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John Rampton
General Manager, Market Development
Submissions
Electricity Authority
Level 7, ASB Bank Tower
2 Hunter Street
Wellington

By email: submissions@ea.govt.nz

Dear John

Review of the Undesirable Trading Situation provisions in the Code

Thank you for the opportunity to provide a submission on the Electricity Authority's (the Authority) consultation paper *Review of the Undesirable Trading Situation provisions in the Code*, published 18 March 2013.

Transpower's interest in this matter lies as system operator, a grid owner, the FTR manager and a trader of electricity.

We agree the Authority's principal conclusion

We agree with the Authority's principal conclusion that recent experience has not identified the need for any fundamental changes. Consequently we do not consider there any need to amend the either the definition or scope of the UTS provisions in the Code.

It is not obvious to us that there are material interpretation issues with the UTS provisions as they stand. As even minor changes to regulation can have non-trivial and often unintended consequences we do not support change or clarification except where plainly necessary and beneficial. It is not clear to us that the bulk of the changes proposed by the Authority pass this test. On the contrary it appears that the recent High Court judgement has provided participants with a greater understanding of how the UTS provisions operate thus reducing any potential benefits of clarification.

Proposal equates to an expansion of UTS scope

We do not support the proposal to change the terms used in the definition of 'undesirable trading situation' (UTS) and we have concerns with the definition for 'wholesale market'.

We consider the change in terms will significantly expand the grounds for claiming a UTS and the scope for regulatory investigation and intervention. The new test for declaring UTS is identifying that a 'situation' can be a 'threat to confidence in the market'. This is weaker than the current test '*would, or would be likely to, preclude the maintenance of orderly trading or proper settlement of trades*' that simultaneously introduces uncertainty and lowers the threshold for regulatory intervention. While there are no obvious benefits to this outcome there are clear costs in terms of participant confidence in the integrity of market mechanisms under a regulator that has afforded itself *greater* powers to intervene in *more* matters.

We have identified consequences for the system operator and FTR processes from the proposal to define the wholesale market. Briefly, we strongly suggest that the new definition should apply only to the UTS provisions, and that the Authority factors into its cost-benefit analysis the cost of systems' change to FTR service provision (see response to question 1). We also query the inclusion of the broader hedge market in the definition, given that it is not constituted under the Code.

Inconsistency with the Code should be minimised

We appreciate the practical problem that the Authority is seeking to solve with its proposal to remove the current prohibition on the Authority issuing directions that are inconsistent with the Code. We accept that there may be a need for the Authority to issue such directions on occasion, however we consider that the proposed reversal of the prohibition is too powerful and should be modified to limit regulatory discretion. We suggest that the Authority is first required to identify the Code provisions that need to be departed from and next, to limit the departure from it only to the extent necessary to effect the remedy.

Assessment of each response in light of Authority's statutory objective

We consider the new requirement to articulate a submitter's alternative proposal against the Authority's Statutory Objective may better discipline a submitter's response but we suggest its efficient consideration is at the whole policy level rather than each element. This is because the overall policy outcome reflects both the sum and interaction of its parts. Assessing each response in isolation from the whole is unwarranted and unnecessarily time consuming.

Viewing the proposal holistically, we consider the changes are likely to be less efficient than the status quo, given the regulatory uncertainty and reduced investor confidence likely to result from the expansion in scope and greater powers for Authority intervention.

We have responded to the questions at Appendix A. We would welcome the opportunity to discuss our submission with you if that would assist to clarify any of the points raised. Please contact me directly on (04) 590 7544.

Yours sincerely

A handwritten signature in black ink, appearing to be 'JC' followed by a long horizontal stroke.

Jeremy Cain
Chief Regulatory Advisor

Appendix A – Responses to Consultation Questions

Question No.	Question	Response
1	<p>Do you agree with the proposal that the current definition of “wholesale market” should be clarified as including the spot market for electricity, the ancillary services markets and the hedge market, and that clause 9.14(2)(a) of the Code should be amended accordingly?</p> <p>If you agree/disagree, please explain why, including why in your view the proposal is consistent/inconsistent with achieving the Authority’s statutory objective in section 15 of the Act.</p>	<p>No. We consider that the recent High Court judgement has provided participants with a greater understanding of how the UTS provisions operate, thus reducing any potential benefits of clarification.</p> <p>However should the proposal stand, we query the inclusion of the broader hedge market (given that it is not constituted under the Code); and have identified consequences for the system operator and FTR service provision (outlined below, with suggestions).</p> <p>SO obligation</p> <p>Under 9.14 (2) (a) the System Operator would now be responsible for considering whether the hedge and FTR markets will be unlikely to facilitate adjustment of supply and demand. This is unreasonable, as the System Operator would not have the necessary knowledge or information to make that consideration.</p> <p>We strongly suggest the proposed definition applies only to the UTS provisions, and not to clause 9.14 (2) (a).</p> <p>FTR service provision</p> <p>As a point of compliance, currently the Authority can only suspend an FTR auction in advance up to the point that the FTRs are awarded. This is part of the functional requirements of the FTR Manager, rather than of the Code. In consequence, the FTR Manager’s Nexant i-HEDGE product and processes do not allow retrospective re-assessment of FTR awards (price and quantity). Extending the definition of UTS to include the FTR market would allow such retrospective re-assessment, and the FTR Manager would presumably be obliged to provide that capability.</p> <p>This capability change could add significant costs to service provision that would need to be funded by the Authority and factored into its cost-benefit analysis of the proposal.</p>

Question No.	Question	Response
2	<p>Do you agree with the proposed changes to Part 1 of the Code to clarify the definition of a UTS?</p> <p>If you agree/disagree, please explain why, including why in your view the proposal is consistent/inconsistent with achieving the Authority's statutory objective in section 15 of the Act.</p>	<p>No. We consider the changes go further than clarification and are instead policy changes.</p> <p>We understand from the Authority's review of the provisions that 'fundamental change' was not required and is not the Authority's intent. Since we consider the changes to the terms in the definition result in an expanded scope for a UTS, we conclude this is a fundamental change. Therefore we cannot agree with proposed changes since they do not meet the Authority's objective for clarification only.</p> <p>We also do not agree with the Authority's assessment that its clarification proposal will create an efficiency gain. We consider the expansion will create regulatory uncertainty and consequently decrease efficiency through greater likelihood of claims, investigations, appeals, and rulings.</p>
3	<p>Do you agree that the examples in paragraph (c) of the current definition of a UTS should be retained in the Code, and moved to Part 5?</p> <p>If you agree/disagree, please explain why, including why in your view the proposal is consistent/inconsistent with achieving the Authority's statutory objective in section 15 of the Act.</p>	<p>We agree that the examples may be better placed in Part 5.</p>
4	<p>Do you agree with the proposed changes to clause 13.255 of the Code to align it with the suggested changes to UTS provisions?</p> <p>If you agree/disagree, please explain why, including why in your view the proposal is consistent/inconsistent with achieving the Authority's statutory objective in section 15 of the Act.</p>	<p>No, because we do not agree with the proposed changes to the UTS provision for the reasons given in question 2.</p> <p>However, alignment would be necessary should changes to the UTS provision be made.</p>

Question No.	Question	Response
5	<p>Do you agree with the proposal that there should be a restriction on the Authority initiating a UTS investigation for situations earlier than a defined time limit in the past?</p> <p>If you agree/disagree, please explain why, including why in your view the proposal is consistent/inconsistent with achieving the Authority's statutory objective in section 15 of the Act.</p>	Yes.
6	<p>Do you agree with the proposal that the time limit should be no more than 10 business days, and apply between the commencement of the alleged UTS and the date the Authority initiates an investigation?</p> <p>If you agree/disagree, please explain why, including why in your view the proposal is consistent/inconsistent with achieving the Authority's statutory objective in section 15 of the Act.</p>	We agree with the proposal for a time limit.
7	<p>Do you agree with the proposal that there should be no time limit on republication of final prices per se?</p> <p>If you agree/disagree, please explain why, including why in your view the proposal is consistent/inconsistent with achieving the Authority's statutory objective in section 15 of the Act.</p>	Yes, although there should be a best endeavours timeframe set, so that the situations, and calculation of a final price, have some degree of confidence. This would be set on a case by case basis specific to the incident.
8	<p>Do you agree with the proposal that the Authority should be able to take any action to remedy a UTS, provided the action relates to an aspect of the electricity industry that the Authority could regulate in the Code under section 32 of the Act?</p> <p>If you agree/disagree, please explain why, including why in your view the</p>	No. However, we appreciate the practical problem that the Authority is seeking to solve with its proposal to remove the current prohibition on the Authority issuing directions that are inconsistent with the Code. We accept that there may be a need for the Authority to issue such directions on occasion, however we consider that the proposed reversal of the prohibition is too powerful and should be modified to limit

Question No.	Question	Response
	<p>proposal is consistent/inconsistent with achieving the Authority's statutory objective in section 15 of the Act.</p>	<p>regulatory discretion.</p> <p>We suggest that the proposal is modified by requiring:</p> <ul style="list-style-type: none"> • first, identification of the Code provision that needs to be departed from • second: limiting the departure only to the extent necessary to affect the remedy.
9	<p>Do you agree with the proposal that industry participants following directions from the Authority do not face the risk of breaching the Code as a consequence of doing so?</p> <p>If you agree/disagree, please explain why, including why in your view the proposal is consistent/inconsistent with achieving the Authority's statutory objective in section 15 of the Act.</p>	<p>Yes, if the proposal remains to direct participants to act inconsistently with the Code.</p>