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Submission on Preliminary Decision 2019 Undesirable Trading Situation

Introduction

1. This is Vector Limited's (Vector) submission on the Electricity Authority's (the Authority) *Preliminary Decision 2019 UTS claim*, dated 30 June 2020.
2. Vector considers that certainty and confidence in spot prices and by default the spot market is important for retailers, generators, consumers and investors, both existing and future.
3. It is clear that more can be done by the Authority to improve surveillance/monitoring and consequently confidence in the market. The saying "sunlight is the best disinfectant" applies to the spot market and the Authority should ensure that information is available to allow it, participants and stakeholders to monitor and moderate behaviour.
4. Vector does not have any specific comments on the analysis or initial conclusions of the Authority in relation to the UTS as this modelling is not an area of Vector's expertise. Vector does have broader recommendations in relation to market monitoring and analysis.

General Comments

5. From the advent of the electricity market there have been concerns that participants may be able to exercise a degree of market power. The concept of transitory market power is to an extent an accepted part of the market and has been somewhat moderated through the initial High Standard of Trading Conduct Guidelines (HSOTC) and clarifications around so called "net pivotal" positions.
6. Original market design concerns included the belief that hydro generators would spill water to create higher prices. The industry responded to this with voluntary spill reporting which has inexplicably ceased, although the Authority still provides links to non-existent generator pages¹.
7. UTS decisions since 2011 have generally included references to the Authority improving aspects of the market to prevent recurrences. The 8 May 2017 letter to Meridian notes the difference of opinion between the Authority and Meridian with respect to the HSOTC and that the guidelines would benefit from further clarifications. It is unfortunate that this work is still not completed and once again the Authority and Meridian will hold different perspectives on whether Meridian or others are compliant.
8. The Authority is current consulting on Thermal Fuel Information Disclosure. The consultation paper notes correctly that "Information is critical to efficient and well-functioning markets".

¹ <https://ea.govt.nz/about-us/what-we-do/our-history/archive/operations-archive/security-of-supply/short-term-monitoring/hydro-spill-archive/>

However, the information disclosure consultation could be viewed as responding to last year's problem (gas disclosure), and that next year's problem will be broad hydro disclosure.

9. There is potential for the Authority to be judged as having dropped the ball in one of its core roles of ensuring the spot market is efficient and well-functioning². Many non-gentailer participants are of the view that the Authority has an unwavering belief that the spot market is best practice and well-functioning, despite evidence that this is not always true.
10. The multi-year effort on a massive redistributive transmission pricing exercise, the amount of time to review the HSOTC guidelines and the fact that the Authority does not have ready access to detailed and timely inflow and storage data plays to this perception. In fact, the Authority's own data shows that in 2019, confidence among consumers in the competitiveness of electricity markets³ is only marginally ahead of 2011 (and unlikely to be statistically significant, although this is not reported).
11. During the recent COVID lockdown period the Authority needed to request data from participants to help it understand the extent and magnitude of problems relating to consumer debt, despite energy hardship being an enduring concern that would surely be informed by this type of data.
12. The above examples indicate that the Authority needs to spend more time and effort on market monitoring and analysis if it is to improve the perceptions of all market participants of the efficiency of the market and the Authority's expertise as the regulator and ultimate arbiter of behaviour in the wholesale market.

Recommendations

13. Just as the Authority is consulting on thermal fuel disclosure, it should quickly move to ensure that the market can easily access and assess hydro operator spill, inflow and production data. While it is possible for participants to piece some of the data together from public sources, this should not need to be the case for the fuel supply for ~70% of New Zealand's annual production. The Authority should contract for hydro data on the basis that it is has significant public good attributes and publish it on the EMI website. The Authority should also implement spill reporting from the five main hydro generators. This should be a low cost/low burden activity as four of them previously did it voluntarily.
14. The Authority should continue to develop tools or reports accessible on the EMI website that provide insights into competitive behaviour of the generators.
15. The Authority should develop (confidential) analysis that allows it to quickly identify potential problems and seek additional information from participants. Regulators of financial markets are increasingly using machine learning and data analytics to identify potential suspicious or illegal behaviour⁴. The sunlight from strong monitoring will assist in building confidence in the market.
16. The HSOTC guidelines are important for indicating appropriate behaviour and should be supplemented by ongoing guidance from the Authority; the scope for disagreement over what is acceptable conduct should ultimately be limited.

² As the spot market is at the core of the overall electricity market, driving hedging, pricing, investment etc it is crucial that it is viewed by all external parties as extremely well-functioning.

³ Statement of Intent 2020 page 26.

⁴ For example the SEC uses data analytics and uses a "broken windows" approach to prosecute the smallest of illegal activities – see for example <https://www.reuters.com/article/bc-finreg-data-analytics/secs-advanced-data-analytics-helps-detect-even-the-smallest-illicit-market-activity-idUSKBN19L28C>

17. While not related to the UTS paper, the Authority should expand the Stress Testing regime to include counterparty credit concentration in response to the lobbying for debt relief (above some threshold of size) and consider the ongoing collection and publishing of active debt (to be published in an anonymised form). The Authority should consider whether there should be some (limited) financial assessment of participants prior to them becoming active market participants.

Concluding comments

18. The UTS claim and subsequent analysis by the Authority have highlighted the need for more and active monitoring as well as gaps in available information. This is consistent with the Authority's need during the recent COVID period to request additional information and that it took time for the Authority to receive, understand and analyse information relating to the UTS claim.
19. A competitive market is not a regulation or oversight free market and it is incumbent on the Authority to constantly assess whether the information it and the market has access to, and its monitoring is sufficient to ensure confidence in and a well-functioning market.

Please free to contact me at neil.williams@vector.co.nz or 09 978 7633.

Yours sincerely

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