

16 August 2021

James Stevenson-Wallace  
Chief Executive  
Electricity Authority  
Wellington

By e-mail: [compliance@ea.govt.nz](mailto:compliance@ea.govt.nz), [uts@ea.govt.nz](mailto:uts@ea.govt.nz), [james.stevenson-wallace@ea.govt.nz](mailto:james.stevenson-wallace@ea.govt.nz)  
Cc MBIE: [gareth.wilson@mbie.govt.nz](mailto:gareth.wilson@mbie.govt.nz)

## Undesirable Trading Situation and Trading Conduct Code Breach on 9 August 2021

Dear James,

1. Vocus supports and joins Electric Kiwi and Haast Energy Trading (Haast) in the view that an Undesirable Trading Situation (UTS), and a breach of the trading conduct rules by Contact Energy and Genesis Energy occurred on 9 August 2021.
2. Vocus considers that the event on 9 August 2021 has further undermined confidence in the Electricity Market, confidence which has already been eroded by previous generator behaviour including the December 2019 UTS caused by Meridian Energy and Contact Energy when they spilled water from their dams rather than making it available to generate electricity.<sup>1</sup>
3. Vocus is seriously concerned that the outages which resulted as a direct consequence of the apparent failure to offer available generation to meet demand by Genesis Energy and Contact Energy had the potential for much more serious consequences for consumers – **particularly those who are dependent on electricity for critical medical equipment or vulnerable.**
4. The objective of the Authority under the Electricity Industry Act 2010 is to “**promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers**”. These events materially undermine these objectives, particularly considering that this is not an isolated event but is a continuation of behaviour that we and other independent retailers have been raising over several years.
5. **Transpower should not be made a scapegoat by the generators who failed to make generation available.** There has been significant criticism directed at Transpower. However, we consider that although Transpower made errors, we should not lose sight of the fact that the root cause of the situation was the failure of generators to make generation capacity available. The events on 9 August 2021 **would not have happened** but for this fact, and the information that we have seen so far suggests that this was a situation of simply withholding available generation supply

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<sup>1</sup> <https://www.ea.govt.nz/code-and-compliance/uts/undesirable-trading-situations-decisions/10-november-2019/>

Level 5, 34 Sale St,  
Auckland 1010 New Zealand

0800 862 876

[vocus.co.nz](http://vocus.co.nz)

without sufficient cause. Indeed, as noted by Transpower even without the error, some homes would have been cut off “for sure”.<sup>2</sup>

6. The current market design is a further cause of the alleged UTS and is no longer fit for purpose. As part of a wider review, we consider it important that the Electricity Authority review the market design.
7. The situation which unfolded on 9 August 2021 make clear that urgent action is required by the Authority.

### Generators were aware of the potential risk well in advance

8. We agree with the Minister of Energy who stated that “*the electricity market had clear warning about the potential for the shortage situation*”<sup>3</sup> and do not find any suggestion that the events could not have been foreseen as credible.
9. The system operator adequate warning of the situation, well in advance. We note the following timeline of notices issued by the System Operator:

#### 9 August 2021 at 06:42AM – Customer Advice Notice:

*Transpower as System Operator advises that North Island residual **generation is less than 200 MW, including spare HVDC capacity**, for trading periods TP 36 - 41 (17:30 -20:00) on 9 August 2021. If system conditions worsen, it could result in a WRN or GEN being issued due to **insufficient offers being available to cover for the largest contingency or meet demand and maintain frequency keeping reserve***<sup>4</sup>

#### 9 August 2021 at 01:02PM– Warning Notice:

*Starting: 09-aug-2021 17:30*

*Ending: 09-aug-2021 20:30*

*Transpower as System Operator advises there **is a risk of insufficient generation and reserve offers to meet demand** and provide for N-1 security for a contingent event.*<sup>5</sup>

#### 9 August 2021 at 05:10PM– Grid Emergency Notice:

*Starting: 09-aug-2021 18:00*

*Ending: 09-aug-2021 19:00*

*This is a New Zealand wide emergency. **There is Insufficient Generation offers to meet demand** and provide for N-1 security for a contingent event. The level of instantaneous reserves being scheduled may or will need to be reduced.*<sup>6</sup>

<sup>2</sup> <https://www.stuff.co.nz/business/126029919/power-cuts-genesis-boss-says-firm-feels-victimised-as-transpower-admits-error>

<sup>3</sup> <https://www.nzherald.co.nz/nz/power-outages-pm-jacinda-ardern-says-not-good-enough-that-we-couldnt-heat-homes/42KMF3MXIUQYZOORUSDLMC2JBU/>

<sup>4</sup> <https://www.transpower.co.nz/sites/default/files/interfaces/can/CAN%20Low%20Residual%20Situation%204025411929.pdf>

<sup>5</sup> <https://www.transpower.co.nz/sites/default/files/interfaces/wrn/WRN%20Insufficient%20Generation%20offers%20National%204026187046.pdf>

<sup>6</sup> <https://www.transpower.co.nz/sites/default/files/interfaces/gen/GEN%20Insufficient%20Generation%20offers%20National%204027364789.pdf>

10. The weather situation was not unknown to Generators, or anyone else. The cold weather was forecast well in advance.
11. We agree with Transpower that *“this is an informed industry”* and that there was an onus on generators to make sure that they were prepared<sup>7</sup>. Any suggestion to the contrary by generators that they were not sufficiently informed should not be considered an excuse, but instead should only raise more serious concern about the structure of the market and its ability to meet the needs of consumers.

#### **There was no transmission constraint**

12. There was no physical or capacity reason for generation not to be able meet demand on 9 August 2021.

#### **There was no generation capacity constraint**

13. There was adequate generation that could have been made available to avoid the shortage on 9 August 2021. As noted by the Minister of Energy *“this wasn’t a physical constraint of generation... We did have the ability to generate the amount of electricity that we needed to keep the lights and the heaters on for New Zealanders last night but commercial decisions were made not to”*<sup>8</sup>.

#### **There is adequate visibility of market demand**

14. We agree with Electric Kiwi and Haast when they rejected the claim by Genesis CEO who claimed they do not have visibility of the whole market. The wholesale electricity market makes this information available to generators through live generation data, generation, and transmission outages, and ahead schedules.

#### **Prima facie evidence suggests that Contact Energy (Taranaki Combined Cycle) and Genesis Energy (Huntly, 3<sup>rd</sup> Rankine) withheld generation capacity.**

15. As noted by the Minister of Energy *“We actually did have capacity that wasn’t brought on. It wasn’t that we didn’t physically have the amount of power to generate. It is the way in which the market responds to these that we need to look at...”*<sup>9</sup>
16. We note the comments by Electric Kiwi and Haast that HLY4 was only turned off on Friday evening and find it difficult to believe that there would have been substantial cost and effort to make it available, particularly given the forecasts. Given the first Customer Advice Notice which was issued early Monday morning, Genesis had the “6 to 10 hours” they needed to make this capacity available.
17. We also agree with Electric Kiwi and Haast that the Tokaanu hydro weed issues were not exceptional or unexpected given that this has happened before.

<sup>7</sup> <https://www.stuff.co.nz/business/126029919/power-cuts-genesis-boss-says-firm-feels-victimised-as-transpower-admits-error>

<sup>8</sup> <https://www.nzherald.co.nz/nz/power-outages-genesis-is-being-scapegoated-by-energy-minister-megan-woods-ceo-says/4QVL7TEQNAI7H5Z3467XUNQPOY/>

<sup>9</sup> <https://www.newshub.co.nz/home/politics/2021/08/power-crisis-megan-woods-sticks-to-guns-says-commercial-reasons-behind-outage-denies-scapegoating-genesis.html>

18. The Electric Kiwi and Haast clearly outline in their letter that available models of ECMWF clearly showed that wind production could be anticipated to drop significantly during the evening of 9 August 2021.

### Market power and vertical integration continues to undermine the market

19. The situation on 9 August 2021 further demonstrates generators have too much market power. In our view, the offers made do not reflect what would be expected absent significant market power at the point of connection and during the trading periods to which these offers relate.
20. The vertically integrated positions of generators clearly affected the decisions that the generators made which led to the situation. This is demonstrated by what are in our view deeply concerning comments by the Genesis CEO:

***“We made a decision on the basis of the information we had ... we knew we could meet our own demand.”***

***“We looked at our portfolio yesterday and we knew that between all our customer demand and the generation we had online we could meet our customer demand.... We did what we always do and made sure we could meet our customers’ demand ... our only accountability is to ensure we can supply our customers.”<sup>10</sup>***

21. It cannot be considered either acceptable, or a representation of a generator acting rationally, for major generators to consider only their own retail customer base when making offers to the market. A generator in a market where they cannot exercise significant market power would have strong incentives to respond to an expectation of high forecast demand. **A generator which was not vertically integrated would aim to supply as much electricity as possible when demand is available.**

### Unacceptably high prices

22. The extraordinarily high interim prices nationwide are not reflective of the supply which was available. Given the circumstances surrounding the event on 9 August 2021, these prices cannot reasonably be sustained in final pricing.

### Confidence in the market has been damaged

23. It is our view that the events clearly reflect an undesirable trading situation which threatens, or may threaten, confidence in, or the integrity of, the wholesale market. The fact that this situation was so serious as to require action and comment by the Prime Minister and Minister for Energy demonstrates this. Indeed, they themselves have stated that:

*“Yesterday’s events have prompted further questions on whether the system is fit for purpose”<sup>11</sup>*

And that:

<sup>10</sup> <https://www.rnz.co.nz/national/programmes/checkpoint/audio/2018807654/power-outages-genesis-ceo-says-energy-minister-scapegoating-but-woods-has-questions>

<sup>11</sup> [https://www.parliament.nz/en/pb/hansard-debates/rhr/document/HansS\\_20210810\\_050760000/woods-megan](https://www.parliament.nz/en/pb/hansard-debates/rhr/document/HansS_20210810_050760000/woods-megan)

*“Regardless of the mechanisms of the electricity market, New Zealanders rightly expect the lights to be on and the heaters to be running on a cold winter's night. That's why the situation that unfolded yesterday was unacceptable. If we're going to have a market-orientated system providing security of supply, then that market must deliver. The market failed in this respect.”<sup>12</sup>*

And:

*“it was not good enough that we could not warm our homes”<sup>13</sup>*

24. The Electric Kiwi and Haast letter outlines in clear detail the degree to which confidence in the market has been damaged.

## Market Structural Design

25. The current market design is a further cause of the alleged UTS and is no longer fit for purpose. With carbon costs continuing to increase a market that continues to pay all generators the highest offer price means perverse incentives exist for all generators to maintain thermal generation in the market. Offer stacks can also be managed to maximise volume whilst continuing to ensure thermal plant runs and sets the marginal price.
26. The systemic effect is that companies like Genesis can be forced into a lose-lose situation whereby they either choose not to run or run at non-commercial returns. Should they continue to run and push prices even higher, to recover reduced volume through higher price, the non-thermal generators profit even further. Genesis has been raising this issue and Vocus supports this position. As a generality they are assumed to be the generator of last resort, but the market design and market outcomes are no longer providing adequate economic incentive.
27. An additional factor is the choice of Meridian to supply electricity to Tiwai at market communicated estimate of \$35/MWh. This is a clear example of generators being able to control the supply and demand curve even where Meridian was well aware of national gas supply issues. Vocus does not support any such deals and recommends rules be put in place such that no commercial deals can be entered below the LRMC of replacement generation plant.
28. The subsidy to Tiwai is at the cost of all other national electricity users and in the current market other TOU users have been experiencing pricing in excess of \$150/MWh. Tiwai should not be used to maintain thermal plant in the market nor keep the supply and demand curves tight. For the reasons explained we are confident that Tiwai will remain beyond Dec 2024 but the doubt in the market creates ineffective generation investment decisions. It is another clear example of a broken market with a direct impact on the ability of the market to provide adequate capacity and security of supply.

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<sup>12</sup> [https://www.parliament.nz/en/pb/hansard-debates/rhr/document/HansS\\_20210810\\_050760000/woods-megan](https://www.parliament.nz/en/pb/hansard-debates/rhr/document/HansS_20210810_050760000/woods-megan)

<sup>13</sup> <https://www.nzherald.co.nz/nz/power-outages-pm-jacinda-ardern-says-not-good-enough-that-we-couldnt-heat-homes/42KMF3MXIUQYZOORUSDLMC2JBU/>

**Actions required by the Authority**

29. The Authority should immediately:

- Stop the Pricing Manager from finalising the prices for 9 August 2021 until the UTS claim is fully investigated
- Prioritize this UTS investigation and move to quickly resolve the situation. Delays in completing this investigation with further undermine confidence in the market and the Authority itself
- Reset prices based on a model where TCC and HLY4 were offered in a way consistent with that which would be expected in a workably competitive market and without the actions that needed to be taken by Transpower to curtail customer demand
- Ensure that the settlement of August contracts by both the Clearing Manager are set at a level consistent with what would be expected if this situation had not occurred.
- Undertake a full investigation into the situation which occurred and consider what structural changes should be undertaken to avoid consumers being once again let down by failures in the electricity market.

Yours sincerely,



Sean Campbell  
Head of Energy Compliance  
**Vocus New Zealand**  
sean.campbell@vocusgroup.co.nz