19 May 2021

Submissions
Electricity Authority
P O Box 10041
Wellington 6143
By email: uts@ea.govt.nz

Dear team,

Re: Proposed Actions to Correct 2019 UTS—Cross Submission

Pulse Energy Alliance (Pulse) welcomes the opportunity to provide a cross submission after reviewing submissions on the Electricity Authority's (Authority's) proposed actions to correct the 2019 UTS.

Pulse commented in its first submission on two key points:

1. the proposed cap of $13.70/MWh is too high and should be more reflective of an opportunity cost of zero when spilling water; and
2. the actions to correct should apply to financial derivatives market as well as the spot market.

We focused only on these two points as we reviewed submissions.

1. The proposed cap should be more reflective of SRMC when spilling is occurring

Pulse agrees with:

> *"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."*

We also agree with Electric Kiwi / Haast Trading's submission that:

> *"The Authority's should alter Contact and Meridian's December 2019 offer prices based on what it reasonably expects the generators should have done in real time to ensure as much of its hydro generation was dispatched as reasonably practicable. The offer prices should reflect the abundance of water, a zero opportunity cost, and that competition should have been increased by the surplus generation capacity. Offering in at no more than SRMC would have been the safest option to avoid unnecessary spill without being financially disadvantaged."*

Pulse agrees with Fonterra's analysis of the implications if the Authority maintains its conservative approach:

> *"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."*

New Zealand businesses and consumers must have confidence prices reflect underlying costs, especially as they are being asked to be more reliant on electricity as NZ transitions to a low emissions economy.

We disagree with Meridian's preference to *"construct an offer cap based on actual offers made during similar hydrological conditions*" as this is obviously not consistent with correcting for a UTS as Meridian also rightly points out that "*a UTS was not found to have occurred*" during these historic hydrological conditions.

As stated in our submission, Pulse can support an offer price cap of $7.42/MWh as derived by the Authority:

> *"reflecting the South Island Mean Injection (SIMI) rate of $6.42/MWh from Transpower that applied in 2019/20 with an additional $1/MWh for other operating and maintenance costs."* (para 5.41(e))

While this offer price cap is well above the offer prices hydro plant owners were prepared to make / take in the market at the time, the derivation of $7.42/MWh is more robust than undertaking "conservative" analysis to reach a $13.70/MWh offer price cap.

2. Actions to correct should also apply to the financial derivatives market

Pulse notes the ASX is inclined not to rework ASX settlement prices. The two reasons given are:

i. the elapsed time: this is within the control of the Authority. The Authority is prepared to reset spot prices after this length of time so the ASX must be required to complete a reset of the ASX part of the wholesale market
ii. being part of an Australian regulatory regime: the ASX is contracted to provide a service under the NZ regulatory regime. If this is the penultimate stumbling block then we suggest it is time to establish a futures exchange trading platform in New Zealand for the long-term benefit of New Zealanders.

Further, Pulse is surprised and disappointed that the ASX is suggesting the Authority should not reset spot prices because it is unwillingly to rework ASX settlement. This does not stand up to scrutiny as a reason not to act to correct a UTS, as required by the regulations.

Pulse fully supports Mercury's view:

> The ASX has indicated that its preference is to not re-settle contracts impacted by the UTS remedy. While this is an understandable position to take in terms of easing administrative issues for itself, this is not a robust decision in terms of 'correcting' a UTS. With prices settling at incorrect values sellers will have less confidence in providing volume to this sales channel and may be less likely to maintain or increase liquidity in future if their positions are not corrected. Restoring confidence to the entire market, which is the EA's primary goal, must include derivatives and we encourage the EA and the ASX to revisit the decision to not re-settle UTS impacted contracts.

Further, we note Meridian supports resettling the derivatives market and proposes a methodology for this resettlement:

> *"Where the spot market and derivative contracts settle based on different final prices, the proposed action to correct will not restore the normal operation of the market and this difference may lessen rather than restore confidence in the wholesale market. Such differences in the basis for wholesale market settlement should be minimised by the Authority to the extent possible."*
>
> *"Ideally, the Authority would go further and direct resettlement of derivative contracts based on the recalculated final prices."*

Without directing the derivatives market be resettled the Authority is "*leav[ing] open the possibility of wealth transfers between the parties that would never have occurred under the normal operation of the market*".

Our support for resettling the derivatives market is for a process that remains within the bounds of existing contractual parameters of products.

Trustpower notes that the Authority decided in 2013 to extend the definition of a UTS to include hedge markets – the reasons for including the hedge market must be relevant for this UTS event. Trustpower's focus on non-integrated firms is particularly relevant:

> *"We note that the decoupled settlement of the wholesale prices and hedges could enhance perceptions of risk associated with operating in the electricity market. Particularly for non-integrated firms that are more reliant on the hedge market to manage risk".*
>
> *"Trustpower believes that resettling the hedge market contracts would best preserve the overall integrity of the hedge market."*

As stated in our submission, Pulse believes the approach to actions to correct the UTS should be principles based. A principles-based approach would require actions to correct the derivatives market as well as the spot market, to ensure confidence in and the integrity of the entire wholesale market.

Under clause 5.2(1) the Authority should require:

- financial derivatives settled using the high prices created by the UTS to be resettled using the reset final spot prices; and
- margin calls paid using the high prices created by the UTS to be resettled using the reset final spot prices.

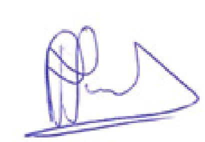
The Authority has the opportunity with its actions to correct the UTS to restore confidence in the forward markets (as well as the spot market) for the long term benefit of consumers by including derivative market transactions in its price reset.

Calls for improved process and timeline

Pulse supports Mercury's call for the Authority to strengthen its market monitoring function as soon as possible. We also strongly support both Mercury and Trustpower's submissions on providing industry participants with more certainty about the process that it will undertake, including timelines, when investigating claims of a UTS and breach of the trading conduct rules.

We would welcome the opportunity to discuss this submission with you in more detail.

Yours truly



Fraser Jonker
Chief Executive

PO Box 10044, Dominion Road, Auckland 1446 P 0800 785 733 F 09 378 4405 W www.pulseenergy.co.nz