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For meeting on 19 May 2020

Trading conduct review: initial summary of submissions

Market
Development
Advisory Group

Note: These slides have been prepared for the purpose of updating the Market Development Advisory Group. Content should not be interpreted as representing the views or policy of the Electricity Authority.

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Introduction

- High-level summary of submissions
- More detailed summary of submissions and cross-submissions will be provided at the next MDAG meeting
- Seven submitters:
 - Contact
 - Genesis
 - Haast and Electric Kiwi
 - Joint independent retailers*
 - Mercury
 - Meridian
 - Trustpower

Disclaimer: this summary reflects a quick initial reading of the submissions and is not exhaustive.

*Ecotricity, Electric Kiwi, energyclubnz, Flick Electric, Pulse, Vocus

Three submitters strongly disagree with proposal

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- Contact, Mercury, and Trustpower all think there's no problem and that the proposed solution is not appropriate for the wholesale electricity market.

	Problem definition	Proposed option	Overview of position
Contact			• Exercise of market power is not a problem. • Proposal is a significant departure from current market design.
Mercury			• No evidence that pivotal situations have led to long-term consumer detriment. • Proposal is de-facto price regulation.
Trustpower			• Based on evidence, not clear there is a problem to be solved. • Proposal is complex and it's not clear how it would interact with price discovery.



Strongly support



Conditional support



Neutral



Disagree

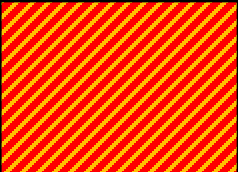
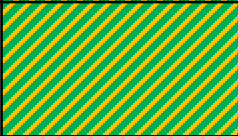
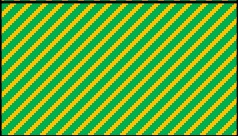


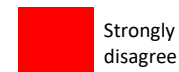
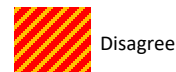
Strongly disagree

Four submitters provide conditional support

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- Four submitters agreed that market power is an issue during pivotal situations, but two submitters (Haast and Electric Kiwi, and Independent retailers) consider the problem is bigger than indicated by MDAG.
- Three of the submitters support the proposal with some enhancements, but Genesis thinks the proposal is not appropriate for the wholesale electricity market.

	Problem definition	Proposed option	Overview of position
Genesis			- Market power is an issue. - Proposal is an improvement on HSOTC but is based on framework for monopolies not a workably competitive market.
Haast and Electric Kiwi			- Problem is bigger than indicated by MDAG. - Support proposal with some enhancements.
Independent retailers			- Market power and market manipulation are both issues. - Support proposal with some enhancements.
Meridian			- Significant issues with current provisions. - Tentatively support proposal, conditional on purpose statement being re-drafted.



MDAG asked for feedback on five issues

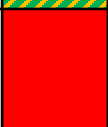
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- The discussion paper asked submitters for feedback on:
 - a) whether we have correctly defined the problems (regarding the potential problem of pivotal behaviour and potential problems with the current provisions)*
 - b) whether we have correctly characterised the possible options to address the problems*
 - c) your opinion on the MDAG's preferred option*
 - d) whether the proposal should apply to all offers at all times, as proposed, or should be restricted to pivotal supply and, if so, whether it should apply only to net pivotal supply*
 - e) any comments on the cost-benefit analysis.*

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Problem definition

Question: have we correctly defined the problems (regarding the potential problem of pivotal behaviour and potential problems with the current provisions)?

Contact		Exercise of market power not a problem.
Genesis		There are occasions when generators have ability to exercise unfettered market power.
Haast and Electric Kiwi		Problem bigger than MDAG indicated. Need to look at sub-Island pivotal situations. Market manipulation and insider trading an issue too.
Independent retailers		Market power is an issue. Market manipulation also an issue.
Mercury		No evidence that pivotal situations have led to significant long-term consumer detriment.
Meridian		There are significant problems with the current provisions.
Trustpower		Not sure (based on the evidence presented) that there is a problem to address.



Strongly support



Conditional support



Neutral



Disagree



Strongly disagree

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Characterisation of different options

Question: have we correctly characterised the possible options to address the problems?

- Most submitters provided no comment on this question.
- Trustpower submitted that:
 - more options analysis needed to be undertaken
 - the focus should be on structure and incentive options, rather than conduct
 - there should be consideration of whether the HSOTC provision should be deleted altogether and rely on other methods of managing market power.

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MDAG's preferred option

Question: what's your opinion on the MDAG's preferred option?

- Several parties thought the proposal was a form of price regulation and more suited for a monopoly/regulated market.
- However, three submitters provided conditional support for the proposal.

Contact		Proposal is a significant departure from the current wholesale electricity market design, and it mandates specific market outcomes which are usually a feature of regulated markets.
Genesis		Proposal is an improvement on HSOTC but is not appropriately targeted at the problem. The proposal also follows a legal and economic approach that has been developed for monopolies and is not applicable to workably competitive markets. Have made an alternative proposal.
Haast and Electric Kiwi		Support proposal with some enhancements. HSOTC clause should be retained as a catch-all. Note there may be alternative trading conduct rules that are worth considering.
Independent retailers		Support proposal with some enhancements. HSOTC clause should be retained as a catch-all. Note that suggestions by other parties that liken proposal to price control are not a reasonable or accurate representation of the proposal. Consider proposal would provide more clarity.
Mercury		The net effect of the MDAG proposal will be to introduce de-facto price regulation on the wholesale market. Disagree that efficient prices will always equate to underlying economic costs. Efficient prices are set through the price discovery process in competitive markets.
Meridian		Tentatively support, conditional on re-drafting of purpose statement and a full CBA by the Authority. Proposed purpose statement suggests the application of an entirely different test to that set out in subclause 1.
Trustpower		Proposal is difficult to understand and apply in real time. Wellington International Airport case not relevant as deals with a monopoly. Concern with how proposal would interact with process of price discovery. Conduct provisions are not the best tool for addressing market power in electricity markets.

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Application of proposal to all offers

Question: should the proposal:

- apply to all offers at all times (as proposed), or*
 - be restricted to pivotal supply and, if so, should it apply only to net pivotal supply?*
- No consensus on whether proposal should apply to all offers or just pivotal supply.
 - No support for proposal to apply only to net pivotal supply.
 - Independent Retailers and Trustpower did not comment on this question.

Contact	Pivotal only	Not necessary to apply to all offers for a market that is fundamentally competitive.
Genesis	Pivotal only	Don't understand why it applies to all offers when MDAG has identified that the problem only exists when a generator is pivotal.
Haast and Electric Kiwi	All offers or all pivotal	Do not support limiting to net pivotal—gross pivotal situations can give rise to concerns about abuse of market power.
Mercury	Pivotal only	Do not support it applying to all trading periods.
Meridian	All offers	It is challenging to determine when generators are gross or net pivotal.

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Cost-benefit analysis

Question: any comments on the cost-benefit analysis?

- The five gentailer submitters thought the CBA underestimated the costs.
- Haast and Electric Kiwi thought the CBA understated the benefits.
- Genesis, Meridian, and Trustpower said a more robust/quantitative CBA was needed given the importance of the proposed change.
- Haast and Electric Kiwi and Independent retailers suggested some ways in which a more quantitative CBA could be undertaken.

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Cost-benefit analysis (cont.)

Question: any comments on the cost-benefit analysis?

Contact	Questionable that costs will be negligible—expect alleged breaches to increase and Authority will need to increase monitoring and compliance
Genesis	Agree that quantitative CBA difficult due to subjective judgements, but given importance of proposed change, suggest MDAG should seek to do a full quantitative CBA. MDAG underestimates the cost of generators offering at inefficiently low prices due to the uncertainty of falling foul of the too much, too long standard. Don't agree that additional staffing costs for the Authority and participants will be minimal/nil.
Haast and Electric Kiwi	CBA understates benefits as only considers efficiency benefits and not consumer price benefits. Reduction in wealth transfers from consumers is likely to be the most substantial benefit. Provide some suggestions on how a more quantitative CBA could be undertaken.
Independent retailers	If MDAG was going to try developing a quantitative CBA it could consider modelling the results of more competitive outcomes using vSPD.
Mercury	Do not agree that proposal will come with negligible cost—there is potential for distorted generation offer behaviour and increased regulatory intervention in response to the economic cost-based trading conduct test.
Meridian	CBA is inadequate. CBA does not assess how the proposal might distort price discovery and the economic cost of these distortions. A full CBA is needed and should be consulted on. Sapere showed that the proposal erodes the price discovery function of the market and replaces it with a form of discretionary price control regulation.
Trustpower	A more robust CBA needed for reform of this magnitude. Another CBA should be done that includes assessing the proposal against other options. Think proposal will increase costs due to complexity of test and potential for higher compliance costs, vexatious claims, and rule breaches.

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Need for Authority consultation

- Three submitters (Genesis, Meridian, Trustpower) don't support bypassing Authority consultation.
- Two submitters (Haast and Electric Kiwi, Independent Retailers) support bypassing Authority consultation.
- Contact and Mercury had no comment.

Genesis	Don't support proceeding to Code change without Authority consultation. Doing so would heighten the risk of a less than optimum outcome. An Authority consultation would improve the likelihood of the proposal being effective and enduring.
Haast and Electric Kiwi	Support skipping the Authority consultation on the Code amendment.
Independent retailers	Support the Authority going straight to Code amendment following the public release of the MDAG recommendations paper.
Meridian	Regulatory change of this potential significance should be consulted on by the Authority. Note this proposed Code amendment does not meet the criteria of being technical, non-controversial, and having wide support.
Trustpower	Strongly suggest a full consultation process by the Authority—this will allow affected parties to have their views heard directly by the decision maker. Don't think consultation by an advisory group should be used as a substitute for direct consultation by the decision-maker (particularly for matters of significance).

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Other issues and suggestions

Submitter(s)	Comment
Contact	Recommend the Authority consider introducing specific measures to ensure cases are legitimate (eg, a two-step process or an Early Resolution Team to quickly respond to and progress/dismiss claim allegations).
Haast and Electric Kiwi	MDAG should recommend the Authority review whether the \$0.00/MWh price floor in clause 13.15 of the Code can be removed.
Haast and Electric Kiwi, Independent retailers	Support for more stringent monitoring and enforcement.
Haast and Electric Kiwi, Independent retailers	Review has taken too long.
Meridian	Concerned that MDAG has misrepresented and seemingly misunderstood the 2 June 2016 decisions.
Trustpower	Need to develop case studies to see how rules might apply “at the trading desk”.