

20 November 2020

James Stevenson-Wallace  
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Dear James,

## Submission in response to the UTS preliminary decision supplementary consultation

Ecotricity, Electric Kiwi, Flick Electric, Haast Energy Trading (Haast), Oji Fibre Solutions and Vocus (the independents) welcome the opportunity to submit in response to the Electricity Authority's Preliminary decision on claim of an undesirable trading situation: Supplementary consultation of 6 November 2020:

- We commend the Authority for undertaking additional analysis, and giving stakeholders the opportunity to comment;
- We welcome the Authority publishing a target date to make a final decision on the UTS in December; and
- We support the pragmatic and efficient approach Authority staff have taken of commencing "some work in parallel to the ongoing UTS investigation to understand what actions to correct might be possible".

### Summary of the independents' views in support of extending the UTS period

- **We agree the UTS period includes 3 – 27 December 2019.**
- Based on the "confluence of factors and the consequent reduction of competition" the Authority has identified, the UTS period should be extended beyond 3 – 27 December. **The confluence of all five factors identified by the Authority could be observed from 11 November to 28 December 2019, and factors (a), (c), (d) and (e) from 10 November 2019 to 16 January 2020.**

The independents identified that withholding of capacity by Contact and Meridian (which the Authority now describes as "reduced competition") resulted in spot market prices being more than \$73m higher than they should have between 10 November and 2 December 2019. We also submitted previously that, if the impact of Clutha spill in November and early December and all Tekapo spill is taken into account, the outcomes are worse in the November (pre-3 December) period than the Authority modelled for the preliminary decision.

- **The large inflows and resulting surplus capacity (factor (a)) should have resulted in stronger competitive market outcomes.<sup>1</sup>**

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<sup>1</sup> As reflected in the independents' and Authority modelling of the price outcomes in a workably competitive scenario.

- **A decision that the UTS was caused by a “confluence of factors”,** rather than withholding of generation capacity (including through higher offer prices), **would risk setting a precedent that withholding of capacity/unnecessary spill (including raising spot prices and/or to manage locational risk) is only undesirable under certain “unusual” circumstances.** We do not consider such precedent would fully address the threat to the confidence in, or the integrity of, the wholesale market caused by Contact and Meridian’s offer strategies.
- The distinction between the confluence of factors and market participant behaviour is important. **The principal reason there was less competitive activity was Contact and Meridian’s South Island offer strategies/withholding of capacity** (including by way of offer price). Contact and Meridian were not competing to maximise the amount of electricity they were generating. If the Authority wants to avoid a repeat of the UTS it needs to be very clear about what caused the UTS and what behaviour needs to change in the future.
- **The Supplementary Consultation position has enabled Meridian to spread the blame and claim the UTS is “attributable to four different generators”** (presumably, Contact, Genesis, Mercury and Meridian): “We’re pleased that the Authority has confirmed that the UTS process is not seeking to attribute blame, but is looking at a confluence of five different factors – attributable to four different generators”.<sup>2</sup>
- Four out of the six examples of what may constitute an UTS in section 5.1(2) of Part 5 of the Electricity Industry Participation Code are situations where a market participant is “blameworthy”.
- In summary, **the independents consider the factors that undermined confidence in the integrity of the market,** including but not limited to our confidence in the market, (i) **can be directly attributed to Contact and Meridian’s** response to large hydro inflows; and (ii) were not limited to 3 – 18 December or 3 – 27 December, and **included the entire 10 November 2019 – 16 January 2020 period.**

### **The Authority’s empirical analysis in assessing outcomes**

The market outcomes the new empirical analysis suggests are “unusual” and “incongruous” are undesirable and the result of offer strategies by Contact and Meridian that threaten, or may threaten, confidence in, or the integrity of, the wholesale market:

- There should not be a negative correlation between hydro storage and generation. This did not reflect the supply and demand conditions or what should have been expected in a workably competitive market;
- We agree with the Authority “The fact that abundantly fuelled South Island hydro was not displacing North Island thermal generation as it usually would is unusual and consistent with reduced competition”;
- We agree with the Authority it “seems incongruous” that “prices increased when South Island hydro generation increased”. This outcome did not reflect supply and demand conditions or what should have been expected in a workably competitive market;

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<sup>2</sup> <https://www.energynews.co.nz/news-story/undesirable-trading-situation/60359/meridian-flick-react-further-uts-consultation#comments>

- We agree with the Authority it is “incongruous” that “Northwards flow over the HVDC decreased when South Island storage increased during the UTS investigation period ... given the supply conditions in the South Island: usually the opposite occurs. This is symptomatic of South Island hydro generation not using its abundant fuel to compete to be dispatched”; and
- We agree with the Authority “Despite generators actively managing transmission constraints, empirical evidence shows that usually price separation (between islands, and between the lower South Island and upper South Island) increases (that is, the ratio of the exporting region nodal price to the importing region nodal price decreases) as South Island storage increases. The opposite occurred for price separation between Benmore and Haywards and for price separation between Invercargill and Benmore during the UTS period”. These findings are supported by the modelling in our original submission.

**The Authority is correct that the UTS period should be extended to include more of December 2019**

The independents agree with the Authority that the UTS period includes 3 – 27 December 2019. Our view remains the UTS extended from 10 November 2019 to 16 January 2020. The independents also agree with the Authority that less competitive market outcomes/lower competition could be observed during this period.

In relation to the “confluence of factors” the Authority has detailed:

Factors identified by the Authority	The independents’ observations	Time period
(a) There was a series of very large inflow events. Total inflows into several catchments were amongst the highest since records began.	This should have resulted in increased competitive offers (and lower prices); particularly in the South Island as the large inflows should have resulted in the HVDC link being constrained and greater price separation between the North and South Island.	10 November 2019 to 16 January 2020.
(b) Contact was using its automated spill gates for the first time during a flood event. This resulted in Contact trying to avoid being the marginal generator and the consequent frequent changes in dispatch. While this is not unusual behaviour, Contact has submitted that it was more motivated than usual to avoid being marginal. As a result, competition was reduced and Contact did not participate in price discovery.	<p>While the Authority is avoiding proscribing blame for the UTS, the reduction in competition identified in (b) and (e) is entirely a result of Contact and Meridian’s offer strategies.</p> <p>We note the analysis in our original submission and cross-submission established the harm that was caused was heightened by (b) and (e) occurring for overlapping periods.</p> <p>We also note as mentioned in footnote 4 of the Supplementary Consultation, a number of alternative mechanisms to manage genuine safe operating constraints of spill gates exist that Contact could have used without foreclosing competition in the Lower South Island.</p>	11 November to 28 December 2019.

Factors identified by the Authority	The independents' observations	Time period
(c) The scheduled HVDC outage and a planned Pohokura outage during the first quarter of 2020 meant Mercury was trying to conserve water in anticipation of future high prices that were evident in the forward curve.	<p>The withholding of South Island hydro capacity (factors (b) and (e)) resulted in a reduction in the price separation that should have occurred, and South Island spot prices reflecting North Island circumstances rather than the large inflows in the South Island.</p> <p>The Authority and independents' modelling demonstrate that if Contact and Meridian had not withheld hydro capacity (factors (b) and (e)), factor (c) would not have outweighed the impact of the large inflows in the South Island (particularly in relation to South Island competitive market outcomes).</p>	10 November 2019 to 16 January 2020.
(d) Genesis stated in its submission that it is a price taker in the South Island due to its scale.	This is not specific to the UTS period. Genesis has effectively stated it is competing against generator's with significant market power.	10 November 2019 to 16 January 2020.
(e) Meridian's internal reporting indicated it was withholding generation to avoid the HVDC binding.	See comments in relation to (b) above.	10 November 2019 to 16 January 2020.

While the Supplementary Consultation appears to imply the UTS is a byproduct of a "confluence of factors" that "reduced competition", what we conclude from the evidence and analysis is:

- market offers by both Meridian and Contact should have been highly competitive during the UTS period due to the large inflows<sup>3</sup> in the South Island. Spill significantly exceeded the levels that could be expected in a workably competitive market environment;
- the reduction in competition wasn't due to exogenous factors outside of market participants control; and
- the principal reason less competitive market activity was observed was because of Contact and Meridian's South Island offer strategies/withholding of capacity (including by way of offer price).

The principal attribution to (b) and (e) is evident from the Authority's preliminary decision modelling, and our submission and cross-submission modelling. The respective modelling also demonstrated the outcomes that would have arisen if only (a), (c) and (d) had arisen in the market.

The distinction between the confluence of factors and behaviour is important.

A decision that the UTS was caused by a confluence of factors rather than the withholding of generation capacity (including through higher offer prices) would risk setting a precedent that withholding of capacity/unnecessary spill is only undesirable under certain "unusual" circumstances and there isn't necessarily a need for any market participants to change their offer strategies/risk

<sup>3</sup> Be it using the Authority or independents' defined UTS period.

management. We do not consider such precedent would fully address the threat to the confidence in, or the integrity of, the wholesale market.

### **Manipulative or attempted manipulative trading activity is a factor in the UTS**

In addition to a “reduced competition” approach, we remain of the view “manipulative or attempted manipulative trading activity” is one of the elements of the UTS. The inclusion of “or attempted manipulative trading activity” was reflected in our original submission comment that the Authority can consider both purpose and effect. We reiterate “The decision should be explicit about all elements of the trading situation that were undesirable, including fault”.<sup>4</sup>

We also reiterate “We consider that the prevention or reduction in price separation constitutes manipulative trading activity. The Authority’s preliminary finding is that both Contact and Meridian were purposely structuring their offers to prevent constraints binding and the consequent price separation: “Contact has told us this is the case, and Meridian’s weekly Perform Reports contain direction to prevent transmission constraints”. We consider the Authority’s findings are evidence of market manipulation e.g. “Meridian was endeavouring to ensure that the HVDC did not bind and cause price separation ... We consider that the result of this was higher than necessary spot prices and a less secure power system heading into the HVDC outage schedule for the first quarter of 2020”.”

We also reiterate “Dr Small also noted “the fact that both Contact and Meridian were deliberately structuring their offers to avoid transmission constraints binding” and “economic with-holding of capacity in this instance is inconsistent with normal competitive market conduct”. Drawing on the Authority’s 2016 UTS findings, this appears to be an explicit and ongoing part of Meridian’s risk management strategy”.

### **Attributing blame**

We consider it artificial and imprecise to say the undesirable market outcomes were due to “reduced competition” over the period without attributing blame or responsibility when the weaker competitive market outcomes were directly a consequence of Contact and Meridian’s offer strategies/withholding of capacity (including by way of offer price).

While an ‘act of god’ may have caused the very large inflows event, it wasn’t an ‘act of god’ or exogenous factors outside of the control of any market participant that caused the UTS. The Contact and Meridian submissions were based predominantly on defending their conduct because that is principally what is being questioned. The actions of Contact and Meridian, individually and collectively, resulted in less competitive market outcomes. The precedent value – including helping to ensure there isn’t repeated UTS – makes it important the Authority is clear about what and who caused the UTS.

In our view, the Authority has already established blame on the part of Meridian in its preliminary decision. For example: “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” and “Evidence shows Meridian was offering in such a way as to ensure the HVDC was not constrained”.

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<sup>4</sup> We note Meridian has claimed ““Fault” is a completely foreign concept to the UTS regime”. We are unsure how Meridian has formed this view as it would require, for example, that manipulative or attempted manipulative trading activity could occur without the market participant being responsible for their own conduct. Four out of the six examples of what the Authority may consider to constitute an undesirable trading situation in section 5.1(2) of Part 5 of the Electricity Industry Participation Code relate exclusively to situations where a market participant is “blameworthy”.

The Authority has stated that “in assessing this UTS allegation, we are not looking to establish particular blameworthy conduct by participants as might be required to establish some of the specific examples set out in clause 5.1(2) of the Code” and while “identifying particular blameworthy conduct may in some cases form part of the UTS process” it doesn’t need to in all cases.

Analogous statements could be made in relation to the Authority’s approach of “establishing whether the outcomes that have occurred during the period were the result of reduced competition brought about by a confluence of factors”.

A UTS can arise due to reduced competition or particular “blameworthy conduct”<sup>5</sup> but neither are necessary requirements for there to be a UTS.

And, as we noted above, it can be and is the case that the “blameworthy conduct” (withholding of hydro capacity by Contact and Meridian) can be the predominant factor resulting in “reduced competition”.

Mercury’s comment that “situations where participants are in a position of market power and may exploit offers to earn excessive profits ... fundamentally undermine the confidence and integrity of the wholesale electricity market” is directly relevant to the current UTS investigation.<sup>6</sup> In a similar vein, we agree with Nova that “The SI hydro generators are of course expected to offer their generation in a way that maximises their revenues from the available water, but it has been widely understood that no generator should use its market power in a net pivotable situation to hold prices above what might be considered likely in a competitive market” [emphasis added]. We also agree with Genesis that “Meridian’s dominant position on the South Island provides the incentive to raise prices over the long term. It is economically rational to act on this incentive. ... While we note that Meridian’s behaviour is rational ... it does not represent the sort of market conduct that is acceptable to consumers or other participants” [emphasis added].

Just as there does not have to be reduced competition for there to be a UTS, all the factors in Table 1 in the Supplementary Consultation do not need to be satisfied for there to be reduced competition or a UTS.

### **The period of the UTS**

We agree with the EA that the UTS is over 3 – 27 December.

As discussed in our submission and cross-submission, our modelling clearly demonstrated the outcomes in the 10 November – 2 December period were also harmful, consistent with substantially reduced competition (regardless of how many of the tests in Table 1 of the Supplementary Consultation are satisfied) and undermined confidence, and/or threatened confidence, in the integrity of the wholesale market.

The independents consider the factors that undermined confidence in the integrity of the market, including but not limited to our confidence in the market: (i) can be directly attributed to Contact and Meridian’s response to large hydro inflows; and (ii) were not limited to 3 – 18 December or 3 – 27 December, and included the entire 10 November 2019 – 16 January 2020 period.

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<sup>5</sup> Four out of the six examples of what the Authority may consider to constitute an undesirable trading situation in section 5.1(2) of Part 5 of the Electricity Industry Participation Code relate exclusively to two situations where a market participant is “blameworthy”.

<sup>6</sup> Genesis, Mercury, MEUG, Nova and NZ Steel all provided evidence and examples which supported the preliminary decision. These are listed in more detail in the Appendix to this submission.

The impact of Contact and Meridian individually is reflected in Tables 1 and 2, and collectively in Table 3, from our original submission:

**Table 1: only Meridian unnecessarily spills water/prices above SRMC**

	Entire period: 10 Nov-16 Jan	10 Nov-2 Dec	Draft UTS: 3-18 Dec	19 Dec-16 Jan
Excess spot prices	\$87,397,204	\$23,838,183	\$45,971,014	\$17,588,008
Excess CO2 released	10,546 tonnes	1,633 tonnes	4,421 tonnes	4,492 tonnes
Reduction in storable NI water	23,613 MWh	3,470 MWh	8,507 MWh	11,636 MWh

**Table 2: only Contact unnecessarily spills water/prices above SRMC**

	HSOTC: 11 Nov-28 Dec <sup>7</sup>	10 Nov-2 Dec	Draft UTS: 3-18 Dec	19 Dec-16 Jan
Excess spot prices	\$52,338,284	\$39,158,339	\$12,070,222	\$1,109,723
Excess CO2 released	4,339 tonnes	2,459 tonnes	1,143 tonnes	737 tonnes
Reduction in storable NI water	7,355 MWh	4,394 MWh	2,114 MWh	847 MWh

We also note, based on our submission and cross-submission, that the five confluence factors the Authority identified were not limited to 3 – 27 December:

- the confluence of all five factors identified by the Authority could be observed from 11 November to 28 December 2019; and
- factors (a), (c), (d) and (e) could be observed from 10 November 2019 to 16 January 2020.

Our submission and cross-submission identified that there was substantial harm caused beyond the 3 – 27 December period), including from 10 November to 3 December. For example, from our submission:

**Table 3: Aggregate impact of unnecessary water spill/prices above SRMC by all South Island generators**

	Entire period: 10 Nov-16 Jan	10 Nov-2 Dec	Draft UTS: 3-18 Dec	19 Dec-16 Jan
Excess spot prices	\$176,860,416	\$73,322,755	\$77,149,648	\$27,388,014
Excess revenue collected by Meridian	\$67,820,449	\$28,502,865	\$29,052,753	\$10,264,831
Excess revenue collected by Contact	\$39,667,562	\$18,106,379	\$16,184,963	\$5,376,220
Excess revenue collected by Genesis	\$24,252,062	\$8,727,619	\$11,430,748	\$4,093,696
Excess price paid across all load nodes	\$175,847,083	\$71,201,757	\$77,031,516	\$27,613,810
Excess CO2 released	17,485 tonnes	3,808 tonnes	6,293 tonnes	7,384 tonnes
Reduction in storable NI water	42,530 MWh	9,220 MWh	16,624 MWh	16,687 MWh

## Concluding remarks

We agree with the Authority's preliminary decision analysis that "if wholesale market conduct or outcomes are not consistent with underlying supply and demand conditions, then there may be a risk that confidence or integrity may have been undermined".

<sup>7</sup> The results for Contact are the same for the 10 November to 16 January period and the Authority's HSOTC breach allegation period of 11 November to 28 December.

The Supplementary Consultation doesn't change this.

There is a direct causative link between Contact and Meridian's behaviour, the Supplementary Consultation finding of a "confluence of factors" which "reduced competition" and spot market outcomes which differed markedly – for a sustained period – from what we expect given the "underlying supply and demand conditions".<sup>8</sup>

The competitive market outcomes should have been stronger than normal during the UTS period (be it using the Authority or independents' defined UTS period) due to the large inflows in the South Island (heightened supply relative to demand).

This spot market outcome did not happen impacting confidence in and the integrity of the wholesale market.

The principal reason less competitive market activity was observed was because of Contact and Meridian's South Island offer strategies/withholding of capacity (including by way of offer price).

The affect of Mercury conserving its North Island hydro capacity as a consequence of Pohukura and the HVDC was that it resulted in the outcomes of the UTS being worse than they otherwise would have been (particularly for South Island spot prices), rather than meaning the UTS can be partly attributed to Mercury as implied by Meridian.

If the market participants are to have confidence in the market as a consequence of the UTS determination the Authority needs to be very clear about the cause of the UTS and the type of behaviour that needs to change so it won't happen again.






There will be high inflows in the future. There will be outages of gas supply and parts of the transmission network in the future. What there does not need to be is offer strategies that result in unnecessary spill and waste of resources and harm to the environment.

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<sup>8</sup> While we consider "reduced competition" is a relevant consideration, the Authority does not need to determine there was a reduced competition to determine there was a UTS. However, we agree that the Authority has established in this paper that competition was reduced and reduced to a level that significantly impacted confidence in, and the integrity of, the wholesale market.



Yours sincerely,

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