

MINUTES

Meeting number: 6

Venue: Electricity Authority, Boardroom, Level 7, ASB Bank Tower, 2 Hunter Street, Wellington

Time and date: 10:00am to 3:55pm, Tuesday, 26 June 2018

Attendees

- James Moulder (Chair)
- James Flannery
- James Flexman
- Darren Gilchrist
- Stu Innes [teleconference; left 10:39am]
- Rebecca Osborne
- Bruce Rogers
- Matt Rowe

Apologies

- James Tipping

In attendance

- Murray Henderson (Principal Market Analyst, System Operations, Transpower)
- John Rampton (General Manager Market Design, Electricity Authority)
- Tim Street (Manager Wholesale Markets, Electricity Authority)
- Alistair Dixon (Principal Adviser Market Design, Electricity Authority)
- Avi Singh (Administrator Market Design, Electricity Authority)

Guest speakers on Review of spot market trading conduct provisions

- Colin Magee (Head of Conduct, Financial Markets Authority) [item 1; joined 11:00am, left 11:54am]
- Karl Arns (Dealer, Institutional Commodities, OM Financial) [item 1; joined 1:03pm, left 1:24pm]

The meeting opened at 10:00am

2 Meeting Administration

The Chair moved this item forward on the agenda ahead of its scheduled order

2A Apologies

An apology was received from James Tipping. The Chair noted Stu Innes was joining the meeting from Albania via teleconference at short notice.

2B Interests register

The Chair:

- tabled the MDAG interests register
- reviewed the interests disclosed/updated
- gave relevant group members permission to act.

2C Minutes of previous meetings

The Chair tabled minutes of the previous meeting on Thursday, 3 May 2018.

Bruce Rogers proposed confirmation of the minutes, which Matt Rowe seconded.

2D Matters arising

There were no matters arising.

2E Action list

The Chair noted all actions from the previous meeting were completed, except the ongoing action to explore additional judicial mechanisms that could help expedite any trading conduct breach allegations. This action would be completed by the end of this meeting once the MDAG heard from the Financial Markets Authority.

2F Correspondence

The Chair tabled correspondence from the Authority Chair inviting the MDAG to join the Authority Board at its strategy day on Wednesday, 5 September for a discussion with the:

- Authority Board and Senior Leadership Team
- Innovation and Participation Advisory Group
- General Manager System Operations and Innovation at Transpower.

The Chair asked the secretariat to:

- move the MDAG's originally scheduled 18 September meeting to 5 September to allow the group to take up the Authority Board's invitation
- include preparation for the strategy day discussion on the agenda for the MDAG's 7 August meeting.

| **Action – 6.1:** Secretariat to reschedule the MDAG's September meeting by next MDAG meeting

| **Action – 6.2:** Secretariat to include preparation for the strategy day discussion on the 7 August MDAG meeting agenda by next MDAG meeting

The Chair also noted correspondence from the Authority's Chief Executive, following the MDAG's 3 May meeting with the Authority Board, outlining their feedback on the draft *Saves and win-backs* issues paper.

The group deferred the following discussion on item 2G (Annual report) until after they had considered item 1 (Review of spot market trading conduct provisions)

2G Annual report

The MDAG agreed to consider a previous example for further discussion at their next meeting.

2H Work plan update

The Chair tabled the work plan update for the group to note.

1 Review of spot market trading conduct provisions

Preliminary problem definition

The group deferred parts of this discussion until after they had heard from various guest speakers

The MDAG briefly discussed their progress on the project to date before discussing a presentation on the preliminary problem definition which outlined seven potential problems:

- 1. The general 'high standard of trading conduct' requirement is considered unclear**
- 2. The trading conduct provisions only apply to parties making offers**

The group noted:

- on the load side, only dispatchable demand has compliance obligations
 - 'last minute' reductions in load could have a material impact on prices, and could potentially be an exercise of market power in certain situations
 - the relatively narrow focus of the provisions may be sufficient at present, but new technologies and approaches will increasingly make the situation more complicated
 - it may be difficult in future to determine when a conforming node becomes a non-conforming node.
- 3. The trading conduct provisions do not prevent withdrawal of plant not subject to gate closure**
 - 4. There are divergent views on whether the trading conduct provisions apply to a party altering its offers to avoid a constraint**

The MDAG discussed:

- the three broad perspectives on this issue, and the complexity in determining which perspective would best promote the long-term benefit of consumers
- whether historic decisions around the location of physical infrastructure were relevant to ongoing conduct and whether it was of a high standard
- how the relevant market could potentially encompass multiple markets (eg, the Kawerau 11V, 33V and 110V lines)
- the relevance of both potential scenarios and a principles-based approach in addressing this issue.

5. The trading conduct provisions do not make clear that offers should reflect the underlying physical capability of the plant

The group agreed the use of engineering factors (eg, ramp rates) to affect offers that did not reflect the physical underlying capability of the plant did not meet a high standard of trading conduct.

6. The trading conduct provisions do not make clear that:

- **plant should be offered unless it is not available because of bona fide reasons**
- **where plant is not available, the market should be informed (eg, by informing the market through the Planned Outage Co-Ordination Process [POCP])**

The MDAG discussed:

- the potential for price spikes due to thermal generation being affected by fuel unavailability, and whether this:
 - meant thermal generation should continue being offered until fuel runs out
 - was a market information disclosure issue, because POCP disclosure is designed to notify the market about outages and maintenance
 - could create a ramping issue for thermal generation if it was potentially required to offer prior to when it was capable of generating.

7. The trading conduct provisions do not specifically address co-ordination of offers between generators or ancillary service agents – the Commerce Act 1986 may mean this is unnecessary

The group noted the trading conduct provisions are about raising the standard of market conduct generally, and are separate from the Commerce Commission's investigations into market power which must conform to the thresholds set out in the Commerce Act 1986.

Following this discussion, the MDAG asked the secretariat to prepare a draft term sheet and draft discussion paper for the group to consider further at its next meeting.

| **Action – 6.3:** Secretariat to prepare draft term sheet by next MDAG meeting

| **Action – 6.4:** Secretariat to prepare draft discussion paper by next MDAG meeting

Financial Markets Authority

Guest speaker Colin Magee from the Financial Markets Authority (FMA) discussed the FMA's approach to regulating trading conduct in financial markets, noting that while the FMA oversees trading conduct related to financial products (including derivatives), it does not do so for physical products (such as electricity). He then broadly outlined the FMA's position:

- While the legislation the FMA is responsible for enforcing, the Financial Markets Conduct Act 2013 (FMCA), does not define all circumstances that could constitute unacceptable trading conduct of financial products, the FMCA does prohibit misleading or deceptive conduct in relation to all financial products, with additional restrictions (insider trading and market manipulation) applying to listed products.
- The FMA's approach to insider trading is largely mirrored by regulators in Australia and the United Kingdom, so that if information is not available to the market as a whole it is not allowed to be traded on, unless it falls within defined exceptions.

- The FMA considers there is strong case law on market manipulation noting that trading any financial product with the main purpose of altering price is illegitimate, because it creates a misleading perception of supply and demand.
- New Zealand's approach to regulating market conduct has changed over time. Unlike the regime administered by the Securities Commission, the FMA now prosecutes practices previously considered acceptable by the financial industry. In particular, some traders who were in breach of the rules argued some historic practices were consistent with acceptable trading conduct, but following successful prosecutions, there has been a noticeable behavioural change.
- Trading which created a shortage in one market in order to affect prices in another market would be considered to have an illegitimate purpose, as would trading to push a price up in one market being used to offset losses in another market.
- The FMA's focus is on the impact of the conduct on consumers – if conduct can be shown to be in the best interests of consumers then it is likely any inadvertent breaches of legislation will be treated more leniently. This focus on outcomes for consumers is likely to result in better economic outcomes overall, because it will enhance both consumer and participant confidence in the integrity and durability of the market by reassuring them that the market is operating fairly on a 'level playing field'.
- The incentives on participants and traders are key in relation to what conduct is considered acceptable – if poor conduct is not prohibited or prosecuted, it is more likely traders will consider such conduct acceptable; the FMA considers trader behaviour has improved following successful prosecutions.
- The FMA considers there is benefit from establishing principles to promote desirable trading conduct (and has recently published principles for the trading of bank bills), but notes the desire of market participants for greater certainty to help understanding of, and compliance with, the FMCA.

The MDAG then discussed the FMA's points and the implications for trading conduct in the electricity market. In particular, the group noted the:

- approach to regulating trading behaviour in financial markets provides potential lessons for the electricity market
- need for a balancing act between overarching principles and specific rules to help promote a high standard of trading conduct
- value of a focus on purpose and intent in assessing trading conduct
- relevance of legal mechanisms, enforceability and enforcement practices to trading behaviour.

The Chair then asked the secretariat to:

- circulate the FMA's guidance note on the trading of bank bills, which includes some principles for trading conduct
 - prepare a letter on his behalf to the FMA thanking them for attending.
- | **Action – 6.5:** Secretariat to circulate the FMA's guidance note on the trading of bank bills by next MDAG meeting
- | **Action – 6.6:** Secretariat to send thank you letter to FMA by next MDAG meeting

OM Financial

Guest speaker Karl Arns from OM Financial, a broker of various financial products, provided his observations on trading conduct in various markets in New Zealand and overseas jurisdictions, noting he had limited experience working in Australian markets. In particular, he contended:

- New Zealand generators are wary of testing the limits of the trading conduct provisions following previous investigations by the Authority
- there are more safeguards in place to prevent the exercise of market power across various markets in New Zealand, compared to Australia
- New Zealand electricity market participants often appeared to be fully hedged for price spikes
- consumers should not be required to bear any losses resulting from issues with generation or transmission infrastructure.

The MDAG then noted OM Financial's points, particularly the impact the use of the hedge market by both large and small participants can have on trading conduct.

The Chair then asked the secretariat to prepare a letter on his behalf to OM Financial thanking them for attending.

| **Action – 6.7:** Secretariat to send thank you letter to OM Financial by next MDAG meeting

3 Publication of meeting papers

The Chair asked the secretariat to prepare a letter on his behalf to the Authority's outgoing Chief Executive thanking him for joining the group for lunch, and for his service to the Authority.

| **Action – 6.8:** Secretariat to send thank you letter to the Authority's outgoing Chief Executive by next MDAG meeting

The group then approved publishing the meeting papers on the Authority's website without alteration.

The meeting ended at 3:55pm

I, Bruce Rogers (Acting MDAG Chair), certify that the minutes recorded disclose all issues discussed at the meeting (date at the top), are recorded truthfully and without bias.

Signature:



Date: Tuesday 28 August 2018 (28.08.2018)