

30 April 2020

Tony Baldwin  
Chair  
MDAG  
Electricity Authority  
Wellington

By e-mail: [mdag@ea.govt.nz](mailto:mdag@ea.govt.nz)

Dear Tony

## **Independent retailer recommendations for enhancements to the MDAG draft Trading Conduct Code Amendment Proposal**

Ecotricity, Electric Kiwi, energyclubnz, Flick Electric, Pulse and Vocus (the independent retailers) appreciate the opportunity to respond to MDAG's consultation on improvements to the trading conduct rules.

As a group, we collectively represent 9.21% of the electricity retail market, or 95.5% of the electricity retail market supplied by independent retailers.<sup>1</sup> We are proudly independent entrant retailers who are responsible for delivering New Zealanders choice, innovation and keeping prices down.

We commend MDAG for the quality of the consultation paper and proposals, and for the open way the Group and Group Chair have engaged with stakeholders after release of the consultation paper. We have appreciated the use of workshops and the availability of the MDAG Chair and support staff to answer and discuss queries.

We also welcome the decision to include cross-submissions as part of the consultation process. While the Electricity Authority has tended to shy away from use of cross-submissions, we consider it should be the default option and always be used for potentially contentious projects.<sup>2</sup>

### **Introduction of rigorous market monitoring and enforcement is vital**

We agree with MDAG that "As with any rule" the "effectiveness" of the High Standard of Trading Conduct Rules "depends on monitoring and enforcement". We support MDAG's intention to recommend the Authority adopt rigorous market monitoring and enforcement.<sup>3</sup>

For the avoidance of doubt, observable market power, in both the half-hour markets and futures markets, would indicate an undesirable market outcome. Observable market power can occur in a region, in a time period or with a particular fuel type. All forms of market power need to be transparently monitored and reported upon by the Authority.

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<sup>1</sup> As at 31 March 2020: [https://www.emi.ea.govt.nz/Retail/Reports/R\\_MSS\\_C?Percent=Y&\\_si=v|3](https://www.emi.ea.govt.nz/Retail/Reports/R_MSS_C?Percent=Y&_si=v|3)

<sup>2</sup> As a general rule, a cross-submission step may be unnecessary for technical and non-contentious matters.

<sup>3</sup> We consider that the Authority should adopt more rigorous monitoring and enforcement to other matters such as the Code disclosure requirements as well.

## **Rules to better help curb abuses of market power cannot come fast enough**

The independent retailers support trading conduct rule changes to better help curb abuses of market power in the wholesale electricity market.

We are at the frontline of abuses of market power in the wholesale electricity market. If or when Meridian (ab)uses its market power to raise wholesale electricity prices (including what it euphemistically describes as ‘efficiently managing locational risk’) it also results in windfall gains (higher spot prices) for Contact, Genesis, Mercury and Trustpower’s wholesale businesses. There is no countervailing benefit, only detriments, for independent retailers and, more importantly, consumers. Abuses of market power erode our margins and ability to offer lower and efficient (genuinely cost-reflective) retail prices for consumers.

The MDAG paper, and supporting Concept report, provide details of potential on-going and substantive misuse of market power.

Consistent with the circumstances we face, the European Union recognises that “Where [a supplier] has significant market power on a specific market, it may also be deemed to have significant market power on a closely related market, where the links between the two markets are such as to allow the market power held in one market to be leveraged into the other market, thereby strengthening the market power of the [supplier]”.<sup>4</sup> In short, what this says is that problems of market power in the wholesale electricity market can result in heightened market power problems in the retail market. This is consistent with our observations and experience.

## **We support MDAG’s proposals, but refinements would better ensure they curb and prohibit abuses of market power**

We support the MDAG draft Code Amendments, but consider they would better promote the long-term interests of consumers with the following enhancements:<sup>5</sup>

- The existing clause 13.5A(1) should be retained;
- The proposed purpose should be amended to align more tightly with workably competitive market outcomes rather than competitive market outcomes or “efficiency outcomes”;
- Clause 13.5(A)(3) should be simplified and tidied up by ensuring subclause (3)(b) corresponds with the chapeau and removing the repetitious and tautological references to efficiency and “efficiency outcomes”;
- Clause 13.5(A)(3) should be amended to explicitly capture all workably competitive market outcomes, including that “workably competitive markets have a tendency towards ... normal rates of return, and ... prices that reflect such normal rates of return”; and
- The scope for any ambiguity about the interpretation of significant market power should be removed, either by clarifying that “For the avoidance of doubt, significant market power includes transient market power” or otherwise defining what significant market power means in the Code.

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<sup>4</sup> Article 14(3) of Directive 2002/21/EC: <https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:32002L0021>

<sup>5</sup> Appendix 1 of our submission provides an explanation for each of the five enhancements we recommend for MDAG’s proposed trading conduct rule changes. Appendix 2 provides a track-change version of MDAG’s proposed trading conduct rule changes, incorporating our recommendations in full.

There are alternative ways the proposed trading conduct rules could be rewritten or amended which could be worth considering, including a more direct prohibition on market participants using significant or excessive market power in a way that results in outcomes that are inconsistent with the outcomes in a workably competitive market. We note, for example, the Commerce Commission position that: “Conduct which may be pro-competitive or competitively neutral when engaged in by a firm lacking market power may harm competition when engaged in by a firm with market power”.<sup>6</sup>

### **It is important that there is a clear understanding of what the proposal is and is not**

At the workshops there were attempts to liken the proposed trading conduct rules to price control. This is not a reasonable or accurate representation of the MDAG proposals (including our proposed variations and enhancements).

The way the MDAG proposals restrict the extent to which market participants may use their significant market power to set prices that deviate from associated economic costs could more accurately be described as akin to the exemption provisions for insurance products under the Human Rights Act. The Human Rights Act, for example, allows “different terms or conditions for each sex or for persons with a disability or for persons of different ages if the different treatment” but these need to reflect their underlying economic costs i.e. the differences need to be “based on ... actuarial or statistical data, upon which it is reasonable to rely, relating to life-expectancy, accidents, or sickness; or ...where no such data is available in respect of persons with a disability, reputable medical or actuarial advice or opinion, upon which it is reasonable to rely, whether or not contained in an underwriting manual”.

This does not mean that the Human Rights Act or the Human Rights Commission is responsible for setting prices. The Human Rights Act simply places an obligation on insurance suppliers to be able to provide “justification ... for reliance on the data or advice or opinion and for the different treatment” and “views of an actuary on the justification for the reliance and for the different treatment”.

The same type of onus should be placed on generators to be able to justify and explain their pricing. The generators should be able to provide an ‘objective justification’ for their offer pricing to demonstrate what they are doing is not an attempt to exploit their position in the market or to distort competitive dynamics. The Commerce Commission has commented that “The concept of objective justification should be viewed as relatively broad and flexible, but one which requires adequate supporting evidence” and “Objective justification depends on individual circumstances and available evidence in support”.<sup>7</sup>

### **There are enduring issues with market concentration in the wholesale electricity market**

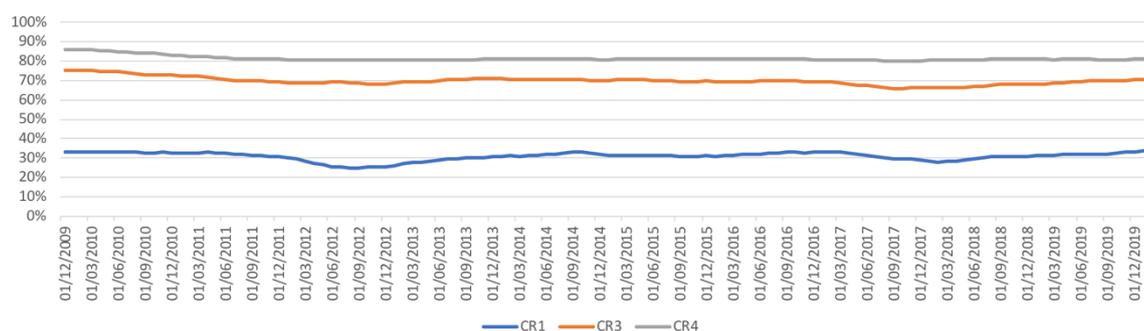
The market share of the largest 4 generators is basically unchanged since the Electricity Authority was established (see Figure 1 below).

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<sup>6</sup> Commerce Commission, Equivalence and non-discrimination – guidance on the Commission’s approach for telecommunications regulation, 4 March 2020, paragraph 4.49.

<sup>7</sup> Commerce Commission, Equivalence and non-discrimination – guidance on the Commission’s approach for telecommunications regulation, draft version, 4 March 2020, paragraphs 4.24 and 4.25.

**Figure 1: Changes in wholesale electricity market share (unweighted 12-month rolling average)<sup>8</sup>**



The lack of change in the level of market concentration is notable given the Commerce Commission determined in 2009 that “... each of the four largest gentailers - Contact, Genesis, Meridian and Mighty River Power - is likely to have held substantial market power on a recurring basis, particularly during dry years ... Each of these companies has the ability and incentive unilaterally to exercise market power and increase wholesale prices during certain periods ... the gentailers are using that market power to maximise their profits ...”<sup>9</sup>

It is also notable that the market share of the largest 3 generators is in excess of 70% which is a threshold the Commerce Commission uses to determine whether a market is concentrated.

In the absence of reform initiatives to promote stronger competition in the wholesale electricity market, it can reasonably be assumed there will be an enduring need for market rules to prohibit/mitigate abuses of market power.

#### **MDAG should clarify what is intended or meant by “significant market power”**

We support adoption of the threshold of “significant market power” rather than “substantial market power”, on the proviso that:

- (i) significant market power includes short-term or transient market power (which MDAG has given as a “key reason” for using the term significant market power); and
- (ii) significant market power is a lower threshold (requires a weaker level of market power) than substantial market power i.e. substantial market power is a subset of significant market power (not vice versa).

The MDAG consultation paper is silent on the differences and interrelationship between significant and substantial beyond that MDAG consider significant to include transient market power, while it notes ““substantial degree of power in the market” in section 36 [Commerce Act] is typically used to refer to the existence of market power over much longer periods than the short run occurrences that can cause concern in the electricity spot market”.<sup>10</sup>

<sup>8</sup> Source: <https://www.emi.ea.govt.nz>

<sup>9</sup> <https://comcom.govt.nz/news-and-media/media-releases/archive/commerce-commission-finds-that-electricity-companies-have-not-breached-the-commerce-act>

<sup>10</sup> MDAG, “HIGH STANDARD OF TRADING CONDUCT” PROVISIONS: A REVIEW BY THE MARKET DEVELOPMENT ADVISORY GROUP, DISCUSSION PAPER, paragraph 119.

MDAG should further clarify what is intended by significant market power. The plain English meaning of the term “significant” is that it is “large or important enough to have an effect or to be noticed” which seems appropriate.

It may be helpful to draw on international precedent, and to consider whether the term should be defined in the Code. The European Union, for example, provides the following definition of significant market power: “An undertaking shall be deemed to have significant market power if, either individually or jointly with others, it enjoys a position equivalent to dominance, that is to say a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers”.<sup>11</sup>

We have suggested Code wording to clarify that significant market power includes transient market power. Regardless of whether our suggested Code changes are adopted, MDAG should clearly articulate, in the Final Recommendations Paper, the intended definition of significant market power, and MDAG’s views on the differences and interrelationships between significant and substantial market power. This could aid with the potential legal interpretation of the new Code provisions.

### **More specific obligations on bidding behaviour need to be coupled with a general market abuse backstop**

MDAG have commented that “the legal meaning of HSOTC is somewhat amorphous -- akin to a semi-opaque emulsion with different layers of potential meaning” and “the idea that an amorphous, single sentence HSOTC requirement may be effective in capturing unwanted behaviours beyond pivotal abuses is likely to be somewhat illusory”.

There is risk that going from the, current, relatively high level HSOTC prescription which potentially casts a wide net over “unwanted behaviours beyond pivotal abuses” to a narrower and more targeted set of specific trading conduct rules could result in some forms of undesirable trading conduct being permitted. For example, in our view market manipulation and insider trading should be captured by any new trading conduct rules.

The more specific and narrower MDAG try to make the rules regarding spot market offers, the greater the (unintended) risk that some forms of undesirable trading conduct could go unchecked is likely to be.

A good way to address this risk would be to retain the existing clause 13.5A(1) as a ‘catch-all’ requirement that trading conduct has to be of a high standard, which would be complemented by the replacement of the remainder of the existing rules with MDAG’s offer behaviour rules. We see no detriment from retaining a high standard of trading conduct rule that requires a high standard of trading conduct.

### **The trading conduct rules need to limit the risk of “by too much or for too long” being interpreted too permissively or too generously for generators**

The other main risk of unintended consequences with MDAG’s proposal is that offers that “exceed [economic cost] ... by too much or for too long” could be interpreted in a way that is effectively “by way too much or for far too long”. MDAG has intimated this is a potential risk given the broad range of outcomes that could be considered to be consistent with workably competitive market outcomes.

With respect, we consider MDAG’s diagnosis isn’t quite right.

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<sup>11</sup> Article 14(2) of Directive 2002/21/EC: <https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:32002L0021>

We consider the risk the proposed new trading rules result in offers that “exceed [economic cost] ... by way too much or for far too long” is driven by the omission of any explicit clause capturing the High Court precedent that “workably competitive markets have a tendency towards generating certain outcomes. These outcomes include the earning by firms of normal rates of return, and the existence of prices that reflect such normal rates of return, after covering the firms’ efficient costs”.<sup>12</sup>

The clear emphasis of the High Court is that workably competitive market outcomes include constraint on the level of excessive or supranormal profits, but the MDAG proposal turns this on its head with the proposed Code drafting expressing a normal return as a price floor e.g.:<sup>13</sup>

“... the tendencies in workably competitive markets towards ... returns [commensurate with the risks faced by their owners when they made their investments] and [efficient] prices ... will also lead towards incentives for efficient investment (investment that is reasonably expected to earn at least a normal rate of return) and innovation.”

“The same tendencies towards prices based on efficient costs and reasonable rates of return will lead also to improved efficiency, provision of services reflecting consumer demands, sharing of the benefits of efficiency gains with consumers, and limited ability to extract excessive profits.”

One of the problems with the MDAG drafting is that the adverse efficiency outcomes can be muted where demand for electricity is inelastic or large numbers of customers are not directly exposed to spot prices. Even the extreme spot price spikes in the Genesis 26 March 2011 UTS breach would have had little impact on the “efficient ... consumption decisions by consumers”. This lowers the potential (allocative) efficiency impact (deadweight losses) of prices that exceed economic cost “by too much or for too long”. There is even potential for countervailing arguments that high (variable) prices can result in better energy efficiency (an argument used to support the Low Fixed Charge Regulations) and lower carbon emissions.

We consider that there is material risk MDAG’s proposals would be overly permissive of abuses of market power. The best way to address this is likely to be by amending the proposed 13.5(3) to refer to:

- (i) “outcomes consistent with workably competitive markets” rather than “efficiency outcomes” and “outcomes consistent with competitive markets”. This would enable the trading conduct rules to be interpreted in a way that is fully consistent with precedent on how workably competitive market outcomes should be interpreted; and
- (ii) “... offers or reserve offers made by generators or ancillary service agents ... limits extraction of excessive revenue and returns and promote efficient ... consumption decisions ...”.

These refinements would help tighten and clarify the proposed trading conduct rules, by aligning the rules more tightly with the High Court precedent MDAG has already drawn on in relation to the meaning of competitive/ workably competitive market outcomes.

### **The December 2019 HSOTC and UTS complaint lends support to MDAG’s analysis**

The December 2019 HSOTC and UTS complaint submitted by Haast Energy Trading, Ecotricity, Electric Kiwi, Flick Energy, Oji Fibre, Pulse and Vocus:<sup>14</sup>

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<sup>12</sup> WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [18].

<sup>13</sup> WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraphs [19] – [22].

<sup>14</sup> <https://www.ea.govt.nz/dmsdocument/26144-haast-letter-to-authority-12-december-2019>

- provides support that the appropriate tests for determining a breach of the trading conduct rules is use of market power/outcomes that are inconsistent with workably competitive markets;
- details that use of market power and market manipulation are overlapping concepts (the MDAG consultation paper treats them as separate);
- confirms MDAG's views on the outcomes that can be expected to be produced in workably competitive markets; and
- confirms MDAG's views about the relationship between SRMC and LRMC pricing.

### **Implications for the UTS rules**

The interrelationship between the existing UTS rules and the proposed trading conduct rules was discussed at the Wellington workshop. No changes to the existing UTS rules are needed, and it is appropriate that the UTS rules are additive to the trading conduct rules. The current arrangements reflect that a UTS can simply be an extreme form of breach of the existing HSOTC rules, as reflected in the December 2019 HSOTC and UTS breach complaint.<sup>15</sup>

### **Bouquets and brickbats**

We are pleased to be able to offer positive support for MDAG's proposals and the quality of the consultation paper, after being highly critical of the work on saves and winbacks. However, the trading conduct review is symptomatic of our wider concern about Electricity Authority project management.

We raised concern with the Authority about its "lack of progress on the spot market trading conduct highlights the problems with project inertia" in response to both the Authority appropriations consultation in 2018 and 2019, and again in relation to its progress on the EPR reforms.<sup>16</sup> We support the Electricity Authority's desire to "deliver ... projects faster, so that the benefits for consumers are realised sooner".<sup>17</sup> 27 months is simply too long to produce a single consultation paper. We recommend Advisory Groups engage and consult with stakeholders throughout the policy development process rather than adopting the Authority's 'propose-respond' style for consultation.

### **Cost benefit analysis**

We do not contest MDAG's views about the practicability of quantifying the costs and benefits of its proposals. If MDAG was going to try and develop quantified CBA it could consider modelling the results of more competitive outcomes e.g. if offer prices were closer to SRMC. The modelling in the December 2019 UTS and HSOTC complaint shows how vSPD can be used to do this.

### **Next steps**

We welcome MDAG's agreement to provide for cross-submissions.

We support the Electricity Authority moving straight to Code amendment following the public release of the MDAG Final Recommendations Paper. MDAG can undertake any further consultation that may be needed on the Code Amendments e.g. if technical drafting consultation is needed or there are material

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<sup>15</sup> This has parallels, for example, that under New Zealand laws an act of murder can also be an act of terrorism.

<sup>16</sup> Letter of Minister's expectations 2020/21: Specific expectations regarding the Electricity Price Review, 20 March 2020.

<sup>17</sup> <https://www.ea.govt.nz/dmsdocument/23836-market-brief-24-july-2018%23mctoc1#mctoc1>

changes to the proposals. MDAG will need to ensure it has met the Electricity Industry Act requirements for amendment of the Code.

### Concluding remarks and recommendations

The independent retailers welcome and support MDAG's draft proposed trading conduct Code Amendments. We agree with MDAG that the proposed trading conduct rules would provide more clarity about what a breach of the high standard obligations is. While it isn't the responsibility of MDAG, we want to emphasise the success of any Code change depends on the Authority having and applying the resources to rigorously monitor and enforce the Code requirements.

We recognise there are several valid ways the trading conduct rules could be expressed in the Code. We are open to considering variations and alternatives to the MDAG proposal, be they submitted by other stakeholders or from the further work MDAG undertakes before finalising its recommendations.

We have proposed five specific changes to the MDAG proposals which we consider would better promote the long-term interests of consumers. Matters that specifically warrant consideration include:

- *Whether moving from 'helicopter' level Code requirements to a very specific, narrow, set of Code requirements could inadvertently permit some forms of conduct that are not of a high standard to be permissible?* We consider that the Code should preserve the current 13.5A(1) or similar as a 'catch-all' provision. We see no detriment from retaining a high standard of trading conduct rule that requires a high standard of trading conduct.
- *Is there enough clarity about what is meant by "significant market power", and that it includes transient market power?* We consider that the Code should specify that significant market power includes transient market power, and MDAG should consider whether to include a definition of significant market power. At the least, the Final Recommendations Paper should clarify MDAG's intended meaning of significant market power including differences and interrelationship with substantial market power.
- *Do the proposed Code Amendments provide enough direction to ensure the thresholds for determining whether prices exceed economic costs "by too much or for too long" are not excessive or unduly permissive of the exercise of significant market power?* We consider that the Code should be clear that the purpose should be to promote ALL desirable workably competitive market outcomes, including limiting the extraction of excessive revenue and returns.
- *What are the implications of focusing on "efficiency outcomes" rather than desirable workably competitive market outcomes more generally, and of treating efficiency as an "outcome" to be promoted for its own sake, rather than promoting efficiency for the long-term benefit of consumers?* See above. We consider that the purpose should be to promote ALL desirable workably competitive market outcomes, and not just "efficiency outcomes". We also question the propriety of treating efficiency as an "outcome".

While it is desirable to promote efficient consumption decisions, efficient production decisions, innovation and efficient investment and efficient risk management, it should also be recognised that "what matters is that workably competitive markets have a tendency towards generating certain outcomes. These outcomes include the earning by firms of normal rates of return, and the existence of prices that reflect such normal rates of return, after covering the firms' efficient costs" [emphasis added].<sup>18</sup> Normal returns aren't simply

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<sup>18</sup> WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [18].

something that suppliers should be able to recover (as per clause 13.5A(3)(c)), but something that should not be exceeded “by too much or for too long” (not captured by the MDAG proposed Code drafting). The trading conduct rules should specifically and directly curb exercise of significant market power which has the purpose or effect of extracting excessive revenue or returns.

Yours sincerely,

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## Appendix 1: Explanation of the Independent Retailers' enhancements to the MDAG trading conduct rule change proposals

Proposed enhancement	Suggested drafting	Explanation
The existing clause 13.5A(1) should be retained.	The existing 13.5A(1) "Each generator and ancillary service agent must ensure that its conduct in relation to offers and reserve offers is consistent with a high standard of trading conduct" should be retained.	We are concerned removal of this clause could have unintended consequences and could result in some forms of abuse of market power not being captured. For example, insider trading and market manipulation may not be captured by another other part of the Code. <sup>19</sup>  The risk is highlighted by Figure 4 of the MDAG consultation paper.  The narrow specification of the rules in the MDAG proposal could, by way of example, omit market manipulation and insider trading. We note and agree with the comments made by Kieran Murray (Sapare) that "Manipulation of market trending and hence prices is an offence under most, if not all, organised market rules" and "Market manipulation is an offence under the rules of organised markets because it distorts prices and there is doubt that markets self correct, or at least self correct without significant welfare losses". <sup>20</sup>
The proposed purpose should be amended to align more tightly with <u>workably</u> competitive market <u>outcomes</u> rather than competitive market outcomes or "efficiency outcomes".	We consider proposed clause 13.5A(3) should be amended to read "The purpose of this clause 13.5A is to promote offer behaviour and <del>efficiency</del> <u>workably</u> outcomes consistent with <u>workably</u> competitive markets ..."	The rules should be drafted in a way that avoids unnecessary and esoteric debates about what is an "outcome" of a workably competitive market versus what is an "efficiency outcome", and what the difference between "efficient" and "efficiency outcome" is.
Clause 13.5(A)(3) can be simplified and tidied up by ensuring subclause (3)(b) corresponds with the chapeau and removing the repetitious	We recommend clause 13.5A(b) be amended to read " <del>with the effect</del> offers or reserve offers made by generators or ancillary service agents ... may have a material	The clause does not follow from its chapeau: "... so that ... with the effect ..." does not make sense.  The proposed drafting is also circular, repetitive and tautological: the "purpose ... is to promote <u>efficiency outcomes</u> ... [to] promote <u>efficient</u> ...

<sup>19</sup> For further explanation, refer to the section "More specific obligations on bidding behaviour need to be coupled with a general market abuse backstop".

<sup>20</sup> Kieran Murray (Sapare), Claimed undesirable trading situation, 26 March 2011, 6 April 2011.

Proposed enhancement	Suggested drafting	Explanation
<p>references to efficiency and “efficiency outcomes”.</p>	<p>influence on prices <u>efficiency outcomes of the kind referred to in subparagraphs (i) to (iv)</u>”.</p>	<p>decisions ... which ... may have a material influence on <u>efficiency outcomes</u>” [emphasis added].</p> <p>There is no merit in Code drafting which states the “purpose ... is to promote efficiency outcomes ... [to] promote efficient decisions” or that “efficient ...decisions ... may have a material influence on efficiency outcomes”.</p>
<p>Clause 13.5(A)(3) should be amended to explicitly capture all desirable workably competitive market outcomes, including that “workably competitive markets have a tendency towards ... normal rates of return, and the existence of prices that reflect such normal rates of return”.</p>	<p>We recommend clause 13.5A(b) be amended to read “...offers or reserve offers made by generators or ancillary service agents ... <u>limits extraction of excessive revenue and returns and promote efficient ... consumption decisions ...</u>”.</p>	<p>We agree with Meridian’s concern that “if economic rents are being extracted by generators, these will ultimately be passed on to consumers”<sup>21</sup> and “the effects on end users may properly be taken into account. This is ... consistent with the Authority’s statutory objective to “promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers” (EIA 2010 s 15, emphasis added)”.<sup>22</sup></p> <p>We also agree with Meridian’s retail brand, Powershop, that “it is the Authority’s role to prevent participants making money through manipulative trading”.</p> <p>There is a bias in the proposed rules in that they include specific guidance that market participants should be able to recover their costs, including “recovery of capital costs with a suitable premium for risk”, but no explicit guidance that consumers should be protected against excessive revenue or returns.</p> <p>There is also a risk that the proposed rules would be overly permissive of abuses of market power as the focus is exclusively on efficiency outcomes and other outcomes that are inconsistent with the outcomes that can be expected in workably competitive markets are omitted; in particular, workably competitive market “... outcomes include the earning by firms of</p>

<sup>21</sup> Meridian, Draft Decision regarding alleged UTS on 26 March 2011 – Cross Submission, 10 May 2011.

<sup>22</sup> Meridian, Draft Decision regarding alleged UTS on 26 March 2011 – Cross Submission, 10 May 2011.

Proposed enhancement	Suggested drafting	Explanation
<p>The scope for any ambiguity about the interpretation of significant market power should be removed, by clarifying that “For the avoidance of doubt, significant market power includes transient market power” or otherwise defining what significant market power means in the Code.</p>	<p>The proposed Code provisions should include clarification that “For the avoidance of doubt, significant market power includes transient market power”.</p>	<p>normal rates of return, and the existence of prices that reflect such normal rates of return, after covering the firms’ efficient costs”.<sup>23</sup></p> <p>We agree with the MDAG position that “For the avoidance of doubt, our proposal is not intended to allow the transient exercise of market power”. We recommend making it explicit that “significant market power” includes “transient market power”. MDAG has noted “market power is the ability “to affect the market price even a little and <u>even for a few minutes</u>” ... [emphasis added].</p> <p>The MDAG position is also consistent with Meridian’s view that:</p> <p>“The issue for the Authority is ... whether, in the absence of a transient market power mitigation regime in the Code ... “anything goes” is an acceptable outcome ... in circumstances where there is no energy or capacity shortage and a net pivotal generator takes advantage of its market power situation without any view to the public interest”.<sup>24</sup></p> <p>“It is odd to suggest that generators with transient market power should have unconstrained ability to take advantage of that power, or that the resulting price outcomes are an essential feature of an efficient spot market. Rather than signalling the need for investment ... such outcomes are likely to result in a loss of dynamic efficiency. That is, there is no reason to think that high prices caused by the illegitimate exercise of transient market power are necessary to ensure efficient investment or recover of costs.” [footnote removed]<sup>25</sup></p>

<sup>23</sup> WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [18].

<sup>24</sup> Meridian, Draft Decision regarding alleged UTS on 26 March 2011 – Cross Submission, 10 May 2011.

<sup>25</sup> Meridian, Draft Decision regarding alleged UTS on 26 March 2011 – Cross Submission, 10 May 2011.

Proposed enhancement	Suggested drafting	Explanation
		<p>Similarly, Meridian's retail brand Powershop has submitted: "We also strongly recommend that the Authority ... undertake thorough investigation of possible code changes to curb abuse of transient market power ..." and "The Authority needs to make it clear that during times of transient market power, in particular where there are planned transmission outages, that it is unacceptable to exploit that market power by pricing at a level that is not economically valid. This kind of behaviour is unacceptable because productive and dynamic efficiency will be materially reduced as participants are incentivised to find/ create situations that generation 'super' profits. This behavioural dynamic will make the market extremely risky, volatile and unpredictable. It will cause market prices to increase and there will be inefficient signals affecting the timing and location of generation investment".<sup>26</sup></p>

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<sup>26</sup> Meridian (Powershop), Draft decision of the Electricity Authority under Part 5 of the Electricity Industry Participation Code regarding an alleged Undesirable Trading Situation on 26 March 2011, 13 May 2011.

## Appendix 2: Refined/enhanced version of the MDAG proposal

### 13.5A Conduct in relation to generators' offers and ancillary service agents' reserve offers

(1) Each generator and ancillary service agent must ensure that its conduct in relation to offers and reserve offers is consistent with a high standard of trading conduct.

~~(21)~~ Where a generator submits or revises an offer for a point of connection to the grid, that offer must be consistent with offers that the generator would have made where no generator could exercise significant market power in relation to that point of connection to the grid for that trading period.

~~(32)~~ Where an ancillary service agent submits or revises a reserve offer for a point of connection to the grid (including an interruptible load group GXP), that offer must be consistent with reserve offers that the ancillary service agent would have made where no ancillary service agent could exercise significant market power in relation to that point of connection to the grid for that trading period. For the avoidance of doubt, significant market power includes transient market power.

~~(43)~~ The purpose of this clause 13.5A is to promote offer behaviour and ~~efficiency~~ outcomes consistent with workably competitive markets, in particular so that—

- (a) the prices of offers or reserve offers do not exceed, by too much or for too long, the associated economic costs to the generator or ancillary service agent respectively, assuming a market in which no generator or ancillary service agent has significant market power; and
- (b) ~~with the effect that~~ offers or reserve offers made by generators or ancillary service agents limit extraction of excessive revenue and returns and promote efficient:
  - (i) consumption decisions by consumers; and
  - (ii) production decisions by suppliers (including generators and providers of electricity services); and
  - (iii) innovation and investment by suppliers and consumers (including the location of their investments); and
  - (iv) risk management and risk management markets,

in relation to the point of connection to the grid (including an interruptible load group GXP) at which the generator or ancillary service agent, as applicable, submits or revises an offer or a reserve offer, and any node in respect of which the offer or reserve offer may have a material influence on prices~~efficiency outcomes of the kind referred to in subparagraphs (i) to (iv); and~~

- (c) where, for the purposes of paragraph (a) “economic costs” in clause 13.5A(3)(a):
  - (i) when assessed in relation to short-run costs, includes scarcity rents and the opportunity cost of generating electricity or of providing instantaneous reserve, as applicable;
  - (ii) when assessed in relation to long-run costs, includes recovery of capital costs with a suitable premium for risk.