

## **UTS PRELIMINARY DECISION: Briefing 30 June 2020**

### **INTRODUCTION**

Welcome – I'm James Stevenson-Wallace, Chief Executive of the Electricity Authority. The Authority is the regulator of electricity markets in New Zealand.

#### **Scope of the announcement today**

The purpose of today's briefing is to provide an overview of our preliminary decision relating to claims of an undesirable trading situation (UTS) for market events that commenced in December 2019.

I emphasise that this is a preliminary decision based on the Authority's assessment of currently available information and is subject to consultation and cross submissions. We will consult for six weeks, followed by a three week period for cross-submissions.

I also note, up front, that the preliminary decision does not discuss corrective actions. If a UTS is found, the Authority will form a decision on actions to correct.

#### **Overview of UTS**

An undesirable trading situation maintains a high test and extensive corrective powers open to the Authority.

A UTS refers to a situation that:

- threatens confidence or integrity of the wholesale market;
- is outside normal market operations;
- may have serious consequences for the wholesale market;
- doesn't happen on a regular basis; and
- cannot be resolved via other mechanisms.

It's not possible to directly observe confidence or integrity, so the Authority looks at indicators and other evidence to determine if a UTS has occurred.

The preliminary decision released today documents our approach and our findings.

It is a detailed account of the investigation and reflects the depth of information and analysis required to reach this preliminary decision.

The expectation is that consultation will ensure that any subsequent decisions benefit from the best available information.

We will keep this short but there will be an opportunity for questions at the end. There will be other opportunities during consultation to ask the team questions. We have a technical briefing scheduled for 17 July. This gives you time to go through the document and read the details first.

#### **So, recap of December 2019**

In December the Authority received a claim from seven participants that a UTS had begun on 10 November and was continuing at the time of the claim. The claim alleged the UTS was caused by Meridian Energy (Meridian) and Contact Energy (Contact) spilling water from their hydro generation stations in the South Island, while simultaneously offering this generation into the spot market at prices above its short-run marginal cost (SRMC).

[Context of the physical environment is important in this claim]: At the time the claim was received, the South Island was suffering extraordinary weather conditions.

- An extreme weather event resulted in significant flooding and lakes were at or above maximum levels.  
These circumstances were similar to that suffered in 2011 and 1995 before that.
- Water was being spilled by South Island hydro generators between 10 November and 16 January.
- The flood conditions and spilling peaked in December.
  - Spilling refers to water being spilled into waterways without being used for generation.
  - Some of that spilling was a necessary and acceptable practice designed to manage water levels/flows for resource consents.

[Importantly, plans were also in place to conserve North Island hydro reserves]: with the scheduled outage of the HVDC Inter-Island link, or Cook Strait Cable, scheduled for the first quarter of 2020.

This HVDC outage was well-signalled and well-integrated into operational planning – meaning that North Island hydro generators were focused on conserving water to cover the outage and ensure security of supply.

### **THE CLAIM, EA review, and status of the Compliance Process**

The UTS claim was received on 12 December from Haast Energy, Ecotricity, Electric Kiwi, Flick Energy, Oji Fibre, Pulse Energy and Vocus.

- The claim was received soon after the Electricity Authority confirmed a self-initiated review into 2019 wholesale market prices.
- The claim focuses on activities and trading behaviour of Meridian Energy and Contact Energy spilling water from their hydro generation stations in the South Island, while offering this generation into the spot market at prices above its short-run marginal cost (SRMC).
- The Authority included Genesis in the investigation as it was also spilling from its South Island lakes during this period.

With spilling having stopped on 16 January, the Authority and the claimants agreed the period for investigation was to cover the period from 10 November to 16 January.

### **EA Initiated-Review**

The Authority were actively monitoring the market at the time spilling commenced in November as part of our ongoing market oversight role.

- We recognise that wholesale electricity prices are a careful balance of supply and demand.
- The price should reflect the availability and cost of the fuel.
- Excess water that cannot be stored and is spilled has zero opportunity cost.
- The market outcomes in December, in our view, did not match our expectations of a power system with abundant cheap fuel.
- In response we initiated a review.
- That review has been paused whilst we investigated the allegations in the claim but will continue in the background.

In addition to the UTS investigation, the Authority has a separate compliance process underway to respond to potential breaches of the Code.  
This process is ongoing.

## **AUTHORITY'S APPROACH TO THE INVESTIGATION**

For a situation to constitute a UTS, confidence or integrity of wholesale market has or may have been threatened.

Part of the complexity in investigating an alleged UTS is that it is not possible to directly observe confidence or integrity of the wholesale market. We therefore look at indicators and other evidence to determine whether a UTS has occurred. [based on the information before us and the analysis subject to consultation]

For the spot market we tested whether the outcomes we observed during the period of the spilling reflected supply and demand conditions.

- *If participants observe prices and outcomes that are consistent with supply and demand conditions at that time, it shows the spot market has integrity and participants can have confidence in it.*

The Authority considers that if wholesale market outcomes reflect the supply and demand conditions, then there is no reason for confidence or integrity to be undermined.

- *Conversely, if spot market outcomes vary widely from the underlying supply and demand conditions, then confidence or integrity may have been undermined and a UTS may have developed.*

We specifically looked at the spilling and trading activities of hydro generators spilling at some stage during the investigations period.  
This included Contact, Meridian and Genesis.

### **Authority framework versus that of the Claimants**

The Authority's investigation framework does however differ from the approach laid out by the claimants.

- [The claimants framework suggests that]: the behaviour breached high standard of trading conduct provisions (HSOTC), and the nature and scale of this breach was so significant as to qualify it also as a UTS (i.e. UTS test applied implicitly).
- The EA considers that there were limitations as to how the claimants have estimated the financial impact.
- [The EA framework]: applies the UTS test directly.  
Specifically, a UTS situation, does not also require a breach of the HSOTC provisions to have been found.  
The alleged breach of the HSOTC is being investigated separately.

## UNEXPECTED OUTCOMES

We observed activity between 3-18 December which we consider, based on the information before us, may constitute a UTS situation.

This is also subject to consultation. NB: The **relevant period differs** from that suggested by Claimants

- The period 10 November to 16 January 2020 covers the period where spilling was occurring.
- The period of 3-18 December, used by the EA, covers the period where generators spilled water in preference to lowering their offer prices.

### Findings

[The Outcomes in the spot market]: did not match our expectations of a power system with abundant cheap fuel:

- Price response was not what we would expect given the conditions – that is, high prices despite excess spilling
  - We would expect lower offer prices that reflect the zero opportunity-cost of water that cannot be stored.
- Evidence shows Meridian was pricing its offers in such a way as to ensure the HVDC was not constrained.
  - Managing the HVDC in this way benefits all SI generators by preventing spot price separation between the NI and SI.
  - This behaviour limited generation keeping prices in the SI higher than we would expect given the abundance of fuel.
- The Authority does not agree with using offers to manage transmission constraints in this way.
- No significant price separation occurred between NI/SI - price separation indicates where transmission is constrained.
- Thermal generation ran in the NI when SI stations were spilling despite the HVDC not being at capacity and abundant hydro fuel.
- Spot prices subsequently fell in late December, but this was due to reduced demand rather than offers changing due to spilling.

[Specific to the Companies involved]:

- Viewed in isolation, the Authority considers the behaviour of **Contact** and **Genesis** would not constitute a UTS.
- The Authority considers **Meridian's** behaviour **was material enough to constitute a UTS**; and was contrary to previous Authority advice to Meridian that we do not agree with using offers to manage transmission constraints.

### Meridian

In December when there was abundant fuel in the South, and the HVDC had capacity to transport it North:

- Meridian could have used the water to generate but chose to spill instead in order to increase its SI prices and avoid price separation.'
- Meridian has advised they did this to manage their risk. The Authority considers there are other risk management tools available.
- Meridian's activity lead to more expensive generation running in the NI at a time when there was excess fuel in the south
  - This also occurred at a time NI generators were seeking to conserve hydro reserves to manage through the scheduled HVDC outage.

## THE FOCUS ON THE PERIOD 3-18 DECEMBER 2019:

### Summary findings

Our preliminary decision documents the approach but in summary, we found:

- Excess spill equivalent to at least 55MW of generation capacity in December that could have been used for generation.
- By our calculation, a total of about 41GWh of additional energy could have been produced during December.
- North Island generation, including more expensive thermal generation, was dispatched despite excess spill and abundant hydro fuel.
- We also estimate:
  - 17MW of Waikato generation could have been displaced during December by extra South Island generation.  
This would have resulted in an extra 12.6GWh of energy stored in Lake Taupo before the HVDC outage at the beginning of 2020.
- Based on our preliminary findings, the estimated impact of the alleged UTS period is **\$80m extra paid by electricity purchasers**.
  - The Authority's estimate is based on the quantity of excess spill calculated, and offer price required to clear that amount of spill.
  - **This is not a measure of profits.**
    - Many retailers use hedge contracts to lock in the price of electricity ahead of time to protect against price movements. Profits and losses are determined by these contracts and other financial management tools versus their exposure to spot.  
This makes it difficult to determine the financial impact.

### WRAP UP AND NEXT STEPS

This is a preliminary decision.

We have published the decision on our website and we will hold an industry briefing on Friday 17 July.

The intent is to allow time for stakeholders to read and assess our analysis. This will support discussion and questions with the Authority staff.

There will be an initial six week consultation period followed by three weeks for cross submissions.

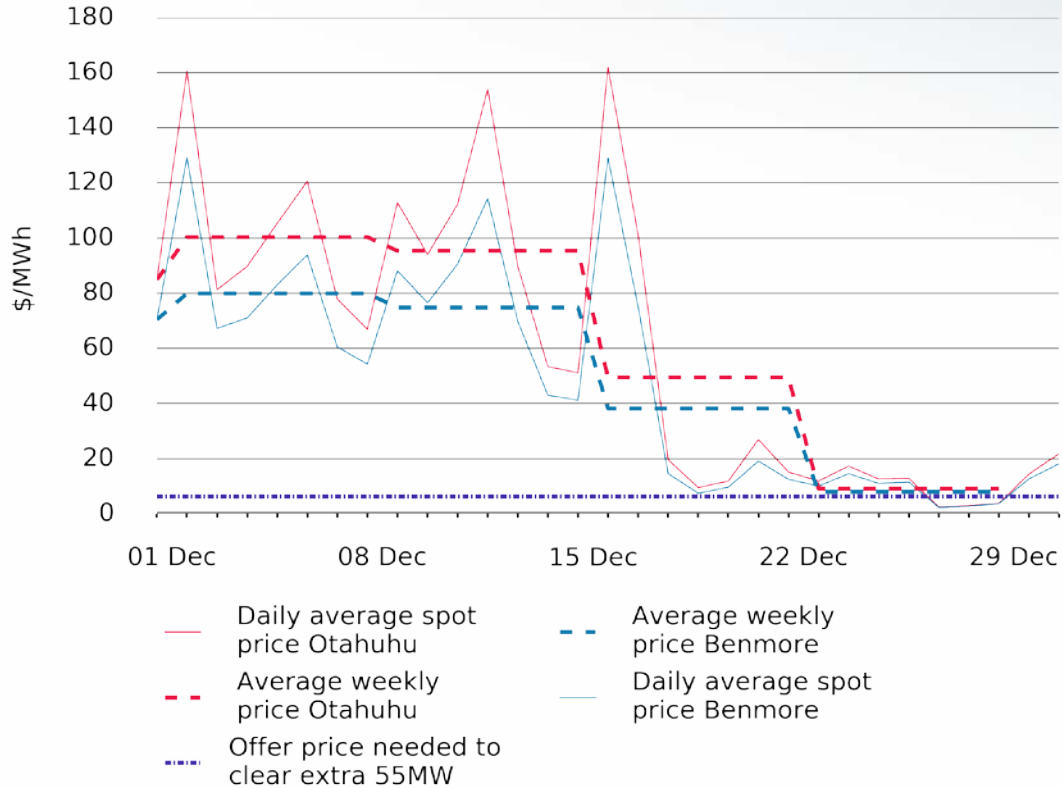
We have followed a robust process in which we have tested our framework and analysis. We are now keen to test our findings with industry.

As mentioned before, there is a separate compliance process underway to respond to potential breaches of the Code and this process is ongoing.

*Thank you for your time this morning.*

<<<<<<<<QUESTIONS>>>>>>>>

# WHOLESALE PRICES IN DECEMBER 2019



# PROCESS

- Preliminary decision released on Tuesday 30 June 2020
- Six-week consultation period followed by three-week cross submissions
- Actions to correct if UTS is found – drafted and consulted on
- Separate compliance process underway to determine if there was a breach of the high standard of trading conduct (HSOTC) provisions.