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Submissions  
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### **High Standard of Trading Conduct provisions: Discussion paper**

Contact recognises that the Market Development Advisory Group (MDAG) has provided a comprehensive review of its proposed alternative option for the High Standard of Trading Conduct (HSOTC).

We support the general principle that generators and ancillary service agents should promote offer behaviours and efficiency outcomes consistent with competitive markets. However, the proposal assumes that the exercise of market power is a problem, whereas we believe that the market is fundamentally competitive and that economically efficient outcomes for the long term benefit of consumers should continue to be delivered by the effective competition which occurs among market participants.

We propose MDAG seek solutions beyond the current proposed approach and we highlight the following overarching issues:

#### **1. Departure from the current wholesale market design**

The proposed Code change would mark a significant departure from the current wholesale electricity market design.

The Authority's statutory objective is "to promote competition in ... and the efficient operation of, the electricity industry for the long term benefit of consumers". This is almost identical to the purpose of the Commerce Act 1986, which is "to promote competition in markets for the long-term benefit of consumers within New Zealand". However, the Commerce Commission does not ordinarily look to regulate pricing unless workable competition is not present (e.g. use of Part 4 of the Commerce Act with the lines companies where, by default, competition does not exist). Rather, its focus is on supporting the competitive process.

The proposed 13.5A(3) Code provisions mandate specific market outcomes which are usually a feature of regulated markets. Regulation in this way can impact the ability of a market to function properly over time. Furthermore, if the Authority is given the power to influence prices, that will create review requests by participants who stand to benefit from those powers being used and invites political pressure on the Authority to assess lower economic costs, with the consequential negative impact on dynamic market efficiency and further investment.

If the purpose statement in 13.5A(3) is to remain then we raise the following additional concerns:

### **1.1 Lack of certainty**

For any change to be beneficial, the Authority must provide participants with an increased level of certainty and clear guidelines on what constitutes acceptable market conduct. We believe that interpretations should not be left to costly case law to develop a body of jurisprudence over time and it is therefore imperative that the Authority release formal non-binding guidelines to accompany the new Code which provide clear standards, definitions and guidelines, including an:

- (1) assessment framework on what constitutes acceptable market conduct; and
- (2) interpretation of the economics and law relevant to the proposed standard to be applied in any compliance and enforcement, specifically:
  - *What will be considered “too much” or “too long”. There is the potential for ambiguity and MDAG notes it is clearly subjective and a matter of judgement.*
- (3) when market power will be viewed as ‘significant’.

### **1.2 “by too much or for too long”**

In order to give effect to the Authority’s statutory objective in 13.5A(3)(a) “or” should be replaced with “and” so that the outcomes to be promoted are long-term. Abuse of significant market power is not demonstrated by a short-term ability to raise prices above, or drop prices below, competitive levels. Conversely, this is a necessary feature of workably competitive markets.

### **1.3 The concept of “efficient SRMC”**

The price offered by competing generators tends towards the competitive market price (as set by the marginal unit). This is not necessarily the “efficient SRMC” of all plant being dispatched.

There are also limitations to the market model which make it impossible to offer at “efficient SRMC”. For example, there are times when plant will have volume offered at \$0 to get a certain amount dispatched so it can run at its minimum load. If only that amount is dispatched (which can happen) then that offer would not achieve “efficient SRMC”.

### **1.4 The assessment of ‘economic costs’**

The interpretation and assessment of ‘economic costs’ is crucial. Participants would need to be confident ex ante as to how the Authority would determine ‘economic costs’ otherwise the uncertainty of not knowing how the parameters of the new proposal will be applied or developed by Courts will delay innovation and investment. However, we are concerned that the amount of (often commercially sensitive) information that goes into the price discovery process would make it impossible for any regulator to calculate ‘economic cost’ accurately.

Furthermore, calculation of the true 'economic cost' is highly subjective and any analysis will result in different conclusions from different interpretations of opportunity costs, selection bias and choosing particular data to produce a desired result.

## **2. Should the proposal apply to all offers at all times?**

The proposed wording for part 13.5(1) empowers the Authority to scrutinize all offers at all points of connection, whether or not competitive pressures were weak.

The breadth of the proposal to capture every offer for all trading periods implies that abuse of market power is a problem in the New Zealand electricity market. It does not seem necessary for a market that is fundamentally competitive. There are very limited occasions when competitive pressure may not exist among market participants as identified by the EA's 2012 review on locally net pivotal generation. This review identified 0.2% of traded energy that may be impacted by locally net pivotal generation. Also, as noted above, the only offer that matters is the price set by the marginal unit.

We also have a concern that offers made in real time, based on the then available information, and whilst participants are also managing operational complexities, may fail to pass a retrospective assessment by the Authority despite a party's legitimate reasons for making an offer at the time the offer was made.

## **3. Inter-relationship with Commerce Act**

The proposed Code obligations in 13.5A(1) appear more stringent than section 36 of the Commerce Act (aimed at prohibiting parties from taking advantage of market power).

The MDAG consultation does not appear to explore how other jurisdictions promote competition in, and the efficient operation of, their electricity markets (for example Chapter 89A of Singapore's Electricity Act, which prohibits 'Abuse of dominant position' and the accompanying Competition and Consumer Commission's guidelines which state that "market power only arises where an undertaking does not face sufficiently strong competitive pressure and has the ability to profitably sustain prices above competitive levels").

## **4. Removal of obligation to offer all available capacity**

The decision to remove the obligation for generators to offer all available volume may have unintended consequences which do not align with the Authority's statutory objective. A party could exercise market power through the unjustified withholding of generation or reserve volumes.

## **5. Increased costs for the Authority and participants**

Contact would like to see further evaluation of why this proposal increases efficiency over the status quo. We consider MDAG's view that the costs of the proposal are expected to be negligible is questionable.

Under the current proposal it is likely the number of alleged breaches will increase significantly, which in turn will drive increasing costs incurred by the Authority and participants for compliance, researching the large volume of information that goes into the price discovery process, pursuing and responding to the alleged breaches. As a result the Authority will need to increase its resourcing of both monitoring and compliance and provide clear guidelines and parameters on how and when allegations can be made to ensure that all requests are legitimate and justified.

We recommend the Authority consider introducing specific measures to ensure cases are legitimate; a two-step process or an Early Resolution Team to quickly respond to and progress/dismiss claim allegations according to their evidence and merits; or any requests of alleged breaches to be made within certain time limits or the amount claimed under each request be curtailed. These types of parameters are common in other industries such as the financial sector and would help ensure the electricity industry's limited resources are used efficiently and effectively.

We are happy to discuss any aspects of our submission. Please do not hesitate to contact me if you have any queries.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Chris Abbott', with a stylized flourish at the end.

Chris Abbott

***GM Regulatory Affairs and Government Relations***