

Submission

Electricity Authority Consultation 'Proposed Actions to Correct Undesirable Trading Situation 2019'
27th April 2021

Fonterra is a major electricity user with demand of approximately 1,160 GWh per annum and is also an active user of the ASX hedge market in order to manage electricity spot price exposure. We welcome the opportunity to submit on the Electricity Authority's (the EA) 'Proposed Actions to Correct Undesirable Trading Situation 2019' consultation paper.

The Undesirable Trading Situation (UTS) which occurred in late 2019 provided the market with considerable evidence of market power being used to drive prices ahead of normal competitive pressures. Sustained high prices alongside spilling occurred in such a way as to be relatively transparent to the market. In our view this was an example of the extreme end of a not uncommon practice (exercise of market power), but one which afforded a clearer set of evidence in what is a complex and often opaque market.

Fonterra is concerned not only with the length of time it has taken to investigate and conclude the UTS, but also considers that the proposed actions to correct the spot price, do not go far enough to restore confidence in the market. This is particularly the case given the EA have also concluded that there was no breach of the High Standards of Trading Conduct due to safe harbour provisions.

The EA have noted at length that they are not required to and are unable to correct every immediate and forward-looking implication of the UTS as many of these are irreversible, such as the spill of water, or difficult to identify, such as timing and price for dispatch of North Island hydro which would otherwise have been available. Whilst we agree this is impractical, we believe actions to correct should attempt to provide compensation for some of the downstream impacts which the market has to date paid for, such as the cost of emissions as a result of additional thermal dispatch, and the impact of reduced security of supply for North Island hydro (even if estimated).

The EA has considerable latitude under clause 5.2 of the Code to take any action it deems necessary to correct the UTS, yet we note that the EA has described its preferred method to reset offer prices at \$13.70/MWh as "conservative". From our perspective this leaves transgressing parties in a net positive position and reinforces the advantage of such conduct. In the financial markets when the penalties for market manipulation are no longer effective in deterring manipulative behaviour, the risk that participants choose to exercise market power increases.

This UTS resolution comes at a critical point in time for the EA – New Zealand's zero carbon goals will see significant electrification as consumers change to electrical technologies in order to reduce emissions profiles. The EA must take this opportunity to restore confidence in the market and seek to ensure that the supply side is unable to earn systematic economic rent.

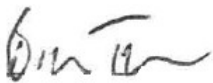
Under the current market structure, the wholesale market informs both dispatch and forward markets and the EA's decision in regard to this UTS is critical in defining the trading approach for the supply side of the

industry. If the EA maintains its “conservative approach” it is reinforcing acceptance of the behaviour that leads to the supply side freely raising prices above competitive levels. Fonterra’s view is that this is further evidence of the current market structure no longer being fit for purpose as the supply side can take systematic economic rent from both the spot and forward markets.

Buyers of electricity in the wholesale market, as well as downstream consumers, in the current situation, will be in a net negative position under this proposal, and it is therefore difficult to see why the market would restore its confidence in the operation or regulation of the wholesale market.

Fonterra’s view is that the hydro resource has close to zero value under spill conditions and the EA should reinforce that through it’s resetting of the offer prices to levels that reinforce this.

Regards,



Bruce Turner

Director Central Portfolio Management

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You, me, us, together
Tātou, Tātou**