

Review of Trading Conduct: Problem definition

Market
Development
Advisory Group
(MDAG)

Introduction

This presentation:

- Provides context on the trading conduct provisions to assist MDAG in developing a problem definition for the *Review of spot market trading conduct provisions* project
- Sets out scenarios for discussion to assist with development of the problem definition

Reminder of scope of project (A)

- 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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Reminder of 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.

Context for trading conduct provisions

- The trading conduct provisions were introduced in June 2014
- Similar provisions have existed since the establishment of the wholesale market, eg NZEM conduct rules
- 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 WAG 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 WAG 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

Rationale for trading conduct provisions

- The trading conduct provisions are focused on offers by generators and ancillary service agents when they lack competitive pressure
- The trading conduct provisions seek to encourage generators and ancillary service agents to behave as if they faced competitive pressure at all times
 - See the safe harbour provisions, eg clause 13.5B(1):

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).

Note the coverage of the UTS provisions

5.1 Occurrence of undesirable trading situation

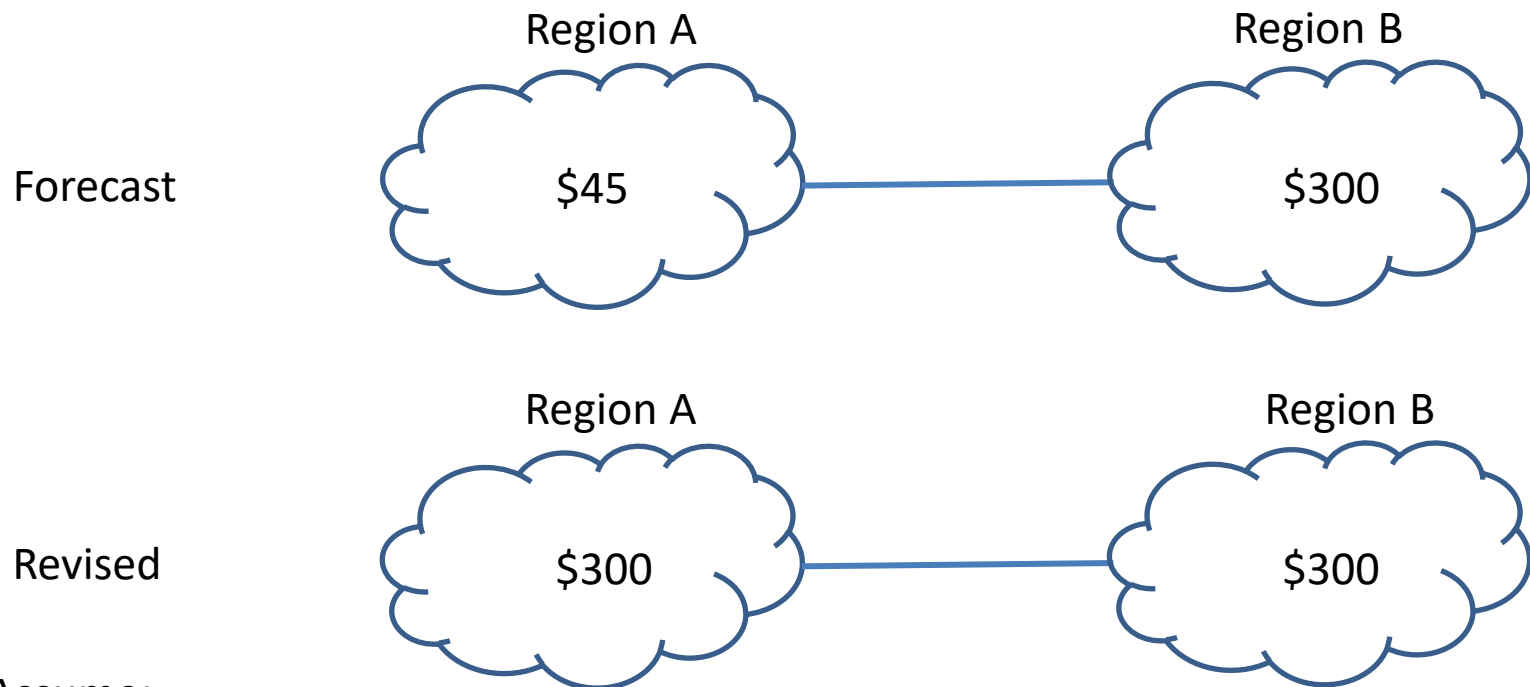
- (1) If the **Authority** suspects or anticipates the development, or possible development, of an **undesirable trading situation**, the **Authority** may investigate the matter.
- (2) The following are examples of what the **Authority** may consider to constitute an **undesirable trading situation**:
 - (a) manipulative or attempted manipulative trading activity:
 - (b) conduct in relation to trading that is misleading or deceptive, or is likely to mislead or deceive:
 - (c) unwarranted speculation or an undesirable practice:
 - (d) material breach of any law:
 - (e) a situation that threatens orderly trading or proper settlement:
 - (f) any exceptional or unforeseen circumstance that is contrary to the public interest.

Scenarios for discussion

Are the following consistent with a high standard of trading conduct?

- Raising an offer price to avoid a constraint / a price difference between locations
- Raising an offer price to deal with expected fuel scarcity
- Using engineering factor co-efficients to affect offer
- Offering plant that is in practice not available, eg because of maintenance
- Not informing market that plant is not available
- Withdrawal of plant not subject to offer provisions after gate closure
- Co-ordination of offers across multiple plant
- Offering / grouping of offers on behalf of others
- Not offering all available plant or capacity
- Other?

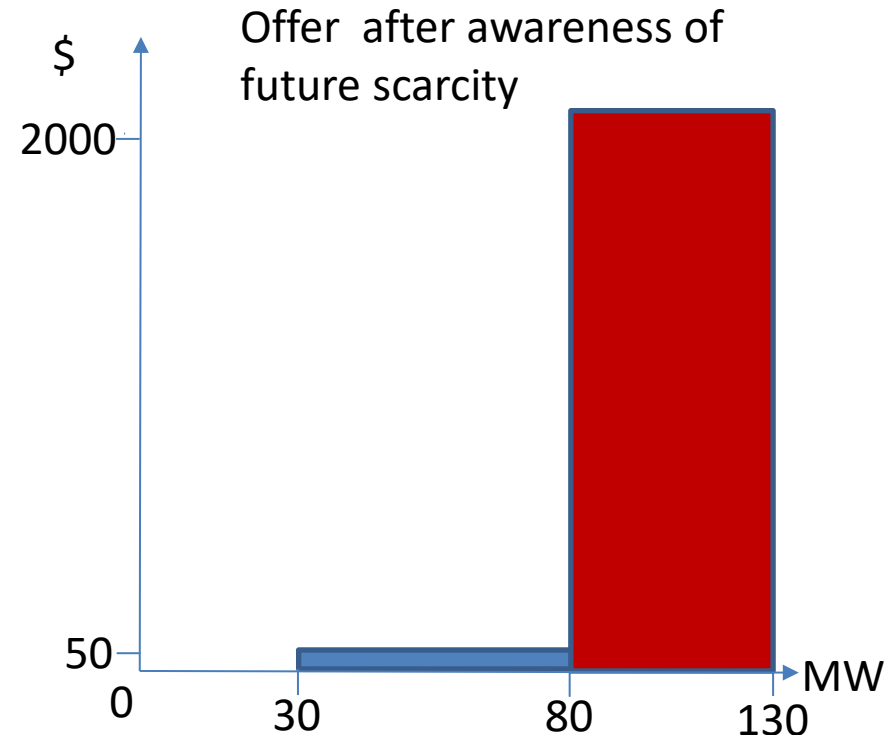
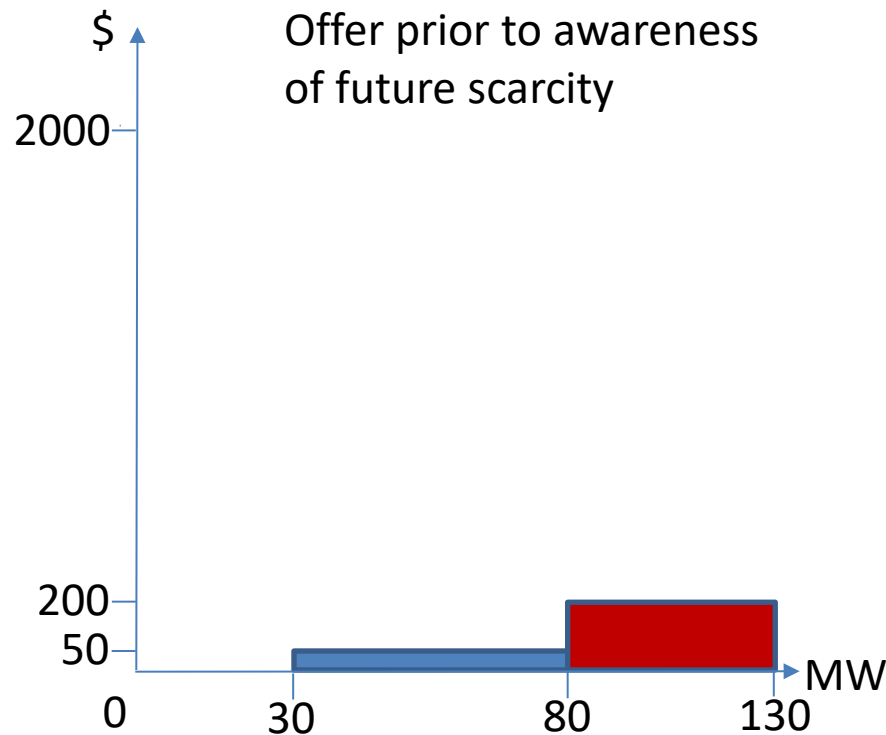
Scenario 1: Raising an offer price to avoid a constraint price difference



Assume:

- a) party lacks competitive pressure in Region A
- b) no change to fundamentals, eg underlying costs
- c) other short- and long-run risk management strategies available

Scenario 2: Raising an offer price to deal with expected fuel scarcity

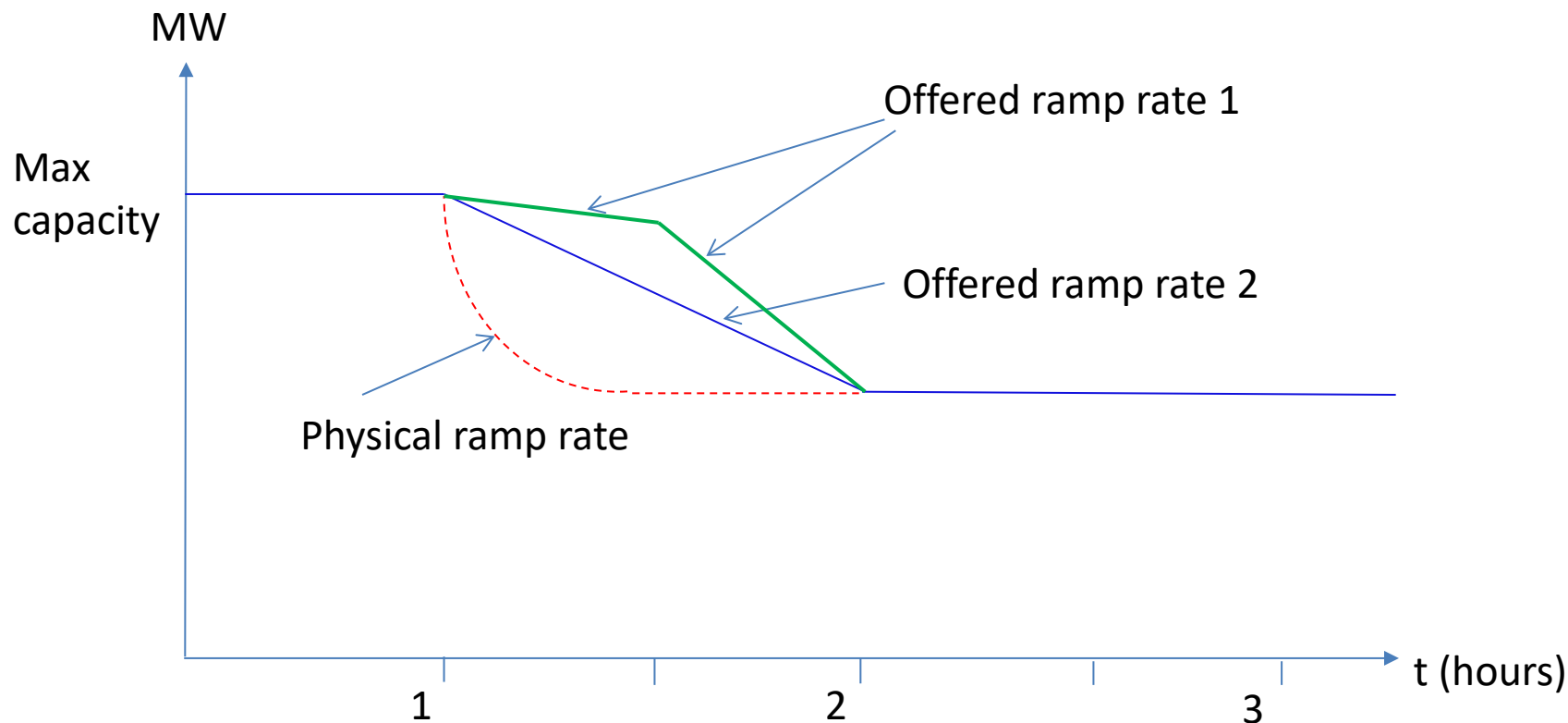


Assume:

- the fuel scarcity is the party's own fuel
- the party states they are not aware of future scarcity until just prior to changing their offer.
- other assumptions as for scenario 1

Is changing their offer acceptable 1 month out? 1 day out? 2 hours out?

Scenario 3: Using engineering coefficients to affect offer



Scenario 4: Use of reserve coefficients to affect offer (1)

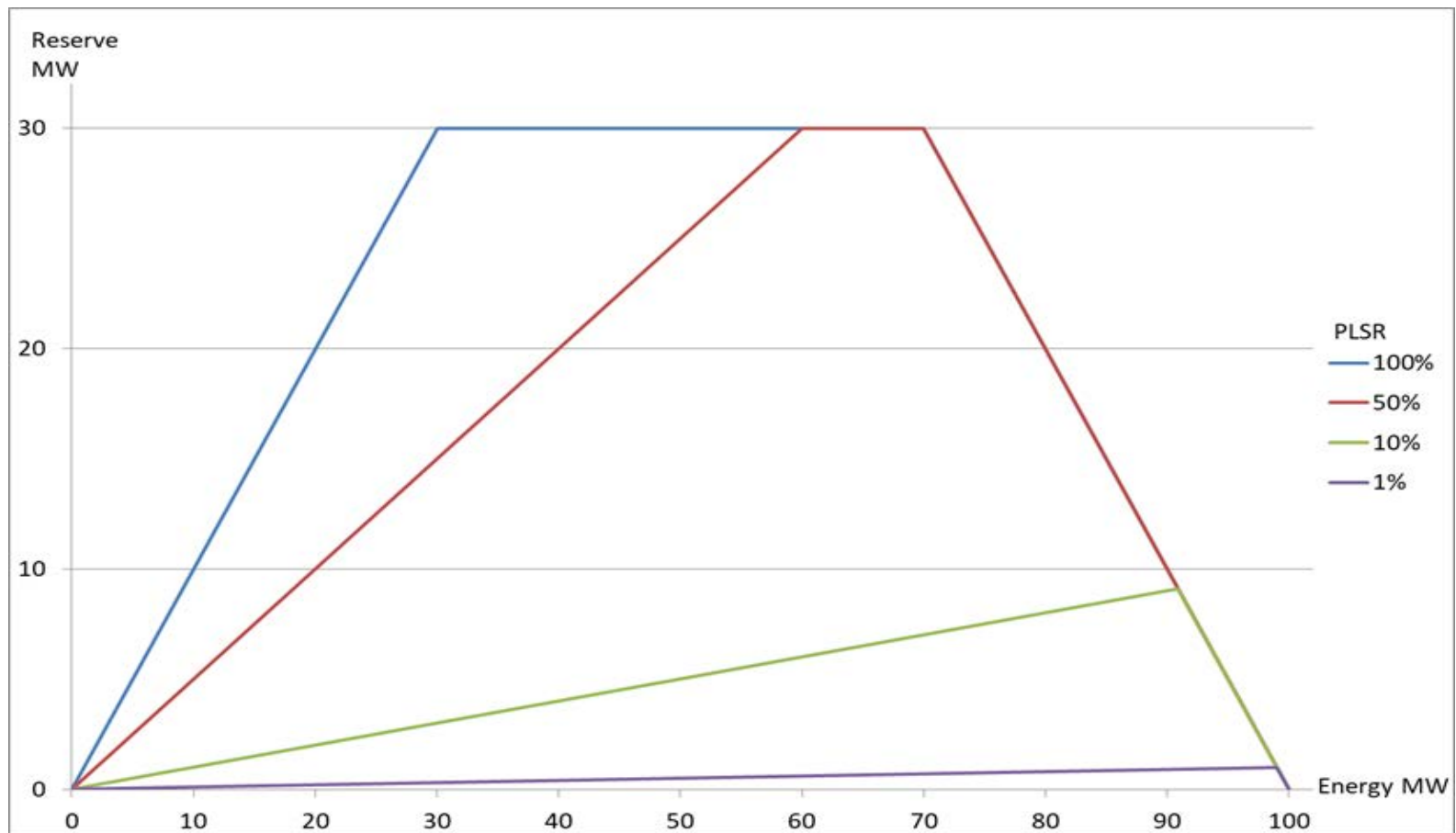
Trading period	Energy Offer Quantity	Reserve Offer Quantity	Reserve Offer Price	PLSR Percent	Effective Reserve Offer
1	100	30	\$0.01	100%	30
2	100	30	\$0.01	50%	30
3	100	30	\$0.01	10%	9.09
4	100	30	0.01	1%	0.99

PLSR = partly loaded spinning reserve

- See illustration on next slide for impact on reserve vs energy available

Scenario 4: Use of reserve coefficients to affect offer (2)

Effect of PLSR coefficient on energy vs reserve availability



Scenario 4: Use of reserve coefficients to affect offer (3)

Trading period	Energy Offer Quantity	Reserve Offer Quantity	Reserve Offer Price	PLSR Percent	Effective Reserve Offer
1	100	30	\$0.01	100%	30
2	100	30	\$0.01	50%	30
3	100	30	\$0.01	10%	9.09
4	100	30	0.01	1%	0.99

PLSR = partly loaded spinning reserve

- Co-optimisation of energy and reserves means availability of reserves will affect final prices
- Availability of reserves can affect ability of competing plant to generate
- Is it acceptable for the reserve co-efficient to be based on anything other than physical ability to provide reserves?

Scenario 5: Unsignalled withdrawal of capacity without physical reason

- Is it acceptable to withdraw capacity when there is no physical impediment to offering the capacity, such as a generator outage?
- Is it acceptable to withdraw capacity when there is anticipated scarcity or should this just be signalled through the offer price?
- If capacity is to be withdrawn, at what point should it notified?
- Note safe harbour provisions making capacity available (see next slide)

Scenario 5: Safe harbours require available capacity is offered

- e.g. reserves safe harbour requirements

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).

Recommendation and next steps

It is recommended MDAG:

- a) **agree** to the key milestones to be set out in the project plan for the *Review of spot market trading conduct provisions* project (see next slide)
- b) **request** the secretariat draft a paper that captures MDAG's preliminary view on the problem definition for discussion at the next meeting

Proposed key milestones (from draft project plan, page 11)

Activity	Dates	Status
Initiation		
MDAG agrees to include project in work plan	28 November 2017 (1 st MDAG meeting)	Completed
MDAG agrees project plan	8 February 2018	
MDAG agrees problem definition	[May 2018]	
MDAG finalises discussion paper	[September 2018]	
Submit discussion paper to Board for comment	[November 2018]	
MDAG releases discussion paper for consultation	[February 2019]	
MDAG prepare summary of submissions following consultation	[April 2019]	
MDAG finalise recommendations paper	[June 2019]	
Submit paper to Board to consider recommendations	[September 2019]	