

Trading conduct review: summary of cross- 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.

Introduction

- Eight cross-submissions were received from:
 - the seven submitters
 - Major Electricity Users' Group (MEUG).
- This summary considers:
 - whether there has been any substantial change in submitters' views
 - submitters' views on the key themes in cross-submissions
 - any other issues or suggestions raised in cross-submissions.

Disclaimer: this summary reflects an initial reading of the cross-submissions and is not exhaustive.

Reminder of what submissions said

Submitter	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.
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.
Mercury			- No evidence that pivotal situations have led to long-term consumer detriment. - Proposal is de-facto price regulation.
Meridian			- Significant issues with current provisions. - Tentatively support proposal, conditional on purpose statement being re-drafted.
Trustpower			- Not clear there is a problem to be solved. - Proposal is complex and it's not clear how it would interact with price discovery.

What is MEUG's position?

- Unsure whether MDAG's proposal will lead to better long-term benefits to consumers or whether there is a better option.
- More analysis needed (including full CBA).
- Further worked examples should be provided.

Have submitters'
views changed?

Did submitters' views change in cross-submissions?

- The views of the submitters didn't change substantially in their cross-submissions.
- However:
 - despite stating its view was unchanged, Meridian's cross-submission seemed more negative than its submission
 - Contact may have softened slightly—in their cross-submission they supported further development of Genesis' proposal*
 - the Independent retailers said they were open to additional Code changes that may address some of the other submitters concerns.

* Under Genesis' proposal the requirements would only apply to net pivotal suppliers and clause 3 would be replaced by a non-exhaustive examples of offer conduct that is non-compliant.

What are the key
themes?

Key themes in cross-submissions

- Is the proposal effectively price control?
- Should the HSOTC clause be retained along with the proposal?
- What role should the Courts have?
- Are examples/case studies needed? Should these be in the Code?
- Is further consultation required? What form should this consultation take?

* Note that while the focus is on cross-submissions, comments in submissions have been included where relevant.

Is the proposal effectively price control?

Yes	Maybe	No
Contact – the proposal is akin to Part 4 regulation. Genesis – the proposal amounts to the imposition of a price control standard (albeit it seemingly unintentionally). Mercury – being forced to publicly justify and explain pricing is essentially a form of price regulation.	Meridian – there's a risk that the proposal (as currently formulated) will over time become a form of price regulation.	Haast and Electric Kiwi – the MDAG proposal is important for protecting the integrity of the price discovery process. Independent retailers – claims that proposal is price control are scaremongering—the MDAG proposal protects the integrity of price discovery.

Should the HSOTC clause be retained along with the proposal?

In their submissions, Haast and Electric Kiwi and the Independent retailers proposed retaining the HSOTC clause (along with MDAG's proposal) as a catch-all.

Three cross-submitters did not support retaining the HSOTC clause:

Contact – one of the primary reasons for the Code change is to provide clarity to the existing undefined concept of a high standard of trading conduct.

Genesis – would make rules unworkable and risky, and trader behaviour already comprehensively regulated.

Meridian – all the problems with the status quo would be perpetuated by adding the problems introduced by the proposal.

What role should the Courts have?

Should not rely on the Court for clarification of an uncertain standard	Proposal improves certainty, but still need case law
Contact – increased certainty and clear guidelines on what constitutes acceptable market conduct needs to be provided by the Authority not the Courts. Genesis (sub) – strongly disagree with MDAG’s proposed approach to leave the standard uncertain—it is unlikely to go to Court and this is poor regulatory practice. Mercury – not an effective pillar of regulatory design to say clarity from a opaque piece of regulation will come through the legal system. However, note that clarity on principles-based regulation will be provided by regulatory guidance or developed over time in response to cases being tested through legal channels. Meridian – poor regulatory practice to rely on clarification by courts.	Independent retailers – proposal will increase certainty, but this does not mean absolute certainty—regulation cannot substitute for case law and jurisprudence.

Are examples/case studies needed?

Should these be in the Code?

Yes, in the Code	Yes, during development of the Code	We already have examples
Contact – support replacement of safe harbour provisions with some non-exhaustive examples of offer conduct that is non-compliant. Genesis (sub) – clause 13.5A should be amended to include non-exhaustive examples of offer conduct that is non-compliant.	Independent retailers – open to including examples of what would constitute a breach, but this should be in MDAG’s recommendations paper or guidelines (not in the Code). Meridian (sub) – suggest the Authority develop and publish various real-world examples to work through. MEUG – further worked examples should be provided and discussed in the development of the Code change. Trustpower – case studies are a valuable first step towards management of regulatory certainty issues.	Haast and Electric Kiwi – December 2019 HSOTC and UTS breach complaint provide a worked example.

Is further consultation needed? What form should this consultation take?

Submitter	Further consultation?	Consultation by Authority?	Consultation on quantitative CBA?	Comment
Contact	✓	✓		More consultation on alternative options needed.
Genesis	✓	✓	✓	Need normal Authority consultation process.
Haast and Electric Kiwi				No comment in cross-submission on whether further consultation was needed. However, in their submission did support skipping Authority consultation.
Independent retailers	✓			Recommend at least one further technical consultation step to ensure final drafting is error-free and aligns with policy intent.
Mercury	✓	✓	✓	Stakeholders views should be heard directly by the Authority. Need to consult on proposed Code amendments by Independent retailers and Meridian.
Meridian	✓	✓	✓	More consultation needed given different views and risks identified. Vital Authority undertake its own analysis.
MEUG	✓	✓	✓	Authority needs to consider Code change in normal way with full CBA.
Trustpower	✓	✓	✓	Submissions provide strong evidence further work is needed.

Other issues and suggestions

Submitters made various comments on the CBA in cross-submissions

Submitter	Comments
Contact	• No comment on CBA in cross-submission. • In submission questioned whether costs of proposal were negligible.
Genesis	• A change of the magnitude proposed by MDAG should be subject to a full CBA. • Don't think the difficulties of doing a quantitative CBA are sufficient justification for not undertaking such analysis. • The CBA understates the costs.
Haast and Electric Kiwi	• No comment on CBA in cross-submission. • In submission stated that CBA understated benefits as it only considered efficiency benefits and not consumer price benefits.
Independent retailers	• Other submitters haven't explained why they disagree with MDAG on the lack of practicality of a quantitative CBA.
Mercury	• A more robust CBA is needed. • There are potential costs MDAG hasn't accounted for.
Meridian	• A high-level CBA is not satisfactory for a change of this magnitude—a full CBA is needed. • Need to quantify the potentially significant costs to market participants and consumers.
MEUG	• There needs to be improvements to the qualitative and quantitative CBA. • Recommend that MDAG consider the Code refinements proposed by some submitters using an improved CBA approach.
Trustpower	• A new CBA is needed that assesses the proposed option against the status quo, a more modest reform, and having no conduct provisions. • Disagree with Independent retailers and Haast and Electric Kiwi that wealth transfers should be considered in the CBA. • Need to further investigate whether costs are negligible.

Other issues and suggestions

Submitter	Comments
Contact	• Should focus on net pivotal situations. • Number of alleged breaches is likely to increase significantly under current proposal. • Do not consider that insider trading needs to be specifically captured by any new trading conduct rules as the Financial Market Conduct Act contains prohibitions and controls preventing insider trading.
Genesis	• The proposal provides too much scope for participants to raise complaints whenever they think prices are too high. • Undesirable or anti-competitive conduct of the type raised by some submitters is already addressed in other regulation (eg, Commerce Act and Financial Markets Conduct Act).
Independent retailers	• Contact and Meridian identified a legitimate concern that the MDAG drafting could be construed as allowing a party to exercise market power by withholding generation or reserves volumes. This needs to be tidied up. • Need to clarify in drafting that significant market power includes transient market power.
Mercury	• Authority will struggle to enforce MDAG's proposal due to the potential divergent views in the industry on what constitutes reasonable "economic costs" or efficient outcomes. It would be susceptible to legal challenge. • Disagree with Haast and Electric Kiwi that the Authority should recruit a much larger, well-resourced and proactive compliance team. A large staff of compliance experts is not required to provide clarity on principles-based regulation.
Meridian	• Consider that submitters broadly agree that the concept of workable competition should be the basis for any new trading conduct provisions. • Encourage MDAG and the Authority to consider the consistency of the proposal with the Authority's statutory objective.

End

MDAG's proposal

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

- (1) Where a **generator** submits or revises an **offer** for a **point of connection** to the **grid**, that **offer** must be consistent with **offers** that the **generator** would have made where no **generator** could exercise significant market power in relation to that **point of connection** to the **grid** for that **trading period**.
- (2) Where an **ancillary service agent** submits or revises a **reserve offer** for a **point of connection** to the **grid** (including an **interruptible load group GXP**), that **offer** must be consistent with **reserve offers** that the **ancillary service agent** would have made where no **ancillary service agent** could exercise significant market power in relation to that **point of connection** to the **grid** for that **trading period**.
- (3) The purpose of this clause 13.5A is to promote offer behaviour and efficiency outcomes consistent with competitive markets, in particular so that—
 - (a) the prices of **offers** or **reserve offers** do not exceed, by too much or for too long, the associated economic costs to the **generator** or **ancillary service agent** respectively, assuming a market in which no **generator** or **ancillary service agent** has significant market power;
 - (b) with the effect that **offers** or **reserve offers** made by **generators** or **ancillary service agents** promote efficient:
 - (i) consumption decisions by **consumers**; and
 - (ii) production decisions by suppliers (including **generators** and providers of **electricity** services); and
 - (iii) innovation and investment by suppliers and **consumers** (including the location of their investments); and
 - (iv) risk management and risk management markets,in relation to the **point of connection** to the **grid** (including an **interruptible load group GXP**) at which the **generator** or **ancillary service agent**, as applicable, submits or revises an **offer** or a **reserve offer**, and any **node** in respect of which the **offer** or **reserve offer** may have a material influence on efficiency outcomes of the kind referred to in subparagraphs (i) to (iv);
 - (c) where, for the purposes of paragraph (a) “economic costs” in clause 13.5A(3)(a):
 - (i) when assessed in relation to short-run costs, includes scarcity rents and the opportunity cost of generating **electricity** or of providing **instantaneous reserve**, as applicable;
 - (ii) when assessed in relation to long-run costs, includes recovery of capital costs with a suitable premium for risk.

MDAG's proposal

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

- (1) Where a **generator** submits or revises an **offer** for a **point of connection** to the **grid**, that **offer** must be consistent with **offers** that the **generator** would have made where no **generator** could exercise significant market power in relation to that **point of connection** to the **grid** for that **trading period**.
- (2) Where an **ancillary service agent** submits or revises a **reserve offer** for a **point of connection** to the **grid** (including an **interruptible load group GXP**), that **offer** must be consistent with **reserve offers** that the **ancillary service agent** would have made where no **ancillary service agent** could exercise significant market power in relation to that **point of connection** to the **grid** for that **trading period**.

MDAG's proposal

- (3) The purpose of this clause 13.5A is to promote offer behaviour and efficiency outcomes consistent with competitive markets, in particular so that—
- (a) the prices of **offers** or **reserve offers** do not exceed, by too much or for too long, the associated economic costs to the **generator** or **ancillary service agent** respectively, assuming a market in which no **generator** or **ancillary service agent** has significant market power;
 - (b) with the effect that **offers** or **reserve offers** made by **generators** or **ancillary service agents** promote efficient:
 - (i) consumption decisions by **consumers**; and
 - (ii) production decisions by suppliers (including **generators** and providers of **electricity** services); and
 - (iii) innovation and investment by suppliers and **consumers** (including the location of their investments); and
 - (iv) risk management and risk management markets,in relation to the **point of connection** to the **grid** (including an **interruptible load group GXP**) at which the **generator** or **ancillary service agent**, as applicable, submits or revises an **offer** or a **reserve offer**, and any **node** in respect of which the **offer** or **reserve offer** may have a material influence on efficiency outcomes of the kind referred to in subparagraphs (i) to (iv);
 - (c) where, for the purposes of paragraph (a) “economic costs” in clause 13.5A(3)(a):
 - (i) when assessed in relation to short-run costs, includes scarcity rents and the opportunity cost of generating **electricity** or of providing **instantaneous reserve**, as applicable;
 - (ii) when assessed in relation to long-run costs, includes recovery of capital costs with a suitable premium for risk.