

Review of Trading Conduct: Introduction and Scope

Market
Development
Advisory Group
(MDAG)

Introduction

This presentation:

- Provides background on the project to review the trading conduct provisions in the Code
- Requests that MDAG include the *Review of spot market trading conduct provisions* project in its work plan
- Sets out a proposed scope for the project
- Sets out proposed next steps

Background

The *Review of spot market trading conduct provisions* project is number C4 in the Authority's 2017/18 work programme.

The project description is:

“Review of trading conduct provisions in light of events that have tested these provisions. Take into account any findings from case studies, performance reports and compliance reports.”

The aim for the project is:

“To ensure the trading conduct provisions are effective in promoting outcomes consistent with workable competition.”

Please note this aim varies slightly from that published in the Authority's work programme.

The project is priority 2 and the target for 2017/18 is to start preparation of an issues paper.

Trading conduct provisions: history

The trading conduct provisions were promulgated in June 2014.

The trading conduct provisions resulted from work by the Wholesale Advisory Group (WAG) on the *Pricing in pivotal supplier situations* project (pivotal pricing project).

The pivotal pricing project had the objective to improve the confidence in the efficiency of prices when competitive pressures in the wholesale market are weak.

The pivotal pricing project was initiated following several incidents where generators raised prices to a high level in a region in which they were temporarily pivotal but there was no supply scarcity.

The WAG recommended the Authority consider introducing trading conduct provisions in October 2013.

Trading conduct provisions

The trading conduct provisions in the Code are as follows:

13.5A Conduct in relation to generators' offers and ancillary service agents' reserve offers

- (1) Each **generator** and **ancillary service agent** must ensure that its conduct in relation to **offers** and **reserve offers** is consistent with a high standard of trading conduct.
- (2) Subclause (1) applies when—
 - (a) a **generator** submits or revises an **offer**; or
 - (b) an **ancillary service agent** submits or revises a **reserve offer**.

13.5B Safe harbours for clause 13.5A

- (1) A **generator** complies with clause 13.5A if—
 - (a) the **generator** makes **offers** in respect of all of its generating capacity that is able to operate in a **trading period**; and
 - (b) when the **generator** decides to submit or revise an **offer**, it does so as soon as it can; and
 - (c) in the case of a **generator** that is **pivotal**,—
 - (i) prices and quantities in the **generator's offers** do not result in a material increase in the **final price** at which **electricity** is supplied in a **trading period** at any **node** at which the **generator** is **pivotal**, compared with the **final price** at the **node** in an immediately preceding **trading period** or other comparable trading period in which the **generator** is not **pivotal** at that **node**; or
 - (ii) the **generator's offers** are generally consistent with **offers** it has made when it has not been **pivotal**; or
 - (iii) the **generator** does not benefit financially from an increase in the **final price** at which **electricity** is supplied in a **trading period** at a **node** at which the **generator** is **pivotal**.
- (2) A **generator** does not breach clause 13.5A only because the **generator** does not comply with subclause (1).

Trading conduct provisions

Trading conduct provisions continued:

13.5B Safe harbours for clause 13.5A

- (1) A **generator** complies with clause 13.5A if—
 - (a) the **generator** makes **offers** in respect of all of its generating capacity that is able to operate in a **trading period**; and
 - (b) when the **generator** decides to submit or revise an **offer**, it does so as soon as it can; and
 - (c) in the case of a **generator** that is **pivotal**,—
 - (i) prices and quantities in the **generator's offers** do not result in a material increase in the **final price** at which **electricity** is supplied in a **trading period** at any **node** at which the **generator** is **pivotal**, compared with the **final price** at the **node** in an immediately preceding **trading period** or other comparable trading period in which the **generator** is not **pivotal** at that **node**; or
 - (ii) the **generator's offers** are generally consistent with **offers** it has made when it has not been **pivotal**; or
 - (iii) the **generator** does not benefit financially from an increase in the **final price** at which **electricity** is supplied in a **trading period** at a **node** at which the **generator** is **pivotal**.
- (2) A **generator** does not breach clause 13.5A only because the **generator** does not comply with subclause (1).
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Trading conduct provisions

Trading conduct provisions continued:

13.5B Safe harbours for clause 13.5A

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- (3) An **ancillary service agent** complies with clause 13.5A if—
 - (a) the **ancillary service agent** makes **reserve offers** in respect of all of its capacity to provide **instantaneous reserve** that is able to operate in a **trading period**; and
 - (b) when the **ancillary service agent** decides to submit or revise a **reserve offer**, it does so as soon as it can; and
 - (c) in the case of an **ancillary service agent** that is **pivotal**,—
 - (i) prices and quantities in the **ancillary service agent's reserve offers** do not result in a material increase in the **final reserve price** in a **trading period** in an island in which the **ancillary service agent** is **pivotal**, compared with the **final reserve price** in the island in an immediately preceding **trading period** or other comparable **trading period** in which the **ancillary service agent** is not **pivotal**; or
 - (ii) the **ancillary service agent's reserve offers** are generally consistent with **reserve offers** it has made when it has not been **pivotal**; or
 - (iii) the **ancillary service agent** does not benefit financially from an increase in the **final reserve price** in a **trading period** in an island in which the **ancillary service agent** is **pivotal**.
- (4) An **ancillary service agent** does not breach clause 13.5A only because the **ancillary service agent** does not comply with subclause (3).

The review should use a framework of workable competition

The trading conduct provisions enliven the competition and efficiency limbs of the Authority's statutory objective.

The Authority has interpreted competition to mean workable or effective competition (paragraph A15, Interpretation of statutory objective).

As stated by JD Hayden QC:

“Workable competition means a market framework in which the pressures of other participants (or the existence of potential new entrants) is sufficient to ensure that each participant is constrained to act efficiently and in its planning to take account of those other participants or likely entrants as unknown quantities.... Workable competition exists when there is an opportunity for sufficient influences to exist in any one market which must be taken into account by each participant and which constrains its behaviour.”

Trade practices law: Introduction and restrictive trade practices, 2nd edition, Law Book Co, at 1548

Proposed scope (A)

As a result of a preliminary problem definition by the secretariat it is proposed the scope of the project is:

- a) trading conduct affecting outcomes in the energy and reserves markets in the New Zealand wholesale electricity market (spot market)
- b) considering whether the trading conduct provisions in clauses 13.5A and 13.5B of the Code are adequate or whether changes are required to better promote outcomes consistent with workable competition
- c) considering options, including guidelines, to aid in the interpretation of 'high standard of trading conduct' in clause 13.5A of the Code

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Proposed scope (B)

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- d) in light of any proposals to assist with interpreting 'high standard of trading conduct', considering whether the safe harbour provisions in clause 13.5B should be modified to ensure that behaviour of parties operating within the safe harbour is consistent with a high standard of trading conduct
- e) considering whether the trading conduct provisions should be broadened to apply to parties not subject to offer requirements but whose actions can impact on spot market outcomes inconsistent with workable competition, or whether it would be preferable to address this by other means, such as amending other Code provisions
- f) considering whether the trading conduct provisions should apply to actions other than offers that can impact on spot market outcomes inconsistent with workable competition or whether it would be preferable to address this by other means, such as amending other Code provisions.

It is proposed clause 13.5 is out of scope

Note clause 13.5 of the Code requires bids and offers must be lawful. Arguably, this clause also relates to trading conduct, but no issues have been identified in relation to this clause. Accordingly, reviewing clause 13.5 is outside the proposed scope.

Recommendation and next steps

It is recommended MDAG **agree** to include the *Review of spot market trading conduct provisions* project in its 2017/18 work plan

Should MDAG agree to this, the next steps would be for MDAG to:

- a) develop a project plan
- b) develop a problem definition