



Submission by Genesis Power Limited

Trading as Genesis Energy

ON

Review of the Undesirable Trading Situation provisions in the Code
Consultation Paper

1 MAY 2013

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Consultation Paper

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Executive Summary

The Electricity Authority (“the Authority”) has released a consultation paper “Review of the Undesirable Trading Situation provisions in the Code” dated 18 March 2013.

Genesis Energy supports the objective of the review of the undesirable trading situation (UTS) provisions in the Electricity Industry Participation Code (“the Code”). In particular, we agree that it is helpful to consider whether any amendments would improve certainty around the application of the UTS provisions in the Code in light of technical issues emphasised in the 26 March 2011 UTS and the High Court judgment that followed.¹

However, we consider that the substantive proposed changes in the consultation paper will have the unintended effect of materially reducing rather than improving certainty around the scope of the UTS provisions (compared to the status quo). The basis for such changes is also unclear as they go considerably beyond what might be required to address technical and minor issues raised by the events in 2011. Accordingly, we strongly oppose most of the substantive proposed changes to the UTS provisions.

We recommend some minor changes to improve the certainty and clarity of the provisions. We suggest that the Authority undertake further consultation or, alternatively, ask the Wholesale Advisory Group (WAG) to consider the issue on their work programme, particularly given the close correlation with the net pivotal provider work stream.

Proposed changes fail to meet the Authority’s criteria

Genesis Energy agrees with the Authority that any amendments may have unintended adverse effects on dynamic efficiency if they are less clear than current provisions. Accordingly, it is critical that any proposals provide participants with clearer signals on what conduct is restricted compared to the current position.

In this regard, we consider the Authority’s criteria for assessing the proposed amendments are helpful, being the extent to which:

- the amendments would improve clarity relative to the status quo;
- procedural checks and balances on Authority action would be increased or reduced; and

¹ *Bay of Plenty Energy Limited v The Electricity Authority* HC WN CIV-2011-485-1371 [27 February 2012]

- the Authority's powers would be altered.

Changes to the UTS definition are unnecessary and increase uncertainty

The Authority is proposing to remove reference to trading and orderly trading in the core UTS definition and replace this with "confidence in, and integrity of" the wholesale market. Any reference to "trading" is relegated to one of the illustrative examples. We strongly oppose this change as it will considerably increase uncertainty as to the scope of a UTS compared to the status quo. In particular:

- "confidence and integrity in" in the market is an imprecise term that is open to interpretation;
- the proposed changes represent a substantive shift from the status quo where the definition of UTS has consistently referred to trading and orderly trading over many years;
- the proposed changes are inconsistent with the High Court judgment; and
- the proposed changes have the effect of replacing the higher threshold of "likely" with the lower threshold "may".

Application of wholesale market definition to UTS

In order to improve clarity and certainty, Genesis Energy considers that a "relevant wholesale market" definition should specify the markets where UTS provisions should, and can, apply. This would include the spot market, certain ancillary markets (instantaneous reserves and over frequency reserves) and FTRs because:

- these are markets where the Authority is market provider (having oversight of the market rules that apply): and
- these are co-ordinated markets rather than bilateral contracts (so UTS provisions are applicable).

It is our view that the UTS provisions in the Code should not apply to the hedge market (consistent with the previous New Zealand Electricity Market (NZEM) Rules) as:

- the futures hedge market is covered by market rules overseen by ASX; and
- the remaining part of this market consists of bilateral contracts in relation to which UTS provisions should have no application.

Some ancillary services, which are bilateral contracts, should also fall outside the relevant wholesale market definition for the same reason.

We understand the Authority is concerned that it will not be able to take the hedge market into account when assessing a UTS unless the hedge market is included in the definition. This is not correct. The hedge market can be, and has been, taken into account in previous UTS decisions – notwithstanding that the UTS provisions only apply to the spot market. If there is any doubt on this interpretation, we suggest a minor change to the wording of the current provisions to clarify this position.

Unnecessary extension of remedies

This is another substantive change where, in our view, a clear justification for amendment is not made out. The proposed changes to the remedies provision in the Code significantly broaden the Authority's powers by enabling the Authority to:

- take any action, provided it relates to an aspect of the electricity industry that the Authority could regulate under in the Code under section 32 of the Electricity Industry Act 2010 (Act); and
- give directions that are inconsistent with the Code.

The proposed changes risk adverse outcomes compared to the status quo

In our view, assessed against the Authority's criteria the proposed changes to the UTS definition, the wholesale definition and the remedies provision will separately and accumulatively:

- Significantly increase rather than reduce uncertainty around the scope of a UTS. In particular, as a result of the proposed broadening of the UTS provisions:
 - participants will be less certain about what behaviours are or are not acceptable, if and when the UTS provisions will be applied, and what actions might be retrospectively taken as a result; and
 - participants will have an incentive to invoke the UTS provisions as a means of addressing a range of complaints (which could have a significant destabilising impact on the operation of the market).
- Considerably increase the power of the Authority, where this appears to be a disproportionate and unnecessary response to any perceived

problem with the status quo (again increasing uncertainty about the likely application of the UTS provisions).

- By broadening the scope of the provisions and the Authority's discretion, weaken the protective role of question of law appeals and / or judicial review.

Genesis Energy recommendations

Genesis Energy does not support the Authority's proposed changes to the UTS definition, the FTR provisions, and the remedies clauses. However, we agree that some changes would improve clarity and reduce uncertainty about the application of the UTS provisions. Our recommendations are that:

- Subclause (a) of the definition (specifically the reference to trading and the higher threshold "likely"), the remedies clauses; and the FTR clauses remain unchanged.
- In relation to the definition of wholesale market, that the specific markets to which the UTS provisions would be applied are defined ("relevant wholesale market"). This is the spot market and certain ancillary services (instantaneous reserves and over frequency reserves).
- The Code specify that, for avoidance of doubt, when assessing whether a UTS has occurred under (a), the Authority may have regard to markets not included in the relevant wholesale market definition.
- The provisions relating to FTRs remain unchanged (clause 13.255)
- The UTS remedies provisions remain unchanged (clause 3.1.45).

We consider that these proposals are preferable to those proposed in the consultation paper. They provide greater certainty as to the application of a UTS, maintain the current level of checks and balances on the Authority's decisions, and do not unnecessarily increase the Authority's already substantial powers to remedy a UTS. They also reflect a proportionate response to any issues arising from the 26 March 2011 UTS and High Court judgment.

1. Introduction

1. Genesis Power Limited, trading as Genesis Energy, welcomes the opportunity to provide a submission to the Authority on the consultation paper “Review of the Undesirable Trading Situation provision in the Code”.
2. The structure of our submission is as follows:
 - Section 2 discusses the purpose of UTS provisions and the type of markets that they typically apply to.
 - Section 3 explains why the main proposed amendments reduce clarity and judicial oversight, risking the efficient operation of the market, in particular:
 - the proposed changes to the definition of a UTS;
 - the definition of the relevant wholesale market; and
 - the extension of the Authority’s powers in relation to remedies.
 - Section 4 sets out Genesis Energy’s suggested amendments to the UTS provisions.
 - Section 5 sets out our recommendations for next steps.
 - **Appendix A** sets out our proposed amendments with drafting.

2. Purpose of UTS provisions

3. While UTS provisions can promote operationally efficient and competitive markets, they can also undermine confidence in a market if they are too broad or fail to give participants clear signals on what conduct is restricted. Accordingly, when reviewing these provisions, it is important to consider, among other things, why and in what circumstances UTS provisions should be applied. This is necessary to ensure that any changes to the UTS provisions are appropriately targeted and limited.
4. Despite the Authority's description of the review,² the proposed amendments in the consultation paper are fundamental to how the UTS provisions are used in the electricity market (rather than minor and technical). In these circumstances, in our view, a full analysis of the purpose of UTS provisions is essential. This analysis does not appear to have been undertaken as part of the review.

UTS provisions feature in rules that control co-ordinated markets

5. UTS provisions, or provisions with similar effects, feature in the rules that control behaviour in many (but not all) co-ordinated exchange markets. To understand the distinctive role of UTS provisions, it is helpful to analyse the key differences between co-ordinated markets (such as electricity spot markets, stock exchanges and commodity markets) and trading that takes place between counterparties to bilateral contracts (where UTS provisions do not feature).
6. The relevant features of co-ordinated markets that differ from bilateral contracts are set out in the table below:

Feature	Coordinated Markets	Bilateral Contracts
Relationship with counterparty	Market participants have no knowledge of counterparties and thus no on-going commercial relationship. This creates a focus on the short term benefits of the transaction, with no focus on	Each transaction is potentially one of a series. This creates a focus on the long term value of the customer relationship—that is repeat business.

² Electricity Authority, *Consultation Paper: Review of the Undesirable Trading Situation provision in the Code* dated 18 March 2013 (consultation paper), Executive Summary first paragraph and para 1.1.1.

	long term value.	
Gaps in the rules	Participants have no knowledge of counterparties and cannot assess their creditworthiness. Accordingly, they rely on the market to have adequate protections such as prudential requirements.	Participants make their own enquiries and judgement about counterparty creditworthiness.
Creditworthiness of counterparty	High degree of common centralised information on price, bids and offers, demand and supply and transactions volumes. Participants place a high reliance on this information and rely on the market for its accuracy and timeliness and equality of access.	Participants rely much more heavily on private information and their own judgement as to prevailing conditions including prices and volumes.
Centralised common information	Central agency sets the rules under which participants trade. These rules can create risks for participants that they must accept. These rules can also create a level of confidence in that participants see that the rules may protect them—i.e. prudential requirements—and that they can trade freely if they “play by the rules”.	The contract is negotiated between the parties and parties rely on their own judgement and trades only occur if the terms and conditions are mutually acceptable.
Trade rules created by central agency	Rules can provide powers for a regulatory body to apply when there are clear failures of the rules—that is, rules cannot predict every contingency so there might be an agreed process to fill gaps. In a co-ordinated	Contracts cannot anticipate every contingency. Most contracts deal with this by arbitration clauses or by termination clauses. There is also the ability, and the incentive—for example the continuing commercial

	market parties cannot negotiate in such circumstances outside the rules and it's a practical impossibility—for examples clearing prices may affect all participants.	relationship—for parties to negotiate.
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Table 1: Coordinated markets and bilateral markets

7. All of the key differences between coordinated markets and bilateral contracts are largely addressed explicitly in the coordinated market rules. But UTS type provisions may still be necessary in coordinated markets in order to deal with unanticipated situations where the primary rules do not fulfil their purpose.
8. As is apparent from the table above, UTS provisions are not an appropriate feature of bilateral contracts. In particular, parties to bi-lateral contracts negotiate their own arrangements for addressing unanticipated events including by way of arbitration and termination clauses (and have incentives to negotiate). Parties can also seek recourse under relevant contract law.

Balance to be struck to ensure UTS provisions improve rather than reduce efficiency in the market

9. UTS provisions need to be broad enough to cover unanticipated events, but sufficiently narrow to not concern participants in “normal” market situations. As the Authority has previously stated, the event or contingency constituting the UTS must be outside of the normal operation of the wholesale market for electricity.³
10. If UTS provisions are too broad and fail to give participants clear signals on what conduct is restricted, they can reduce confidence in the market, with adverse impacts on dynamic efficiency.⁴ In addition, participants need to have a reasonable expectation that they can trade in accordance with the rules without sanction or regulatory interference.
11. In addition, if the UTS provisions are too broad, participants would have an incentive to invoke the UTS provisions as a means of addressing a range of

³ See, for example, where the Authority’s position is discussed in *Bay of Plenty Energy Limited v The Electricity Authority* HC WN CIV-2011-485-1371 [27 February 2012] at [201].

⁴ Note that not all co-ordinated markets have UTS provisions—for example, the Australian National Electricity Market has no UTS-like provisions (it has a “good faith” conduct provision but this is very different from a UTS rule). This reflects that UTS provision can both improve and reduce market confidence. In Australia, rather than include UTS provisions, the NEM includes a number of features that lessen the need for such provisions.

complaints. There would also be an expectation that the Authority would take action under its broadened powers. This could have a significant destabilising impact on the operation of the market and is contrary to the very concept of a UTS (that these are exceptional situations that occur outside normal market trading).

12. The Authority rightly recognises this balance, specifically, that changes to the UTS definition could result in adverse effects on dynamic efficiency compared to the status quo. It states that this would occur if the changes are perceived as being less clear than current arrangements.⁵ As the consultation paper explains, uncertainty impacts on parties confidence to:⁶
 - invest in and participate in the relevant markets; and
 - make investments that rely on electricity as a productive input.
13. Given the potential for a worse (more uncertain) outcome, the Authority considers that it is necessary to assess each major element of the proposed Code amendments against the following criteria:⁷
 - the extent to which the amendment would improve clarity relative to the status quo;
 - the extent to which procedural checks and balances on Authority action would be increased or reduced; and
 - the extent to which the Authority's powers would be altered.
14. We agree that these are useful assessment criteria to test any proposed changes.

⁵ Consultation paper at paras 3.3.9 to 3.3.12.

⁶ Ibid at para 3.3.4.

⁷ Ibid at para 3.3.12.

3. Proposed changes reduce clarity and judicial oversight

Proposed changes to the definition of a UTS

Elevating “confidence in, and the integrity of, the market”

15. The Authority proposes removing the reference in the UTS definition to threats to trading, orderly trading and proper settlement and replacing this with “confidence in, and the integrity of” the wholesale market.
16. Genesis Energy considers that this proposed change will significantly reduce certainty about the scope of a UTS and, therefore, should not be adopted. In particular:
 - The term “confidence in, and the integrity” in the market is imprecise and capable of wide and different interpretation by market participants and the regulator. Applying this definition, a UTS could potentially cover anything that the Authority judges to be “a threat to confidence in the wholesale market” irrespective of whether it concerns threats to trading or orderly trading.
 - The proposed change represents a significant change in the drafting of UTS provisions in the Code. Since 1996, a UTS has been consistently defined by reference to threats to trading and/or orderly trading.⁸ This is precisely because the role of a UTS is to manage unanticipated situations and undesirable conduct that impact on trading in the relevant market (where market rules do not cover all contingencies, as explained above).⁹
 - Critically, removing references to trading and settlement removes:
 - the benefit of previous decisions and practice which have incrementally improved certainty over many years; and
 - clarity provided by the High Court judgment analysis of trading and orderly trading.

⁸ This was emphasised in the High Court judgment where it was noted that “Since the commencement of the wholesale market in 1996 there has been continuity in the definition of a UTS in the three regimes that have operated since then. The UTS definition has not changed since then”. *Bay of Plenty Energy Limited v The Electricity Authority* HC WN CIV-2011-485-1371 [27 February 2012] at [131].

⁹ UTS provisions seen in other jurisdictions also tend to be considerably narrower and more specific than the proposed “confidence in the market” approach. See for example: Chicago Board of Trade (CBOT) Rule 402.C. Emergency Actions (Appendix A); and ERCOT Rule 25.501 Oversight of Wholesale Market Participants.

- Broadening the scope of the UTS definition also reduces the likely effectiveness of any question of law appeal or judicial review (where appeal rights operate as the key check and balance on the Authority). This in itself increases uncertainty around the operation of the UTS rules (participants will have less confidence that poor decisions will be corrected).
17. There does not appear to be a strong rationale for expanding the UTS definition in this way, particularly given the high risk of unintended adverse impacts on dynamic efficiency and confidence in the market. Specifically:
- The consultation paper states the UTS provisions in the NZEM Rules represent a useful reference point because they were the outcome of a multilateral negotiation among industry participants. It then states that the change to confidence in the market brings the definition closer to the previous rules.¹⁰ This statement cannot be correct. The NZEM Rules defined a UTS as “any situation which threatens or may threaten fair orderly or proper trading on NZEM”.
 - The Authority seeks to elevate confidence in the market as the “the core policy concern” for a UTS.¹¹ However, this position is directly at odds with the High Court judgment which held that, while confidence in the market was a relevant factor when determining a UTS, it was not a determinative factor, specifically:¹²

In assessing threats to trading and the likelihood of orderly trading being effected, confidence in the market is relevant. Confidence, or the lack of it, would not by itself be determinative of these questions. Confidence is an integral part of the operation of such a market.
18. If the Authority considers it remains unclear whether confidence in the market can be taken into account (which we do not agree) then the Code could be amended to provide that, for the avoidance of doubt, the Authority may have regard to confidence in the market when assessing whether a UTS has occurred under (a).¹³

¹⁰ Ibid at para 3.3.22.

¹¹ Ibid at 3.1.19.

¹² *Bay of Plenty Energy Limited v The Electricity Authority* HC WN C1V-2011-485-1371 [27 February 2012] at [294].

¹³ We note that such an “avoidance of doubt” provision does not appear necessary given the High Court judgment has clarified that confidence in the market is a relevant consideration. In addition the High Court judgment also recognised that the UTS provisions need to be considered against the Authority’s statutory objectives.

Consequential changes to FTR provisions

19. The consultation paper proposes changes to clause 13.255 of the Code which empowers the Authority to direct the financial transmission rights (FTR) manager to suspend allocations of FTRs. It states that these changes are required in order to be consistent with the proposed changes in wording in (a) of the UTS definition (replacing references to “trading” with “confidence in the market”).
20. Genesis Energy does not agree with the changes to (a) (for the reasons set out above) and, accordingly, does not agree that the proposed consequential changes to clause 13.255 are necessary.

Examples of UTSs (changes to clause (c))

21. The consultation paper refers to an issue raised in the High Court in relation to the relationship between (a) and (b) in the UTS definition on one hand and (c) on the other. In relation to these issues, the High Court:
 - held that (a) and (b) must be met first in order for circumstances in (c) to amount to a UTS (an interpretation that we agreed); and
 - observed that there appeared to be duplication in (a) and (c)(v) as there was no clear difference between “orderly trading” in (a) and “generally accepted principles of trading” in (c)(v).
22. To address these concerns the Authority proposes moving (c) to clause 5.1 and relegating the orderly trading wording in (a) to (c)(v) (in place of “generally accepted principles of trading” in (c)(v)).
23. Given the High Court has clarified the hierarchy between (a) and (b) and (c), we do not consider that moving (c) to 5.1 is required.
24. In relation to duplication between (a) and (c)(v), we consider that it is critical that the references to orderly trading in (a) are retained, with any duplication being removed from (c)(v). In particular:
 - this approach is consistent with the High Court judgment which held that (a) was the prevailing clause and that the examples in (c) were all illustrative of situations that may be beyond orderly trading in (a).¹⁴;
 - as explained above, the reference to trading and orderly trading in (a) is central to the definition of a UTS and has been for many years.

¹⁴ Ibid at [97] to [98].

Removal of the higher threshold “likely”

25. The proposed changes remove the higher threshold of “likely” in (a) and replace this with the lower standard “may”. The reason for this change is not specifically explained in the consultation paper.
26. While the High Court judgment observed an inconsistency between “likely” in (a) and “may” in (c)(v), it nevertheless found that the higher threshold “likely” applied and that the Authority had applied this standard.¹⁵ There was no suggestion that “may” was more appropriate.
27. The proposed amendment has the effect of increasing the Authority’s discretion as to the scope of a UTS (which also increases uncertainty) while at the same time limiting the potential effectiveness of appeal rights.
28. In our view there is no good reason for removing the “likely” threshold. It is the appropriate standard for a UTS which is expected to arise only in exceptional circumstances.

Definition of wholesale markets

29. The wholesale market, referred to in the UTS definition, is not currently defined in the Code (it is referred to “as the wholesale market for electricity”). The Authority proposes to define this term for the purposes of the UTS definition, and suggests that the definition should be broad enough to include all aspects of the wholesale market, (being the spot market, ancillary markets and the hedge market).
30. In our view, the consultation paper confuses the market that is the appropriate target of the UTS provisions and broader markets that the Authority may need to have regard to when deciding whether a UTS exists. These are distinct matters. The result is a proposed approach that unnecessarily broadens the scope of the UTS and further confuses, rather than clarifies, how the UTS provisions would be applied.
31. As explained below, we consider that the UTS definition should refer to a “relevant wholesale market”, being the spot market, certain ancillary markets (reserves and over frequency reserves) and FTRs. The Authority would remain able to have regard to other parts of the wholesale market when assessing whether a UTS in the relevant wholesale market has occurred.¹⁶ For the avoidance of doubt, the Code could be amended to specify that other aspects of the wholesale market can be taken into account.

¹⁵ Ibid at [149] to [152].

¹⁶ For example, the Authority is not prevented from taking account of the potential stabilising influence of the hedge market when considering whether a UTS has occurred in the spot market.

Distinction between target market and markets that can be taken into account

32. To clarify any confusion and provide certainty around this issue, we consider that the Code needs to clearly define the market in relation to which the UTS provisions are directed (because the rules covering that market cannot cover every contingency). We suggest this requires the following criteria to be satisfied:

- **Is this a co-ordinated market where UTS provisions can appropriately be applied?** As set out in section 2 above, there is a strong rationale for UTS provisions applying where there are co-ordinated markets but not whether there are bilateral markets.
- **Is the Authority the market provider with jurisdiction over the rules that govern that market?** The very point of the UTS is to provide for circumstances that cannot be anticipated under the relevant market rules. Further, the Authority should have jurisdiction to oversee and apply the UTS rules in that market. It is not appropriate to impose UTS provisions on related markets where the Authority is not the market provider, for example, the ASX futures exchange.

33. Applying these criteria to the markets that make up the New Zealand wholesale market:

Market / trading activity	Co-ordinated or bilateral contract	Market oversight	Application of UTS provisions
Spot market	Co-ordinated market	Authority has jurisdiction as market provider /market rules set out in the Code.	√
Ancillary market			
<ul style="list-style-type: none"> • Reserves • Over frequency reserve 	Co-ordinated market	Authority has jurisdiction as market provider / market rules set out in the Code.	√
<ul style="list-style-type: none"> • Frequency keeping • Black start • Voltage support. 	Bilateral contract	Authority has general oversight but no relevant market rules in the Code.	X
FTRs	Co-ordinated market	Authority has jurisdiction as market provider / market rules set out in the Code.	√

Hedge markets			
• <i>Futures and Options market</i>	Co-ordinated market	Overseen by the ASX / ASX Operating Rules apply. Authority has general jurisdiction (s 42 of the Act) but not as market provider and no jurisdiction over applicable market rules.	X
• <i>OTC, Fixed price and CFDs</i>	Bilateral contracts	Authority has general jurisdiction (s 42 of the Act) but no market rules / Code does not apply. Source of remedy for breach will arise out of the agreement itself / legislation relevant to financial contracts. ¹⁷	X

Table 2: Application of UTS provisions to wholesale markets

34. We suggest that the Code should be amended to include a new definition – specific to the UTS provisions – that reflects this table. Our suggested drafting is set out in **Appendix A**
35. Note that we do not disagree with the proposed definition of “wholesale market” *per se*. However, as set out above, it is important to properly define which part of this broader definition the UTS provisions should apply to. From a drafting perspective a more limited “relevant wholesale market” can readily be applied for UTS purposes, with a wider wholesale market definition applying to other provisions / circumstances in the Code where appropriate.

Approach consistent with previous understanding of the relevant market in relation to a UTS

36. We consider that our proposed approach is more consistent with previous rules and decisions. The NZEM Rules referred to threats in trading in the “NZEM”, where the NZEM was narrowly defined as covering the spot

¹⁷ Note that trading in futures outside of the ASX market is also subject to dealers receiving authorisation under section 38(1)(a) of the Securities Markets Act 1988. That Act contains provisions that prohibit insider trading and misleading and deceptive (manipulative) conduct in relation to futures dealing.

market but not the hedge market.¹⁸ Other markets, including the hedge market, were then considered relevant to assessing whether a UTS in the NZEM had occurred.

37. The consultation paper states that its proposed definition of wholesale market is more consistent with a July 2001 Market Surveillance Committee (MSC) UTS decision.¹⁹ However, the discussion of the “wholesale market” referred to from this decision was not in relation to the UTS provisions and, accordingly, is of limited assistance. More relevantly, the MSC’s position in the July 2001 decision was that its jurisdiction was “limited to the spot market and the market participants in and service providers to that market”.²⁰ It also stated that UTS rules were for “the protection of an efficient and competitive spot market”.²¹ The MSC went on to find that other markets, such as the hedge market could be taken into account.²²
38. While the term “wholesale markets in electricity” was introduced into the UTS provisions in 2003, subsequent UTS decisions have focused on the spot market. The “wholesale market” has never been broadly applied in the context of a UTS.

Application to hedge market

39. The consultation paper states that hedge markets must be included in the UTS definition as otherwise the Authority would be unable to take hedge markets into account when assessing a UTS.²³ This position is not correct. Indeed, as set out above, hedge markets were taken into account under previous NZEM Rules, despite the fact the jurisdiction was treated as being limited to the spot market. In any event, for the avoidance of doubt, the Code can be amended to specify that the Authority is not prevented from taking into account other aspects of the wholesale market when assessing whether or not a UTS has occurred. Suggested drafting is set out in **Appendix A**.
40. The consultation paper also argues that, while the hedge market operates outside the Code, the Authority is required under section 42 of the Act to facilitate and provide for an active hedge market. We agree that the Authority has a statutory role in the facilitation of the hedge market.

¹⁸ The consultation paper says at para 3.3.23 that the reference to NZEM was all encompassing and could include the retail and network services market – however this is not how the provisions have been interpreted in any UTS decision.

¹⁹ Consultation paper at para 3.1.3

²⁰ *Claimed Undesirable Situation arising from high spot prices in May / June 2001*, Market Surveillance Committee memorandum, page 6, 17 July 2001 at page 6..

²¹ *Ibid* at page 19.

²² *Ibid*, see for example page 22.

²³ Consultation paper at para 3.1.8.

However, that role should not extend to jurisdiction over market rules which the ASX applies, or to the retrospective oversight of bilateral contracts.

UTS should only apply if cannot be resolved by any other mechanism

41. Clause 3.1.13(b) of the Code provides that a UTS will only arise if, in the reasonable opinion of the Authority, it cannot satisfactorily be resolved by any other mechanism under the Code.
42. If the wide definition of wholesale market is adopted (with which we strongly disagree), then (b) should necessarily be broadened to include mechanisms under any other rule, code, regulation or enactment. This is because, in relation to the wider markets, there are a range of remedies available that can be enforced by other agencies or by parties to a contract. It would unnecessarily broaden the scope of a UTS and increase uncertainty if a UTS could be found and acted on where other remedies were available.

Extension of powers to provide for remedies

43. The Authority is proposing significant changes in relation to the UTS remedies. The changes enable it to:
 - take any action provided the actions relate to an aspect of the electricity market that the Authority could regulate in the Code under section 32 of the Electricity Act (under the current drafting the Authority is limited to taking the actions listed in 5.2(2) in relation to the wholesale market);²⁴ and
 - give directions that are inconsistent with the Code (this is currently expressly prohibited).
44. We consider that the proposed amendments risk adverse outcomes compared to the status quo. In particular,
 - the proposed changes significantly broaden the Authority's powers and the potential range of remedies available;
 - the ability to give directions that are inconsistent with the Code is contrary to certainty, where, from a participant's perspective, the Code provides a clear framework as to what can, or cannot, be done; and
 - the broadening of the powers and discretion has the effect of weakening the potential effectiveness of a question of law appeal.

²⁴. Where a UTS, clause 5.2(1) empowers the Authority to take actions set out in clause 5.2(2) (where it may take one or more of the actions listed).

45. Given the potential and likely adverse impact of the proposal, we do not consider the consultation paper makes a strong enough case for changing the status quo. There is no clear evidence to suggest the current provisions have been inadequate. In particular:

- The current remedy provisions are clear, where the available actions are listed in subclause (2). The actions are also sufficiently wide for the Authority to be able to address a UTS.
- The reference to “the wholesale market” does not add ambiguity in this context as the Authority suggests, particularly where it is proposed that this phrase now be defined.
- The metering example provided as a reason for extending the UTS provisions (where there is a widespread loss of data), does not, in our view, provide a persuasive basis for such a fundamental change of the Code.²⁵
- We do not consider that the problems that arose in the 26 March 2011 UTS justify the introduction of a power to provide directions that are inconsistent with the Code.²⁶ The issue that the Authority refers to was appropriately addressed by way of the grant of exemptions.²⁷

46. In relation to the broader justification for the extension of the remedies power we note that:

- The consultation paper considers that the proposed increased powers are comparable to the NZEM Rules.²⁸ However, while the previous NZEM Rules provided that the MSC could take “whatever steps it considers appropriate to correct the situation”, this was in a context where its jurisdiction was limited to the spot market. Further, the NZEM Rules limited who the MSC could give directions to.²⁹
- The consultation paper also places considerable emphasis on appeal rights, which it says provide a check on the Authority’s powers and also states that

²⁵ An possible example is provided where the metering segment of the industry resulted in a widespread loss of date, resulting in a UTS. The Authority states that the preferred remedy may be to take some action in the metering area. However, the risk of such an event ever occurring is extremely low. Further, there are already ample provisions in the Code to address such a metering data issue.

²⁶ In the 26 March 2011 UTS the Authority granted exemptions to the pricing manager and clearing managers in respect of time periods set out in the Code (referred to in the consultation paper at para 3.1.53).

²⁷ As the consultation paper notes, the Authority could have also utilised its power to make urgent Code changes.

²⁸ Consultation paper, Executive Summary.

²⁹ The MSC was empowered to give directions to the Market Participant or any Market Participant or service provider where these terms were relatively narrowly defined (Rules 2.37 of the NZEM Rules).

this is an additional protection as compared to the NZEM Rules.³⁰ However contrary to what the consultation paper suggests:

- the NZEM Rules provided for appeal rights from a MSC decision to an independent appeal board (not limited to questions of law); and
- question of law appeals and judicial review are relatively weak accountability mechanisms for reviewing the decisions of an expert decision maker. In addition, as already noted above, the proposed broadening of the remedy powers further weakens the effectiveness of such appeal rights as a check on the Authority.

10 day time limit

47. We do not have a strong view on the 10 day time limit proposed for UTS applications. If a time limit for lodging a proposal is introduced, we consider that the Code should also include a time limit for the making of the UTS decision by the Authority (which is arguably the more critical event in terms of finality).

³⁰ Ibid, Executive Summary and paras 3.3.36 – 3.3.37, and 3.3.43 – 3.3.46.

Assessment of proposed changes

48. As illustrated below, we consider that the proposed changes contained in the Consultation Paper fail to meet the Authority's own criteria.

Criteria	Assessment	Reasons
The amendments would improve clarity relative to the status quo.	X	<ul style="list-style-type: none"> • Untargeted, and inappropriate, application of the UTS provisions to all wholesale markets. • Introduce new uncertainty as to what may constitute a UTS (particularly the relegation of orderly trading to an "example"). • Inconsistent with previous understanding of what constituted a "UTS" and High Court judgment.
Procedural checks and balances on Authority action would be increased or reduced.	X	Changes to the definition of a UTS and the broadening of the Authority's powers to remedy considerably reduces the protective role of a question of law appeal.
The Authority's powers would be altered (in comparison to the status quo).	X	The Authority will have substantially more power under the proposed amendments to the remedies.

Table 3: Assessment against Authority's criteria

3. Genesis Energy's proposed amendments

49. As set out above, we do not consider that the current proposed amendments improve clarity for market participants on what constitutes a UTS.
50. However, we consider that some changes can be made to the current UTS provisions to provide better clarity around the scope of the UTS provisions compared to the status quo (which would bring efficiency benefits). Importantly, our recommendations preserve benefits arising from the continuity of previous rules while addressing, where necessary, issues raised in the 26 March 2011 UTS and the High Court judgment.
51. In summary our recommendations are that:
- key and longstanding references to trading are retained, in keeping with the role and function of UTS provisions in coordinated markets;
 - the relevant wholesale market definition clearly defines the markets where UTS provisions appropriately apply (spot market, certain ancillary services and FTRs);
 - the Code clarifies, for the avoidance of doubt, that other aspect of the wholesale market may be a relevant consideration when considering whether a UTS has occurred in the relevant wholesale market;
 - subclause c(v) is changed only to the extent necessary to address matters raised by the High Court judgment; and
 - the remedies powers remain appropriately unchanged.
52. We have set out our proposed changes to the current UTS provisions in **Appendix A**.
53. We have also considered our suggested changes against the Authority's criteria. In our view, our changes will still provide the Authority with sufficient powers to address a UTS whilst ensuring that the UTS provisions provide more, rather than less, certainty around the scope of the UTS definition. Checks and balances in the Code are also maintained at their current level.

4. Next steps

54. Genesis Energy recommends that the Authority:

- At the very least, retain the status quo over the main amendments proposed.
- Consider, and consult further on, alternative amendments, including our proposals, which we consider improve certainty and better reflect the High Court judgment and the UTS history in New Zealand. Given the potential adverse implications, it is important that the impact of the changes in the context of the role of a UTS provision is fully considered.
- Preferably, refer the matter to WAG for further consideration and recommendation given the potential significant impact on the market and the correlation with the WAG's net pivotal work stream.

Appendix A: Amendments proposed by Genesis Energy

The current provisions of the Code be amended as follows:

undesirable trading situation means any situation ~~contingency or event~~³¹

- (a) that threatens, or may threaten, trading on the **relevant wholesale market** for electricity and that would, or would be likely to, preclude the maintenance of orderly trading or proper settlement of trades; and
- (b) that, in the reasonable opinion of the **Authority**, cannot satisfactorily be resolved by any other mechanism available under this Code ~~for any other rule, code, regulation or enactment~~ *(if the Authority proceeds with its proposed broad definition of the relevant wholesale market)*;
- ~~(c) may include, without limitation, —~~
 - ~~(i) manipulative or attempted manipulative trading activity; and~~
 - ~~(ii) conduct in relation to trading that is misleading, deceptive, or likely to mislead or deceive; and or~~
 - ~~(iii) unwarranted speculation or an undesirable practice; and~~
 - ~~(iv) material breach of any law; and~~
 - ~~(v) any exceptional or unforeseen circumstance that is at variance with, or that threatens or may threaten, generally accepted principles of trading or the public interest.~~

For avoidance of doubt, and without limitation, when assessing whether an undesirable trading situation has occurred under (a), the Authority may have regard to:

- (a) the hedge market for electricity; and
- (b) those ancillary services which are not included in the **relevant wholesale market** definition.

....

relevant wholesale market means ~~the wholesale market for electricity —~~

- ~~(a) the spot market for electricity, including the process for setting—~~
 - (i) real time prices;
 - (ii) forecast prices and forecast reserve prices;
 - (iii) provisional prices and provisional reserve prices;

³¹While Genesis Energy does not oppose the replacement of “contingency or event” with “situation”, it questions whether this change is necessary given any uncertainty has been clarified in the High Court judgment.

(iv) interim prices and interim reserve prices:

(v) final prices and final reserve prices:

(b) markets for the following ancillary services:

(i) instantaneous reserves:

(ii) over frequency reserve:

(c) the market for FTRs.

...

In the alternative to the above, "relevant wholesale market" in (a) in the UTS definition could be replaced with "spot market and markets for instantaneous reserves and over frequency reserves" with spot market further defined in the definition section.

In relation to the other proposals in the consultation paper:

- the provisions relating to FTRs should remain unchanged (clause 13.255);
- the UTS remedies provision should remain unchanged (clause 3.1.45);
- Genesis Energy does not oppose the new proposed 5.1 (2) and (3) (which replaces (c)(v) in the UTS definition) subject to the removal of 5.1.(2)(e) ("a situation that threatens orderly trading or proper settlement").