uts/decisions-and-claims/

[241] The Authority's view, therefore, was that the events of 2 April illustrated what a properly informed market might have done on 26 March. The important difference between the events of these two days was that on 2 April market participants had good information about the real possibility of very high prices. This included information from the Authority itself. On 2 April, therefore, they were able to take remedial action. Demand forecasts were accurate, no squeeze occurred, no one was in a net pivotal position and so prices were not exceptionally high for 2 April. And so, the vital factors determining price for 2 April were in fact quite different than 26 March.

[242] The Authority did not directly consider these issues. While the market may have been able to respond to the potential for very high prices on 2 April, this capacity to react does not detract from the Authority's conclusions about what happened on 26 March.

[243] The Authority found that the circumstances on 26 March were a UTS, in part, because the prices bore no relationship to the cost of producing the electricity. The prices were the product of the exercise of transient market power. The fact that on another occasion the potential for the exercise of transient market power was avoided does not somehow undermine the Authority's conclusions about the events of 26 March and the fact that they constituted a UTS.

[244] Further, as Meridian pointed out in its submissions such remedial action, particularly the reduction of demand by closing down or reducing power consumption for businesses, is hardly ideal. A hedge contract in such a situation, designed to protect a participant from the exercise of transient market power, will inevitably extract a price which reflects that transient market power. Given the Authority's conclusion that the underlying facts gave rise to a UTS on 26 March, the claimed market solution on 2 April is essentially no more than an attempt to accommodate that which the Authority concluded required a remedy. Therefore, I do not consider that the events of 2 April illustrated that the events of 26 March were no more than the normal operation of the market and could not, therefore, have been the subject to a finding that a UTS existed.

Was this a decision no reasonable decision maker could make given the facts as found?

[245] The appellants submit that in view of the factual findings the Authority made no reasonable decision maker could have concluded a UTS occurred on 26 March. Genesis says that in light of the factual findings made by the Authority no reasonable decision maker could have found the following:

(a) an "*exceptional unforeseen circumstance occurred during trading periods 22 to 35 on 26 March 2011*"; and

(b) the market was not forewarned of the high offer prices; and

(c) demand forecast errors prevented parties in the wholesale market from responding to the high forecast high prices; and

(d) Genesis squeezed the wholesale market for electricity and exceptionally high prices were the result of the claimed squeeze.

[246] Genesis submits, given these "findings", it was therefore untenable of the Authority to conclude a UTS had occurred on 26 March. Genesis says the following factors[39] from the Authority's process and decision are pivotal. In light of these conclusions the Authority could not ultimately have found a UTS existed. I identify and comment on each in turn.

HIGH PRICES

[247] The Authority acknowledged that high prices by themselves do not constitute a UTS and the market is uncapped (see [129]–[130]).

NET PIVOTAL SITUATIONS ARE NOT UNIQUE AND THE AUTHORITY DID NOT FIND THAT ACTING IN A NET PIVOTAL POSITION CONSTITUTED A UTS

[248] These observations are correct. But the Authority did not suggest that any of the individual circumstances that go to make up the UTS in this case could, by themselves, be a UTS. Therefore, the observation that a net pivotal position by itself did not constitute a UTS takes the matter no further. The fact that Genesis was in a

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[39] Identified in [248]–[264].

net pivotal position was one of the factors that went toward making a UTS in this case.

THE PRICES WERE NOT "UNFORESEEN" BECAUSE SOME PARTICIPANTS DID FORESEE THEM AND TAKE ACTION

[249] For the reasons previously given I reject this observation.[40] Secondly, the Authority found that Genesis did not manipulate or mislead or deceive. However, the fact that it did not manipulate, mislead or deceive does not mean that there cannot be a UTS.

THE OFFERS WERE IN ACCORDANCE WITH THE INTERNAL PROCEDURES OF GENESIS

[250] The evidence clearly established that the offers were in accordance with Genesis' internal procedures for very high prices. However, this fact does not take the analysis of whether there was a UTS on 26 March any further. The Authority accepted that Genesis had not been manipulative or misleading or deceitful. The fact that Genesis actions were in accordance with its internal procedures is simply another way of confirming that position.

GENESIS DID NOT CREATE A SQUEEZE

[251] The Authority did not find that Genesis created a squeeze. It found that a squeeze occurred. It did not matter to the Authority whether any individual company created the squeeze or whether the squeeze was created as a result of a combination of circumstances. It was the existence of events the Authority identified as a squeeze which mattered.

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[40] The Authority found that the vast majority of market participants did not foresee the high prices. Those that did were reassured by late 25 March that high prices would not eventuate. In the circumstances, therefore, high prices were neither foreseen nor foreseeable after MRP's actions late on 25 March.

THE BINDING OF THE CONSTRAINT DEPENDED ON THE ACTIONS OF SEVERAL PARTICIPANTS AND THEIR ACTIONS WERE POSSIBLY NOT DIRECTED TO THE CONSTRAINT AT ALL

[252] The binding of the constraint (the reduction in supply caused by the maintenance line outage) depended on the actions of at least Genesis, Mighty River Power and possibly Contact, as well as the unpredicted demand. There were a number of factors that went towards the constraint binding. Whether the actions of the participants were or were not directed at the constraint was not the point as far as the Authority was concerned. Their focus was on whether there was a constraint, not on who caused it once it rejected the claim there had been manipulative or deceitful conduct.

GENESIS OFFERED HEDGES

[253] Genesis did offer hedges on 25 March but not on 26 March for the period of the constraint. Genesis offered hedges for 26 March on 25 March after MRP had intervened and offered low priced electricity for 26 March and after predicted prices had dropped to $150/MWh. The offered hedges were between $350/MWh and $750/MWh. The offering of hedges at those prices indicated that Genesis did not think that there would be extremely high prices for 26 March on 25 March after MRP's intervention. The hedges offered on 26 March were outside the maintenance constraint period.

CONTACT'S DECISION NOT TO OFFER STRATFORD GENERATION CONTRIBUTED TO THE CIRCUMSTANCES WHERE PRICES BECAME EXCEPTIONAL

[254] Contact decided not to offer Stratford generation because it believed high prices were unlikely for 26 March. The fact that they did not offer this generation did contribute to the net pivotal position that ultimately Genesis found itself in.

INACCURATE DEMAND FORECAST CONTRIBUTED TO THE EVENTS OF THE DAY

[255] Inaccurate demand forecasts did contribute to the exceptionally high prices. Indeed the Authority found that if demand had been as predicted, high prices would not have eventuated.

A UTS MUST BE A CONTINGENCY OR EVENT OUTSIDE OF THE NORMAL OPERATION FOR THE WHOLESALE MARKET FOR ELECTRICITY

[256] The market had previously seen a price above $13,000/MWh. But this observation does not tell the whole story. The Authority's conclusion was that a series of events, some events part of a normal market operation (for example, a high price), could in combination be a contingency or event which is a UTS. While market prices had been seen at $13,000/MWh that was on one occasion in a period of seven years for half an hour only. Prices were very rarely above $10,000/MWh. There were only two prices above $10,000/MWh, both for half an hour only. This can be contrasted with the circumstances on 26 March, where final prices were over $20,000/MWh for seven hours.

THE EVIDENCE SHOWS THAT PRICE SIGNALS IN THIS SITUATION ARE EXACTLY THE PRODUCT OF A FUNCTIONING MARKET

[257] This is in contrast to the conclusions reached by the Authority. The Authority concluded that high prices as a result of supply/demand functioning are proper price signals to assist in a functioning market. But price signals such as those on 26 March that bear no relationship to supply or demand will not send proper price signals and nor are they the product of a functioning market.

A NUMBER OF PARTIES PAID MORE FOR ELECTRICITY ON THAT DAY BUT OVER TIME THEY WOULD BENEFIT BEING SUBJECT TO SPOT PRICES AND THEY ELECTED TO REMAIN EXPOSED TO SPOT PRICES FOR THAT REASON

[258] Thus, the appellants say that if the losses of those who chose the spot market on 26 March are adjusted then those industry participants who did manage their position on that day (typically by hedging) will suffer losses.

[259] Two points can be made in response to this. Those who choose to remain on the spot market cannot complain if high prices are the product of a properly functioning market. But they are entitled to complain where the high prices resulted from a UTS. This is why the UTS provision exists. Not all high prices will be products of functioning markets. Some will be a UTS. It is the Authority's function to identify these situations and, if appropriate, reduce price where that is required. It

is, therefore, not a question of "winners and losers" but identifying whether an event is or is not a UTS.

[260] High prices arising in a legitimate market cannot be reduced by the Authority. When they occur those who rely upon the spot market will be the "losers", those who have hedged will be "winners". But high prices arising from a UTS and any subsequent price reduction does not turn the spot market losers into winners. The high prices are not legitimate and the loss, therefore, should not fall on those in the spot market.

THERE IS NO REASON WHY THOSE PARTIES WHO DID MANAGE THEIR POSITION THAT DAY SHOULD BE WORSE OFF THAN THOSE WHO DID NOT, NORMALLY THE REVERSE SHOULD BE THE CASE

[261] This observation I consider misses the point of the undesirable trading situation definition and the remedies available. The Authority understood that by fixing a price at lower than the spot price that day they would affect those who had hedge contracts. (I note there was no evidence that anyone had specifically transferred to a hedge contract for 26 March to avoid higher prices that particular day).

[262] Those who hedge can reasonably expect to benefit from time to time when there are very high prices but only when those very high prices are legitimately set and are not a result of an undesirable trading situation.

THERE WAS NO EVIDENCE OF TRADING BEING THREATENED OR THAT THE SITUATION WAS LIKELY TO PRECLUDE ORDERLY TRADING OR THE PROPER SETTLEMENT OF TRADES

[263] I have already dealt with this situation.[41] Most of the circumstances identified by Genesis which they say support the conclusion that no reasonable decision maker could effectively have found a UTS, I have rejected. Given the factual conclusions reached by the Authority all of which were open to it on the evidence, it was well open to it to reach a conclusion that an undesirable trading situation had occurred that day.

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41 See [199]–[216].

[264] The appellants say by reaching a conclusion that a UTS occurred and by adopting the remedy of resetting the price, the Authority effectively put a price cap on the market and treated those who had hedged for 26 March unfairly. They were treated unfairly when compared with those in the spot market whose trading on 26 March was protected by the finding of a UTS and reduction in the MW/h rate.[42]

[265] I reject the claim that by reducing prices the Authority effectively imposed a cap on electricity prices where a cap had been purposefully left out of both the EIA and the Code.

[266] Clause 5.2 of the Code provides as follows:

> **5.2 Actions Authority may take to correct undesirable trading situation**
>
> (1) If the **Authority** finds that an **undesirable trading situation** is developing or has developed, it may take any of the steps listed in subclause (2) in relation to the **wholesale market** that the **Authority** considers are necessary to correct the **undesirable trading situation**.
>
> (2) The steps that the **Authority** may take include any 1 or more of the following:
>
> (a) suspending, or limiting or curtailing, an activity on the **wholesale market**, either generally or for a specified period:
>
> (b) deferring completion of trades for a specified period:
>
> (c) directing that any trades be closed out or settled at a specified price:
>
> (d) giving directions to a **participant** to act in a manner (not inconsistent with this Code, the **Act**, or any other law) that will, in the **Authority's** opinion, correct or assist in overcoming the **undesirable trading situation**.

[267] This clause, therefore, specifically empowers the Authority pursuant to cl 5.2(2)(c) to direct trades be closed out at a specified price to "correct the UTS". And so in that sense a price cap has always been available as a remedy for a UTS. It is not, however, a price cap in the sense imposed on the Australian market. The national electricity market in Australia is operated by the Australian Energy Market Operator in accordance with the Australian National Electricity Law and the National Electricity Rules. Rule 3.9.4(b) sets the market price cap at $12,500/MWh.

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[42] See para [258]–[260].

In Australia, therefore, prices for electricity have a maximum beyond which they cannot go. Very high prices for electricity in New Zealand are possible. But if, as here, they arise from a UTS then the probable remedy is in cl 5.2(2)(c).

[268] This approach is confirmed by cl 5.5 which provides as follows:

> **5.5 Authority must attempt to correct and restore normal operation as soon as possible**
> The **Authority** must attempt to correct every **undesirable trading situation** and, consistently with section 15 of the **Act**, restore the normal operation of the **wholesale market** as soon as possible.

[269] This clause supports the proposition that pending investigation of whether long term market rules need to change (through Code amendment) the Authority can or should use its cl 5.2 powers where a UTS has occurred to ensure the resumption of a normal market as soon as possible.

[270] The only price cap here is a cap in the particular set of circumstances that arose on 26 March. Even if the broad circumstances repeated themselves and a UTS was again found to have existed, the price to be set (by virtue of cl 5.2(2)(c)) would need to be determined on the particular facts by the Authority. In that sense, therefore, there is no price cap arising from the events of 26 March in the sense of an identified maximum price for electricity irrespective of the circumstances. But there is notice to industry participants that in the circumstances of 26 March very high interim prices will not become final prices.

Subclause (b) – any other mechanism under the Act?

[271] The appellants complained that the Authority undertook no analysis of why there was no other mechanism under the Act available to deal with the threatened trading situation under clause (a). The appellants say that there were other mechanisms; specifically, amendments to the Code to avoid this situation in the future (see s 42 of the EIA).

[272] When the Authority began investigating the circumstances of 26 March 2011, it also said it would undertake a market performance investigation pursuant to s 42 of the EIA. This investigation involved both the spot and hedge electricity markets. The Authority in an update to the industry participants on 1 April 2011 said:

> In parallel with the UTS process, the Authority has commenced a Market Performance investigation into the events of 26 March. The scope of that investigation will encompass both the spot and hedge markets, and focus on identifying areas of the Code for possible further development.
>
> The Authority already has a comprehensive set of reforms underway to substantially improve market performance, in both the spot and hedge markets. These reforms are mandated by section 42 of the Electricity Industry Act 2010. The Act requires the Authority to make Code amendments by 1 November 2011 or explain why it hasn't done so and what alternative measures it is taking to address the matter.
>
> A key reform initiative relevant to recent events is the proposed introduction of a financial transmission rights (FTR) market. If an FTR market had been in place prior to last Saturday then FTR-holders could have been substantially protected from the price spikes at Otahuhu relative to Benmore, and participants would have been likely to have had a wider range of choices for hedging their risks arising from scheduled transmission outages. The Authority is on track to decide Code amendments by 1 November 2011 and have the FTR market operating in 2012.

[273] This investigation, therefore, was designed to identify what amendments to the Code might be required as a result of the trading situation on 26 March. This, however, left the circumstances of 26 March to deal with. Clause (b) of the definition of a UTS is focussed on whether the event which threatened trading (and will be likely to preclude orderly trading) could or could not be satisfactorily resolved by any mechanism available under the Code.

[274] The Authority was entitled, as it did, to consider what could be done to resolve what in fact had happened on 26 March. An amendment to the Code for the future would not have any effect on the events of 26 March. The Authority had identified prices that could not be justified in the market. The Authority was entitled to take the view that the only satisfactory way of resolving those prices was the remedial provisions of the Code only available if a UTS was found to exist.

[275] Secondly, uncertain amendments to the Code in the future would not resolve a repeat of the situation of 26 March unless and until the amendments were passed. The Authority was entitled to conclude that protection of trading in the meantime was required to ensure market confidence. The Authority's intervention by a declaration that a UTS had occurred made it clear to the market that should a repeat of the essential events of 26 March occur, then the very high prices that followed would be vulnerable.

Relevant and irrelevant considerations

[276] The appellants say that when the Authority concluded that if the interim prices were allowed to become final prices then trading on the wholesale market would be threatened and would be likely to preclude orderly trading, it failed to take into account and, therefore, to give sufficient consideration to:

(a) the number of market participants who appropriately managed the risk before 26 March; and

(b) that trading and settlement has continued since the events of 26 March.

[277] The appellants also complain that the Authority took into account an irrelevant matter, in particular, the extent to which the finding of a UTS and the issue of revised final prices might provide incentives for future hedging activity.

Relevant considerations

[278] Firstly, in relation to the failure to take into account relevant matters. I have already dealt with the assertion that a number of market participants appropriately managed their risk in advance of 26 March (see paras [262]–[263]).

[279] The second claim ([277](b)) is that trading and settlement has continued since the events of 26 March and so in fact orderly trading has not been precluded. Trading and settlement has continued since the events of 26 March.

[280] However, the interim exceptionally high prices of that day have not been confirmed and have been substantially lowered. The fact that trading and settlement has continued since the events of 26 March in those circumstances, does not seem to me to support the appellants' argument.

[281] The Authority's conclusion about the likelihood of a threat to trading causing preclusion of orderly trading and proper settlement of trades was predicated on the interim prices of over $20,000/MWh being confirmed as final prices. This required the Authority to make an assessment of how the market would react in those circumstances.

[282] The Authority's conclusion was that there would be a serious loss of confidence in the market if such high prices were confirmed. For reasons I have previously given they based this decision on a rational assessment of the circumstances.[43] In my view, therefore, it cannot be said that the Authority failed to take into account a relevant matter.

[283] Further, although the notion of the public interest was mentioned by the Authority no analysis of what particular public interest the Authority was taking into account was undertaken when it mentioned public interest. The Authority consistent with its s 15 objectives did consider the public interest. It concluded that a competitively and efficiently operated wholesale market was in the public interest. Further, efficient investment signals and the avoidance of unnecessary investment were also prime public interest issues.[44] While the Authority may not, as the appellants complain, have identified what public interest, they did identify the relevant public interest issues. Their conclusions as to what was relevant to the public interest in this market are clearly correct. No error of law has been shown.

[284] The appellants have detailed a series of factors which, they said, the Authority failed to mention. It is not necessary that the Authority mention every

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43 At [207]–[208].
44 Decision of Electricity Authority at [150], [151].

matter which it has taken into account in reaching its decision or every issue raised by an industry participant in its submissions.[45]

Irrelevant considerations

[285] The appellants say that the Authority took into account irrelevant matters "including the extent to which the finding of a UTS and the issue of final prices might provide inappropriate incentives for future hedge activity".

[286] However, the Authority did not take into account this factor in finding whether a UTS had occurred. They did consider this factor as the appropriate remedy once they concluded a UTS had occurred.

[287] The appellants also submit that the Authority erred in taking into account "the position of non-industry participants in assessing whether trading on the wholesale market would be threatened and whether orderly trading was likely to be threatened".

[288] In a section entitled "*Analysis – did parties have time to seek alternative supply or curtail their demand*", the Authority said:

> [145] The UTS Committee also concludes that most time-of-use (TOU) electricity consumers, who are exposed to wholesale electricity prices under commercial arrangements with their retailers, were not forewarned of the possibility of exceptionally high prices for 26 March 2011 and did not have time to organise for alternative supply or to curtail their demand to avoid the high prices. Genesis Energy was therefore able to squeeze the wholesale market for electricity.

[289] And under the heading "*Analysis – do the circumstances on 26 March 2011 satisfy the definition of a UTS?*" it said:

> [154] A particular issue for consumers is that, if they had been aware of the high prices either in advance or in real time, they would have in many instances reduced demand, as occurred on 2 April 2011 at the mere prospect of a repeat of the price outcome. The evidence is that the interim prices of 26 March 2011 greatly exceeded the marginal value of consumption for many TOU consumers, imposing substantial harm on them.

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45 *South Bucks District Council v Porter (No 2)* [2004] 1 WLR 1953.

[290] Contact's point is that the question of whether retail customers receive appropriate price signals and the impact of high prices on retail customers cannot threaten trading on the wholesale market. Such people are not industry participants and are therefore not involved in trading on the wholesale market. They say, apart from the fact that the position of non-industry participants is irrelevant, there is no evidence which clearly showed they were adversely affected, in any event.

[291] I agree with the respondents' submissions that it is simply not possible to break up the market for the supply of electricity between wholesale and retail in the way suggested by Contact. Neither can function without the other. The retail electricity market is inevitably affected by what happens at a wholesale level. This interpretation of the definition of a UTS is also informed by clause (c)(v) of the definition. This suggests that threats to the public interest, which inevitably would include the retail market for electricity can properly inform the Authority's assessment in clause (a) of the definition.

[292] Further, as I have noted, s 15 of the EIA requires the Authority to promote competition, in reliable supply by efficient operation of the electricity industry for the long term benefit of consumers. To therefore ignore the vast majority of consumers when assessing impact is inappropriate and artificial.

[293] In any event, as Meridian points out, the primary focus of the Authority was on the direct participants in the wholesale electricity market and its comments about the effect on consumers other than industry participants were not core to their decision making and were made almost in passing. The references identified by Contact are two paragraphs in a 160 paragraph decision.

[294] The appellants' also stress that the Authority's conclusions about a lack of confidence resulting in inefficient investment signals illustrates that it took into account irrelevant matters. The appellants say that confidence in the market is simply irrelevant in assessing whether a UTS has occurred. I am satisfied the Authority was entitled to take confidence in the market into account in assessing whether a UTS had occurred. In assessing threats to trading and the likelihood of orderly trading being affected, confidence in the market is relevant. Confidence, or

lack of it, would not by itself be determinative of these questions. Confidence is an integral part of the operation of such a market. It would be artificial and wrong to attempt to separate out the effect of particular events on the market. The Authority did not therefore take into account an irrelevant consideration.

Use of a UTS for improper purpose

[295] Genesis submitted that the Authority had used the UTS provision to ex post facto adjust prices for 26 March which unfairly harmed market participants who had managed risk in the wholesale market. This submission, therefore, is really concerned with the Authority's actions to correct the UTS. This ex post facto adjustment Genesis said, unfairly favoured those who had not managed risk. Further, the appellants said adjusting prices failed to address other inadequacies in the market identified by the Authority (for example, inaccurate demand forecasts and poor monitoring of the market by some participants).

[296] Genesis claimed the Authority's decision to adjust prices created regulatory uncertainty and was harmful to the market. The problem identified by the Authority, Genesis says, should have been resolved through the revision of the market design and amendments to the Code, not price adjustments.

[297] Thus, the appellants say by reducing the interim prices for 26 March the Authority effectively "punished" those who had hedged prices in the market, and advantaged those in the spot market on that day. The appellants' case is that the hedge price factored in a variety of prices possible in the market including the possibility of very high prices. Thus, by reducing the spot prices on 26 March the Authority favoured those who had apparently taken a risk in the market (those who favoured spot prices) against those who had chosen certainty of pricing (by hedging).

[298] As Meridian submitted this claim by the appellants does not reflect the logical inferences available from what happened after the very high prices of 26 March. Immediately after 26 March hedge prices on the NZX rose substantially for contracts at Otahuhu. Hedge prices reduced to previous levels after the Authority's decision relating to 26 March was released.

[299] The self evident inference from these facts is that the hedge market had not priced such high prices, in the circumstances of 26 March, into its hedge contracts prior to 26 March. The prices were unexpected. This was reflected in the increase in hedge prices after 26 March and the decrease after the release of the Authority's decision which refused to confirm the interim high prices in the particular circumstances of 26 March.

[300] Thus, those who had hedged before 26 March were not disadvantaged by the Authority's decision by finding a UTS on 26 March and reducing the high interim prices. As the hedge market reflected, such contracts had not priced this situation into the hedge prices.

[301] In relation to correction of the UTS, the Authority said:

> [187] The UTS Committee's decision is that final prices for trading periods 22 to 35 on 26 March 2011 are to be established on the basis of Genesis Energy's offers for its Huntly power station being reduced to a maximum of $3,000/MWh in these trading periods.
>
> [188] The $3,000/MWh offer price cap is intended to remove the effects of the market squeeze, while retaining incentives on participants that are aligned with those in a workably competitive market. In a situation where there is a willing buyer and a willing seller, a net pivotal generator should be able to price up to the economic alternative of the buyer, which would approximate the LRMC of a new entrant generation option or the opportunity cost of electricity for consumers (i.e. the price at which demand response occurs). As noted earlier, the Code restricts the remedies for a UTS to only those interventions necessary to correct the UTS. The UTS Committee considers that setting a cap on Huntly offer prices at SRMC would go further than just correcting the squeeze component of the UTS, while setting a cap on Huntly offer prices above $3,000/MWh would not go far enough to correct the squeeze.
>
> [189] The UTS Committee has considered the possibility that resetting offer prices in these circumstances may have the effect of creating a price cap or distorting incentives in the wholesale market for electricity. However, the UTS Committee emphasises its actions in regard to price-setting are specific to these circumstances. Moreover, by way of context, the UTS Committee notes circumstances such as those that arose on 26 March 2011 can be expected to arise only rarely. As the UTS Committee noted in its decision that a UTS existed on 26 March 2011, an analysis of the net pivotal status of Genesis Energy in the Auckland region from 2007 to 2011 has identified only five half hour trading periods when it might have been net pivotal (apart from 26 March 2011).

> [190] In regard to the impact of its actions on the hedge market, the UTS Committee considers the final prices arising from its actions provide an incentive for parties to manage their risk that is consistent with the incentive those parties would face in a workably competitive market. The final prices should enhance hedge market activity as participants can be confident that hedge market prices do not reflect a market squeeze in the wholesale market for electricity. Market squeezes in the wholesale market for electricity would hamper hedge market activity, which in turn may lessen spot market activity, due to a reduced ability to spot market participants to manage risk.
>
> [191] In particular, market squeezes in the wholesale market for electricity are likely to undermine the development of an active hedge market because any party that is unable to significantly influence prices in the wholesale market for electricity, such as financial intermediaries, but also other parties, are left totally exposed to the price-setting decisions of the party able to execute the squeeze, as the latter can set the wholesale market price at whatever level it chooses.
>
> [192] Similarly, a generator-retailer that is short on generation is highly exposed to the price setting decisions of the squeezer and will become very conservative regarding the volume of hedges it offers to the market. The end result is that allowing market squeezes to occur in the wholesale market for electricity is likely to stifle competition in the hedge market.
>
> [193] Although it may appear that market squeezes in the wholesale market for electricity should increase demand for hedges, this is not necessarily the case. At the margin, hedge purchasers will be left dealing in the hedge market with the same party or parties that exercise market squeezes in the wholesale market for electricity. As a result they are likely to face higher hedge prices than would occur without market squeezes in the wholesale market for electricity, and may view the relative attractiveness of the hedge and wholesale electricity markets as unchanged.
>
> [194] The UTS Committee has given consideration to the issue of whether the actions to correct the UTS will increase regulatory uncertainty in the market. While ex-post regulatory intervention in the wholesale market for electricity *may* create uncertainty in many circumstances, the proposed intervention is only occurring because a UTS has occurred and it is targeted specifically at correcting the UTS.
>
> [195] The UTS Committee's view is that it has exercised regulatory discretion in a manner consistent with the Code and the Authority's interpretation of its statutory objective, and therefore it should reduce regulatory uncertainty for industry participants. In contrast, allowing the interim prices for 26 March 2011 to become final prices would have increased uncertainty in the wholesale market for electricity, as it would have signalled that generators in a net pivotal position had total discretion in setting prices, regardless of whether a market squeeze occurred or not.

[302] This analysis illustrates that the Authority undertook a detailed consideration of the rationale for a price reduction of the interim prices for 26 March. It considered and rejected the claim of a price cap and distortion in the wholesale market should it reduce prices. It emphasised that its decision related to the peculiar

facts of 26 March and created no precedent for broad intervention by the Authority in the wholesale market.

[303] The Authority undertook an analysis of what it considered to be the effect of its decision on the hedge market. It concluded that to allow the circumstances of 26 March including the market squeeze to remain uncorrected would "likely stifle competition in the hedge market".[46] It acknowledged that ex post facto regulatory intervention in the wholesale market might create uncertainty in that market. However, it concluded in the circumstances it was obliged to intervene given the events of 26 March were a UTS and in any event the market would understand the intervention was specific to the circumstances of 26 March.

[304] While the appellants may disagree with the Authority's analysis of the effect of its decision, no error of law is exposed in the Authority's decision making. It did not use its authority or invoke the UTS for an improper purpose. It expressly considered the issues raised by the appellants.

[305] Clause 5.2 of the Code makes it clear that price adjustment is available as a "remedy" for a UTS. The Authority considered that the price adjustment was an appropriate remedy for the events of 26 March. Given the reasons identified by the Authority that a UTS occurred on 26 March it is hardly surprising that price adjustment was seen as the obvious and logical remedy together with an enquiry as to what, if any, amendments to the Code might be required arising from the events that day. In those circumstances no error of law has been identified.

Alternative remedies to a price reduction

[306] Genesis submitted that policy work and Code amendments were the appropriate way to address the Authority's concerns about what happened on 26 March. Genesis, therefore, submitted that in terms of clause (b) of the definition of a UTS the events of 26 March could be satisfactorily resolved by other

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[46] At [192].

mechanisms available under the Code. Genesis mentioned two projects, the development of both financial transmission rights (FTRs) and the hedge market.

[307] As I have noted the Authority indicated when it began its investigation of the events of 26 March that it would also undertake a market performance report of the events of this day. However, by 15 June 2011 when it released its report the Authority decided not to proceed with a market performance report.

[308] It said:[47]

> The Authority has decided not to proceed with a market performance report regarding the events of 26 March, as the UTS decision document already contains detailed analysis of the event. Moreover, the Authority's work programme already contains several pro-competition and pro-hedging initiatives for addition to the Code by the end of the year. The Authority believes that, had these measures been in place, the exceptional events of 26 March would not likely have happened. The Authority has decided to concentrate its efforts on developing these initiatives as expeditiously as possible, given the need and requirement for full consultation with stakeholders about such changes before any final decisions are made.
>
> Details on the Authority's work programme are on its webpage http://www.ea.govt.nz/our-work/programmes/.

[309] Essentially the Authority was saying it had already found the relevant facts for 26 March and it was already making changes to the Code which would be relevant to the events of 26 March. Presumably this was a reference to the development of FTR's and the hedge market. This work no doubt arose in part because of the obligations under s 42 of the EIA which, as relevant, provides as follows:

> **42 Specific new matters to be in Code**
>
> (1) Before the date that is 1 year after this section comes into force, the Authority must either—
>
> (a) have amended the Code so that it includes all the matters described in subsection (2) (the **new matters**); or

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47 Electricity Authority, Summary of UTS decision and related matters, 4 July 2011, available at www.ea.govt.nz/our-work/consultations/uts/15 Jun 11/.

(b) to the extent that the Code does not include all the new matters, have delivered to the Minister a report described in subsection (3).

(2) The new matters are as follows:

...

(c) mechanisms to help wholesale market participants manage price risks caused by constraints on the national grid:

...

(g) facilitating, or providing for, an active market for trading financial hedge contracts for electricity.

[310] Changes to the Code on 11 August 2011 (after the Authority's decision) resulted in the introduction of FTRs described by the Authority in this way:[48]

> FTRs are a special type of hedge product that protects the issuer of FTRs from exceptional movements in the spot market, such as occurred on 26 March this year. FTRs differ from other hedge contracts in that they are funded by surplus money arising from spot market pricing arrangements.

[311] Shortly after the events of 26 March the Authority noted that had there been an FTR market on 26 March FTR holders could have been substantially protected from the price spikes. There were also developments relating to the hedge market.

[312] Genesis' point is that these measures illustrate that if the Authority thought there was a problem with the wholesale market for electricity arising from 26 March then the FTR and the hedge market reforms demonstrate that market correction can properly operate through Code amendment rather than a declaration of a UTS and the use of the powers in cl 5.2 of the Code.

[313] The respondents submit that future amendment to the Code is not a "mechanism available under the Code" in terms of clause (b) of the definition of a UTS. Future amendment to the Code is not a mechanism available under the Code. I agree with the respondents' submissions.

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[48] Electricity Authority, FTR Overview, 2 August 2011. Available at www.ea.govt.nz/our-work/programmes/priority-projects/locational-hedges/ftr-development/.

[314] The EIA authorises amendments to the Code (at s 42). Clause (b) of the definition of a UTS does not provide for any mechanism available under the "Act" to resolve the event identified. And so the key question is whether there was any other mechanism available in the Code at the time of the event which is said to have given rise to the UTS which could satisfactorily resolve the event which threatens to preclude orderly trading.

[315] Bay of Plenty submitted that the Authority could have used the insolvency and prudential provisions in the Code as a "remedy" for the UTS, given one of the main concerns for the Authority was the financial impact on a broad range of market participants. While financial impact was a concern of the Authority it was not the only concern and so such a "solution" (mechanism) as suggested by Bay of Plenty would not satisfactorily resolve the event.

[316] Further, as MRP observed in its submissions neither the insolvency nor the prudential provisions of the Code would, in any event, have provided any resolution of the 26 March event. These mechanisms are forward looking.

[317] MRP submits that the prudential provisions in Part 14 of the Code deal only with matters such as acceptable credit ratings and security for industry participants, while the insolvency provisions apply to situations where financial obligations cannot be met.

[318] I, therefore, reject the appellants' submissions that the Authority failed to consider or wrongly rejected alternative ways of satisfactorily resolving the threat to the market precluding the maintenance of orderly trading.

Conclusion

[319] For the reasons detailed in this judgment I am satisfied that the Authority made no error of law upon which its conclusions that a UTS existed on 26 March 2011 could be challenged. I am also satisfied that the Authority made no error of law in reaching a conclusion as to the appropriate remedy for the UTS on 26 March 2011.

Supporting the Authority's decision on other grounds

[320] Given my conclusion about the proper interpretation of the definition of a UTS in clauses (a), (b) and (c) and their inter-relationship, Meridian's claim that the Authority's decision can also be supported on manipulative conduct grounds in clause (c)(i) cannot be correct. None of the grounds identified in clause (c) are themselves a UTS unless the clauses (a) and (b) factors are established. Here, even if the Authority had concluded Genesis' conduct was manipulative it would still have had to go on to consider whether clauses (a) and (b) were established. In fact it carried out this analysis although in the context of the circumstances described in clauses (c)(iii) and (c)(v).

[321] And so even if I had concluded that the Authority had made an error in its identification of what manipulative trading meant, it would be a hollow victory for Meridian. Such a conclusion would say nothing about whether in fact a UTS had occurred.

[322] The Authority's analysis of clauses (a) and (b), therefore, is the pivotal question and it cannot be helped by Meridian's claim that the Authority misapprehended what manipulative trading consists of.

Costs

[323] Should the respondents seek costs they should file memoranda in support within 21 days. The appellants have a further 21 days within which to respond.

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Ronald Young J

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Simpson Grierson, Auckland for Mighty River Power Limited
Wilson Harle, Auckland for Vodafone New Zealand Limited
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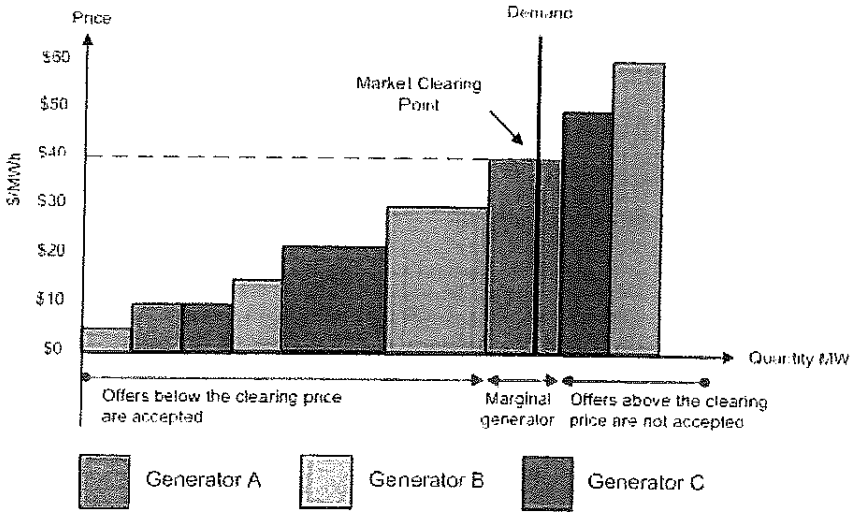
Figure 18: Simplified wholesale merit order



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