

4 September 2020

James Stevenson-Wallace
Chief Executive
Electricity Authority
Wellington

By e-mail: UTS@ea.govt.nz, compliance@ea.govt.nz

Dear James,

Cross-submission in relation to the 30 June 2020 UTS preliminary decision

Ecotricity, Electric Kiwi, Flick Electric, Haast Energy Trading (Haast), Oji Fibre Solutions and Vocus (the independents) welcome the opportunity to cross-submit in response to the Electricity Authority's Preliminary UTS Decision (preliminary decision) of 30 June 2020. We have limited our cross-submission to matters relevant to whether there was a UTS and the scope and scale of the UTS.¹

The Authority's preliminary decision is based on fundamentally sound modelling

The Authority is correct that there was a UTS.

There is nothing in any of the submissions which should cause the Authority to reconsider whether there was a UTS.

We agree with Meridian (circa 2011) that "Participants will lose confidence in the integrity of the market if prices are divorced from efficient supply-demand conditions and excessively higher than underlying costs." [emphasis added]. The Authority's modelling is appropriately based on this analytical framework.

The only modelling changes that should be made in response to submissions is correction of the errors Haast identified as part of the independents' submission. We do not see any basis for Meridian's claim "One error the Authority makes is to overstate the amount of spill that could have been avoided". As detailed in our submission, the Authority was conservative in its estimate of spill and understated the amount of unnecessary spill.

The Haast modelling confirms the Authority modelling is fundamentally sound, but that the UTS went on for longer (10 November to 16 January) and involved Contact (from 11 November to 28 December).

¹ For example, Meridian's commentary on Haast and Electric Kiwi's ownership structure ("both companies being directly or indirectly majority-owned by offshore investors based in the United Kingdom") has no relevance to the question of whether there was a UTS.

Meridian's submission helps demonstrate there was a UTS

The evidence we provided that the preliminary decision understated the duration of the UTS is reinforced by Meridian's commentary about December versus 3 to 18 December. Meridian's submission detailed that the unnecessary spill went on for a longer period than just 3 to 18 December.

The evidence we provided that, viewed in isolation, Contact's South Island stations caused adverse outcomes significant enough to constitute a UTS is reinforced and supported by Meridian's commentary that Contact was also offering in such a way as to ensure the HVDC was not constrained, and "the line between Contact's and Meridian's offers is not obvious".

Meridian criticised the Authority for what it sees as an "Arbitrary distinction between the HVDC and other transmission constraints". Meridian claims that: "According to the preliminary decision "the Authority does not think offers should be used to manage transmission constraints ... However, this analysis seems to only apply to HVDC transmission constraints ..."

Our submission remedies Meridian's criticisms by identifying evidence Contact and Meridian suppressed intra-Island nodal price separation as well as inter-Island nodal price separation. Adoption of our intra-Island nodal price separation modelling in the final decision would address Meridian's criticism.

Meridian claims "the wording in the preliminary report "offering in such a way as to ensure the HVDC was not constrained" overstates the degree to which Meridian is able to influence the HVDC". We consider Meridian's claim to be misleading and incorrect. The Authority does not need to "pretend ... that offering to avoid price separation across the HVDC would constitute a UTS". Both the Authority and Haast modelling provide clear and reasonable evidence Meridian's trading conduct resulted in substantial suppression of nodal price differences across the HVDC and between intra-Island nodes. It is implausible for Meridian to suggest it cannot influence wholesale electricity prices, given its market power and size relative to the rest of the market.

Meridian also criticised the Authority for "Lack of clarity on what constitutes a UTS". The final UTS decision could address Meridian's criticism by explicitly addressing the question of fault, including the extent to which market power was used and there was "manipulative or attempted manipulative trading activity".² This is consistent with our submission.

The Meridian submission – commenting on what they see as an arbitrary distinction between Contact (not in breach) and Meridian (breached the UTS requirements) – reinforces our concern about the risk of creating a de facto unnecessary spill/monopoly pricing 'safe harbour'. Meridian noted "Offer prices somewhere around Contact's offers do not constitute a UTS, while offer prices for Meridian's Waitaki generation do constitute a UTS according to the preliminary decision"; "The dividing line between offer prices when spilling that do and do not give rise to a UTS must presumably rest somewhere between the offer prices for Contact's Clutha generation and offer prices for Meridian's Waitaki generation"; and "Some figure between Contact's offers and Meridian's offers potentially represents an unknown tipping point".

² This would also address the issues MDAG raised about the limited explanation in the Authority's 2 June 2016 High Standard of Trading Conduct (HSOTC) decision.

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Summary of our views on the UTS submissions

- We agree with Genesis that “**the analytical framework the Authority has applied is sound** for the purposes of evaluating whether the circumstances in question constituted a UTS”. Our submission focused on how the Authority’s analysis could be further bolstered and enhanced.
- **The Authority’s modelling can be relied on:** Subject to taking into account the modelling issues raised by Haast, no issues of substance have been raised about the Authority’s modelling. The Haast modelling contained in the independents’ submission confirms the Authority’s modelling is fundamentally sound.
- **The Authority is correct that there was a UTS:** There is nothing in the submissions which should cause the Authority to resile from its preliminary decision that there was a UTS. Quite the opposite.
- We agree with NZ Steel that “... the spilling of water for no apparent valid technical reason has further undermined the creditability [sic] of the spot market”.
- We agree with Mercury that “**situations where participants are in a position of market power and may exploit offers to earn excessive profits ... fundamentally undermine the confidence and integrity of the wholesale electricity market**”.³
- **Contact and Meridian were both responsible for causing a UTS:** The Meridian submission contains evidence and reasoning supporting our submission that both Contact and Meridian were responsible for causing a UTS, for example:

“the line between Contact’s and Meridian’s offers is not obvious”

“It is clear from the preliminary decision that Contact was also [offering in such a way as to ensure the HVDC was not constrained] “... generators structured their offers to prevent the constraints binding and the consequent price separation. Contact has told us this is the case, and Meridian’s weekly Perform Reports contain direction to prevent transmission constraints.” Nevertheless, only Meridian is criticised for this in the preliminary decision.”

“Not only have Meridian and other market participants acted in the same way previously (on multiple occasions), but so too was Contact over this same period.”

- **We agree with Meridian that it would be desirable to provide greater clarity about the offending conduct:** Meridian claimed “The Authority’s preliminary decision is so vague and unclear as to what amounts to a UTS that market participants are left to guess as to whether their pricing approaches will amount to a UTS or not. The preliminary decision fails to isolate the specific actions, either alone or in combination, that amount to a UTS”.

We reiterate that the Authority’s investigation would be supported and strengthened by explicit consideration of the extent to which market power was used, the spilling of water to minimise price separation constituted “manipulative or attempted manipulative trading activity” and/or whether unnecessary spill of water simply to raise spot prices by too much or for too long could breach the UTS provisions. This would address Meridian’s concern about “Lack of clarity on what constitutes a UTS” in full.

³ Genesis, Mercury, MEUG, Nova and NZ Steel all provided evidence and examples which supported of the preliminary decision. These are listed in more detail in the Appendix to this submission.

- **Care is needed with consideration of the extent to which consumers and retailers were hedged against wholesale electricity prices:** We agree with Meridian (circa 2011) that “... It is no answer to say that the risk of high spot prices can be managed in the hedge market” and “It is misleading to suggest that there will be no cost implications to retail customers” [emphasis added].⁴ To use Meridian’s burglar analogy,⁵ whether or not the household was insured isn’t a relevant consideration when assessing the scale of the burglar’s offending or in sentencing.

Consistent with Meridian’s circa 2011 comments, we agree with Nova that “By its actions in December, in the absence of a response by the Authority, Meridian in effect increased expected long term average spot prices across the market, and in the SI in particular. This will have a direct impact on SI consumers through a pass through of higher prices by retailers over the long term, irrespective of whether retailers were hedged in the SI at the time or not”.

- **There are extenuating factors which exacerbate the UTS:** It is no defence for Meridian to suggest that because it considers it has behaved in the same or a similar way in the past the behaviour should be treated as permissible. Meridian attempts to import words into the UTS Code provisions by claiming its behaviour was “normal” and “Normal market operation is a UTS safe harbour that has been disregarded by the Authority”.
- **The Undesirable Trading Situation needs to be rectified:** We agree with MEUG that “The scale of the EA’s estimate of over-charging for the 16 days of the preliminary UTS period at approximately \$80 million must make the EA’s consideration of any action to take as both critical and prompt in order to avoid a repeat of this event”.
- **The Authority’s final UTS decision will provide important precedent:** We agree with Genesis’ expectation that “... the outcome of this UTS process in the first instance provides some safeguard against the exercise of unfettered market power by pivotal generators”.

We also agree with Nova that “If Meridian’s offers under those circumstances are regarded as acceptable, then by extension it could withhold generation capacity and hold SI prices well above competing offers at any time, irrespective of the prevailing hydro inflows and storage”.

Only Haast identified modelling issues the Authority should address

None of the other submissions contained technical reports or modelling that raise questions about the Authority’s modelling.

Meridian makes a number of claims that the Authority’s modelling contains flaws or mistakes but these are, in our view, unsubstantiated e.g. “There are significant errors in the modelling undertaken by the Authority. These errors affect the materiality of avoidable spill as well as the Authority’s modelling of prices and therefore have an impact on the assessment of whether any UTS occurred”. The High Court position in the Wellington Airport decision (which Meridian’s submissions refer to) was clear that “Where a proposition is simply asserted ... we give it little or no weight”.⁶

Meridian claims the Authority’s “reliance upon QWOP rather than actual offers has led to the wrong conclusion” without really explaining why or how. We can confirm the Haast modelling did not use QWOP so does not suffer from Meridian’s objection.

⁴ Meridian, Draft Decision regarding alleged UTS on 26 March 2011 – Cross Submission, 19 May 2011.

⁵ Meridian, Draft Decision regarding alleged UTS on 26 March 2011 – Cross Submission, 19 May 2011

⁶ WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC, [11 December 2013], paragraph [1745].

Meridian claims “the modelling undertaken for the preliminary decision fails to take into account planned generation outages”. We can confirm the Haast modelling took planned and unplanned outages into account.

Meridian also claims “Transmission constraints affected generation at both Manapōuri and throughout the Waitaki chain during the period of the allegations”. This is incorrect. The Authority and Haast modelling both fully take into account real-time transmission constraints.

There were adverse market outcomes for all of December

The distinction Meridian makes between 3 – 18 December and the entire December period simply reinforces our modelling findings that the UTS went on for longer than 3 – 18 December. The entire December month captures 55% of the excess spot prices we identified in our modelling, compared to 43% if only 3 – 18 December is considered. This is shown in a reworking of Tables 1 and 3 from our submission to include the entire December month.

Table 1*: only Meridian unnecessarily spills water/prices above SRMC⁷

	Entire period: 10 Nov-16 Jan	1-31 Dec	Draft UTS: 3-18 Dec
Excess spot prices	\$87,397,204	\$50,455,931	\$45,971,014
Excess CO2 released	10,546 tonnes	6,529 tonnes	4,421 tonnes
Reduction in storable NI water	23,613 MWh	15,172 MWh	8,507 MWh

Table 1* normalised on a daily rate basis: only Meridian unnecessarily spills water/prices above SRMC

	Entire period: 10 Nov-16 Jan	1-31 Dec	Draft UTS: 3-18 Dec
Excess spot prices	\$1,304,436	\$1,627,611	\$3,064,734
Excess CO2 released	157 tonnes	211 tonnes	294 tonnes
Reduction in storable NI water	352 MWh	489 MWh	567 MWh

Table 3* normalised on a daily rate basis: Aggregate impact of unnecessary water spill/prices above SRMC by all South Island generators⁸

	Entire period: 10 Nov-16 Jan	1-31 Dec	Draft UTS: 3-18 Dec
Excess spot prices	\$176,860,416	\$97,960,282	\$77,149,648
Excess CO2 released	17,485 tonnes	11,569 tonnes	6,293 tonnes
Reduction in storable NI water	42,530 MWh	28,708 MWh	16,624 MWh

⁷ Adaption of Table 1 from our submission.

⁸ Adaption of Table 3 from our submission.

Table 3*: Aggregate impact of unnecessary water spill/prices above SRMC by all South Island generators⁹

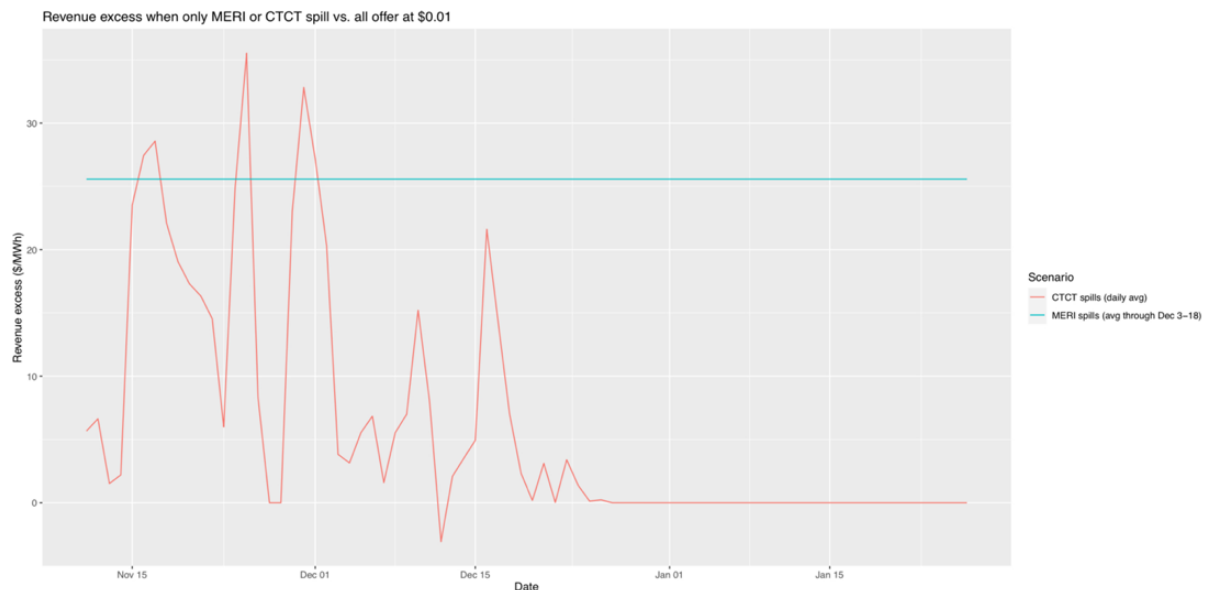
	Entire period: 10 Nov-16 Jan	1-31 Dec	Draft UTS: 3-18 Dec
Excess spot prices	\$2,639,708	\$3,160,009	\$5,143,310
Excess CO2 released	261 tonnes	373 tonnes	420 tonnes
Reduction in storable NI water	635 MWh	926 MWh	1,108 MWh

Adopting granular and trading period analysis could be helpful

There may be some merit in Meridian’s view that the Authority should adopt more granular analysis, including at the trading period level, to help inform the extent to which offer behaviour constituted a UTS.

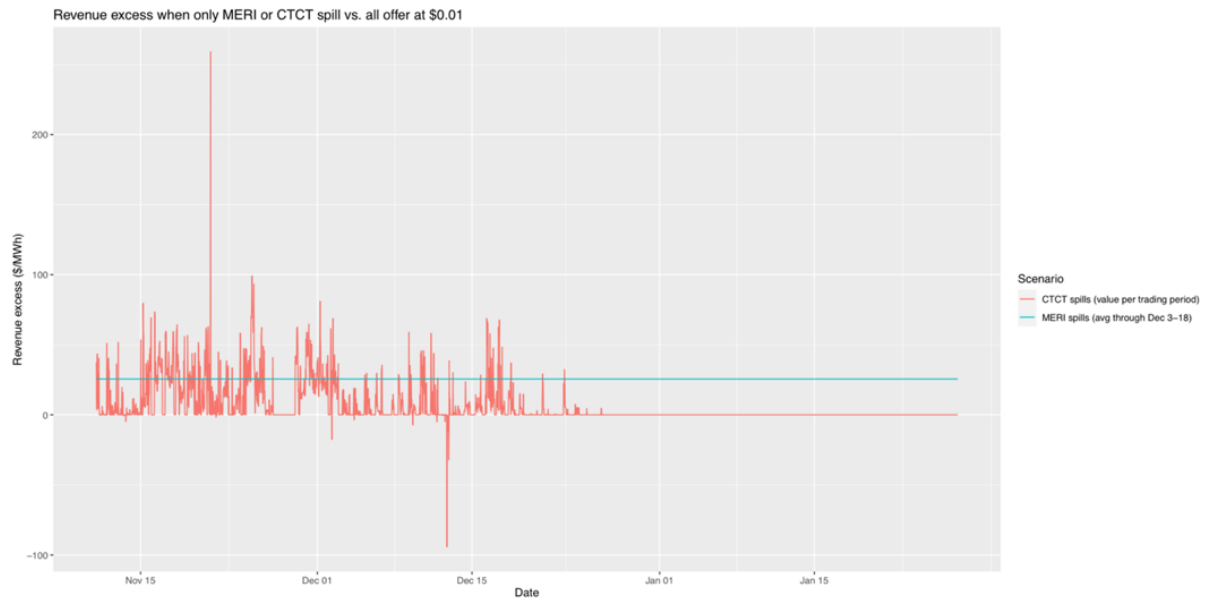
By way of illustration, we have done this for Contact. We looked at the impact Contact’s unnecessary spill had on spot prices on a daily and half-hourly basis and compared this with the ‘UTS threshold’ of 3 – 18 December (see Figures 1 and 2 below). This analysis shows there were a substantial number of days and half-hour periods where Contact’s impact on spot prices exceeded that of Meridian over the 3 – 18 December ‘UTS period’ (when the red line is above the blue line). This evidence reinforces our view Contact was responsible for causing a UTS, in its own right, between 11 November and 28 December.

Figure 1: Comparison of Contact’s impact on daily spot prices versus the preliminary ‘UTS threshold’



⁹ Adaption of Table 3 from our submission.

Figure 2: Comparison of Contact’s impact on half-hourly spot prices versus the preliminary ‘UTS threshold’



Contact’s argument they withheld supply to manage spill gates needs to be scrutinised

We compared the dispatch of the stations on the Clutha scheme to those modelled when all spilling reservoirs were offered at \$0.01 from 10 November 2019 to 16 January 2020. We found the mean absolute change in dispatch of Clutha stations was lower when the hydro reservoirs were offered at \$0.01 when spilling. The mean absolute change in dispatch by trading period fell from an actual of 19.7 MW to 17.9 MW when the generation was offered in a way that reflected SRMC. Our modelling shows Contact's offer strategy led to larger changes in dispatch than if their offers had reflected costs.

If Contact wanted to reduce the frequency of adjustments at spill gates, they could have used the must-run dispatch auction to ensure a high and constant dispatch. Or they could have specified low or zero ramp rates at their plant and periodically increased the ramp rate to allow changes in dispatch at an acceptable frequency. These actions would be entirely consistent with the Code, if they reflect genuine constraints on the safe operating capability of their plant. Contact chose to use neither of these tools but instead withdrew offers from the market and spilled at unnecessarily high levels which led to suppression of price spreads and increases in prices to Contact’s benefit. It is difficult to accept this as a coincidence.

If the Authority is minded to accept elements of Contact’s argument regarding spill gates it must scrutinise the appropriate timeframe the issue existed. Our modelling shows Contact was causing a UTS through most of November and December. The flood conditions where spill gate challenges arose may have existed for only several days around the peak flows in early December. In this context they may cover only a small portion of the UTS period.

Meridian’s circa 2011 views on what constitutes a UTS support the preliminary decision

The difference between Meridian’s views when it was commenting on Genesis’ 26 March 2011 UTS and when it commented on its own UTS could not be more stark. We reiterate from our submission that “While Meridian’s current position may differ from its circa 2011 public position, the respective views should be evaluated on their merits. The 2011 Meridian quotations in this submission are orthodox and fundamentally sound”. The Meridian circa 2011 submissions were signed off by Neil Barclay who is now Meridian’s CEO.

While a substantial element of Meridian’s submission contradicts its previous 26 March 2011 UTS submissions, there is nothing in the current submission that validly refutes their circa 2011 views that, for example:

- “Participants will lose confidence in the integrity of the market if prices are divorced from efficient supply-demand conditions and excessively higher than underlying costs”;¹⁰
- “it is no answer to say that the risk of high spot prices can be managed in the hedge market”;¹¹ and
- the relevant test for whether transient market power is abused is whether offers are in excess of SMRC (not LRMC): “in the absence of any shortage of energy or capacity, there is no basis for using estimates of the LRMC of new entry generation and the cost of demand-side response, rather than “right” price would be SRMC or something closer to it”.¹²

Proposition	Meridian circa 2011	Meridian 2020
<i>Is Meridian correct in its claim that “the difference in total settlement value has ... deliberately misrepresented by some of Meridian’s competitors and misreported by the media as a measure of Meridian profit or</i>	<p>“... <u>It is no answer to say that the risk of high spot prices can be managed in the hedge market.</u> When high prices result from market power, hedge prices will also reflect market power – the same rents are extracted, but in a different way. ...</p> <p><u>“It is misleading to suggest that there will be no cost implications to retail customers under an “anything</u></p>	<p>“Consumers were not affected by the conduct: Contrary to media reporting and claims from some of Meridian’s competitors, most consumers were not impacted by these events. Consumers do not generally purchase from the wholesale market. The vast majority of consumers are on fixed price contracts with retailers, and those retailers in turn manage the fluctuations in the wholesale market.”</p>

¹⁰ Meridian, Draft Decision regarding alleged UTS on 26 March 2011 – Cross Submission, 19 May 2011.

¹¹ Meridian, Draft Decision regarding alleged UTS on 26 March 2011 – Cross Submission, 19 May 2011.

¹² Meridian, Draft Decision regarding alleged UTS on 26 March 2011, 13 May 2011.

Proposition	Meridian circa 2011	Meridian 2020
<p><i>cost to consumers under the hypothetical scenario”?</i></p>	<p>goes” regime. If economic rents are being extracted by generators, these will ultimately be passed on to consumers.” [emphasis added]¹³</p>	
<p><i>Is it appropriate for the Authority to apply the test that “if spot market outcomes vary widely from the underlying supply and demand conditions, then confidence or integrity may have been undermined and a UTS might have developed”?</i>¹⁴</p>	<p>“Participants will lose confidence in the integrity of the market if prices are divorced from efficient supply-demand conditions and excessively higher than underlying costs. This could result in both inefficient investment signals and inefficient consumption by individual consumers, as well as reducing the potential level of demand-side management through deterring demand-side participation in the wholesale market.” [emphasis added]¹⁵</p>	<p>“the Authority is seeking to use the UTS provisions in the Code to impose optimised market reforms that would hold generators to a perfect competition standard in which each generator’s offers must be based on short run costs at any given point in time.”</p>
<p><i>Is SRMC an appropriate benchmark or framework to evaluate offer prices and market outcomes and whether there has been a UTS?</i></p>	<p>“in the absence of any shortage of energy or capacity, there is no basis for using estimates of the LPMC of new entry generation and the cost of demand-side response, rather the “right” price would be SRMC or something closer to it”¹⁶</p>	<p>“Spilling and making non-zero price offers is consistent with the normal operation of the wholesale market: The offer behaviour of Meridian (as described in Part B) is completely consistent with behaviour in the workably competitive electricity market. Throughout the last decade there have been many times in which a hydro generator has been spilling but offering at non-zero prices. This is not an idealised perfectly competitive market where the only rational response is to offer at the level of short run generation costs.”</p>
<p><i>Is workable competition an appropriate benchmark or framework to use to determine whether there has been a UTS?</i></p>	<p>“In Meridian’s view, an appropriate response ... is to recognise that, where a UTS has been declared by reason of a generator taking advantage of a net pivotal position in circumstances where there is no</p>	<p>“It is well established by New Zealand case law that the workably competitive market construct does not enable predictions to be made as to short run market</p>

¹³ Meridian, Draft Decision regarding alleged UTS on 26 March 2011 – Cross Submission, 19 May 2011.

¹⁴ Electricity Authority, The Authority’s preliminary decision on claim of an undesirable trading situation, 30 June 2020.

¹⁵ Meridian, Draft Decision regarding alleged UTS on 26 March 2011 – Cross Submission, 19 May 2011.

¹⁶ Meridian, Draft Decision regarding alleged UTS on 26 March 2011, 13 May 2011.

Proposition	Meridian circa 2011	Meridian 2020
	energy or capacity shortage, prices should be “normalised” by being returned to workably competitive levels. ¹⁷	outcomes, rather it is a theory about the tendencies of such markets over time.”
<i>Should generators be able to use market power to set spot prices?</i>	“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 ...” ¹⁸	“... generation is highly concentrated regionally ... short-term demand responses are very inelastic at low-to-moderately-high spot prices ... When these features of the spot market are taken into account, it is very predictable that there are times when offer prices will not fall to the low levels that might be “expected” despite spill occurring ...”
<i>Should the UTS provisions be interpreted as permitting or sanctioning prices that are “too much or for too long ... above costs”?</i> ¹⁹	“the ability to set an arbitrary high price cannot be said to be an equilibrium of supply and demand in any meaningful sense” ²⁰ “The reality is that Genesis sought to extract a considerable economic rent by taking advantage of transient market power ... In Meridian’s view, allowing a party to offer in at such prices in the absence of any shortage of capacity or energy is detrimental to the wholesale market – New Zealand can ill afford such deadweight losses.” ²¹	“Spilling and making non-zero price offers is consistent with the normal operation of the wholesale market.” “Commonplace strategies ... include ... non-clearing tranches at high prices during periods of spill ...”
<i>Does the preliminary decision create uncertainty about acceptable market conduct?</i>	“... the UTS rules can be thought of as efficiently filling unavoidable gaps in the Code. That is, by addressing behaviour not codified precisely, a UTS reduces the need for such codes, and enables independent participant decision-making that	“Market participants are unable to identify what offer prices would have avoided such a finding. Some figure between Contact’s offers and Meridian’s offers potentially represents an unknown tipping point. This uncertainty makes market participants liable to

¹⁷ Meridian, Proposed actions regarding 26 March 2011 UTS, 21 June 2011.

¹⁸ Meridian, Draft Decision regarding alleged UTS on 26 March 2011 – Cross Submission, 19 May 2011.

¹⁹ WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [15].

²⁰ Meridian, Draft Decision regarding alleged UTS on 26 March 2011 – Cross Submission, 19 May 2011.

²¹ Meridian, Draft Decision regarding alleged UTS on 26 March 2011 – Cross Submission, 19 May 2011.

Proposition	Meridian circa 2011	Meridian 2020
	<p>promotes a workably competitive market in electricity.”²²</p> <p>“ ... Meridian accepts that the dividing line between acceptable and unacceptable offers when a party is in a position of transient market power will not always be easy to draw ...”²³</p>	<p>repeat the behaviour the preliminary decision considers amounts to a UTS.”</p>

²² Meridian, Draft Decision regarding alleged UTS on 26 March 2011, 13 May 2011.

²³ Meridian, Draft Decision regarding alleged UTS on 26 March 2011 – Cross Submission, 19 May 2011.

Meridian's position that it has a right to take advantage of its market power is untenable

When commenting on the 26 March 2011 Genesis UTS, Meridian stated "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 ...".²⁴

Contrary to its circa 2011 UTS submissions, Meridian is now effectively advocating for operation of the UTS provisions in a way that "anything goes" and Meridian has unconstrained ability to take advantage of its market power.

We consider that each of the following Meridian submission statements basically argue Meridian should be able to profit maximise by taking advantage of its market power. These positions of Meridian reflect Undesirable Trading Situations if they result in prices that are above costs by "too much or for too long":²⁵

- "Meridian considers its offer strategy to be economically rational behaviour ... there are no requirements to offer based on costs ... Meridian and other generators have implemented these tactics for many years."
- "Spilling and making non-zero price offers is consistent with the normal operation of the wholesale market".
- "generation is highly concentrated regionally ... short-term demand responses are very inelastic at low-to-moderately-high spot prices ... When these features of the spot market are taken into account, it is very predictable that there are times when offer prices will not fall to the low levels that might be "expected" despite spill occurring".
- "...hydro generators do not offer their generation based on a bottom up assessment of their costs, they ... are economically rational in seeking to generate high volumes at prices the market will support ... Commonplace strategies in this regard include ... non-clearing tranches at high prices during periods of spill ... and ... offering some volumes at a price just below that of the next available source of generation from a competitor (this is economically rational behaviour and is to be expected in the New Zealand electricity market ..." [emphasis added].

We agree with Nova that "The SI hydro generators are of course expected to offer their generation in a way that maximises their revenues from the available water, but it has been widely understood that no generator should use its market power in a net pivotable situation to hold prices above what might be considered likely in a competitive market" [emphasis added].

In a similar vein, we agree with Genesis that "Meridian's dominant position on the South Island provides the incentive to raise prices over the long term. It is economically rational to act on this incentive. ... While we note that Meridian's behaviour is rational ... it does not represent the sort of market conduct that is acceptable to consumers or other participants" [emphasis added].

²⁴ Meridian, Draft Decision regarding alleged UTS on 26 March 2011 – Cross Submission, 19 May 2011.

²⁵ WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [15].

Meridian’s conduct is wholly inconsistent with workably competitive market outcomes

Meridian’s claims “The offer behaviour of Meridian ... is completely consistent with behaviour in the workably competitive electricity market”, but their position is entirely at odds with the workably competitive market outcomes identified in the Wellington Airport decision. The Wellington decision included both short-term and long-term workable competition outcomes:

- “... outcomes ... are reasonably close to those found in strongly competitive markets. Such outcomes are summarised in economic terminology by the term “economic efficiency” with its familiar components: technical efficiency, allocative efficiency and dynamic efficiency. Closely associated with the idea of efficiency is the condition that prices reflect efficient costs (including the cost of capital, and thus a reasonable level of profit)”;²⁶
- “prices are not too much or for too long ... above costs”;²⁷
- “... 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”;²⁸
- “... the prices ... will provide incentives for efficient investment and for innovation”;²⁹ and
- No market participant exercises or uses “significant market power”³⁰ or “excessive market power”.³¹

The Commission adopted an orthodox and reasonable analytical framework for determining whether there was a UTS

Meridian is either mistaken or has misrepresented the Authority’s approach to determining whether there was a UTS claiming “The Authority has watered down that test by transforming it into a test that looks to whether the market is meeting the Authority’s hypothetical and subjective expectations of a workably (or close to perfectly) competitive market”.³²

Similarly, Meridian is either mistaken or has misrepresented the Authority’s preliminary decision in making the claim “... the Authority is seeking to use the UTS provisions in the Code to impose optimised market reforms that would hold generators to a perfect competition standard in which each generator’s offers must be based on short run costs at any given point in time”.

This is not a reasonable interpretation of the Authority’s preliminary decision. The Authority has not adopted a perfectly competitive market test to determine whether there was a UTS.

It is entirely appropriate for the Authority to make judgements about how far removed market outcomes need to be from what would be expected in a competitive market to trigger a a UTS. This is seen, for example, with the Authority preferring \$6.35/MWh over the substantially and materially

²⁶ WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [14].

²⁷ WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [15].

²⁸ WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [18].

²⁹ WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [20].

³⁰ WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [15].

³¹ WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [17].

³² Similarly, the entire Brattle Report appears to be a response to a position that the Authority has not stated that offers should be set at SRMC. We have accordingly not responded to the Brattle Report as it is not relevant to whether there was a UTS.

lower SRMC (perfect competition) benchmark of \$0.01/MWh,³³ and in its judgement that while Contact unnecessarily spilled water, based on its modelling at the time, this was not sufficient to trigger a UTS. It is also reflected in the preliminary decision that the UTS was narrower than its observation that “Outcomes in the spot market did not match our expectations” for a much longer period than 3 – 18 December, and this included actions of each of Contact, Genesis and Meridian.

The Authority’s approach reflects there can be a grey area in terms of where workable competition sits between perfect and imperfect competition, whereas there is a clear ‘bright line’ test for perfect competition. EPOC in their submission, for example, noted “a standard of “workable” competition ... unfortunately is difficult to measure or assess and is open to interpretation” and this is why “Perfect competition, although arguably unattainable in practice, is a computable benchmark against which market participant behaviour can be assessed”. Adopting competitive market benchmarks provide an orthodox framework for reviewing market behaviour and outcomes.

The Authority has adopted an orthodox and sound set of parameters to conclude market outcomes deviated by too much or for too long compared to what should reasonably be expected from a market that relies on the competitive dynamics of supply and demand to clear and set prices. The tests the Authority has applied accord with the tests Meridian’s CEO has advocated including that “Participants will lose confidence in the integrity of the market if prices are divorced from efficient supply-demand conditions and excessively higher than underlying costs” [emphasis added].³⁴

Meridian is effectively trying to rewrite the UTS Code provisions

Meridian has relied heavily on other ‘Aunt Sally’ arguments that misinterpret or misrepresent the Authority’s preliminary decision including the claim that the Authority “radically transformed the UTS test into a question of whether the spot market met the Authority’s expectations”.

While Meridian claims that “through this preliminary decision the Authority appears to have effectively rewritten the established definition of what a UTS is”, in our view it is Meridian who is effectively seeking to effectively rewrite what a UTS is not the Authority.

Meridian appears to be attempting to import an additional safe harbour that does not exist in the Code: “Normal market operation is a UTS safe harbour”. The way Meridian is choosing to define “normal” is novel and includes that if the practice is similar to past behaviour that was not investigated and/or found to be a UTS then it cannot be found to be part of a UTS in the future.

Meridian similarly also conflates 2 June 2016 by concluding because it involved using offer prices to management locational price risk, then it somehow follows a UTS decision cannot include management of locational price risk. It should be clear the preliminary decision was based on a number of factors which accumulatively were enough to satisfy the threshold for a UTS:

- unnecessary water spill;
- higher spot prices when spot prices should have been low;
- suppression of nodal price separation (transmission constraints did not bind);

³³ Regardless, our assessment of the 0.01 and \$6.35 offer price benchmarks indicates that the difference between perfect and workably competitive market outcomes may not materially impact the Authority’s UTS decision in this instance.

³⁴ Meridian, Draft Decision regarding alleged UTS on 26 March 2011 – Cross Submission, 19 May 2011.

- impact on CO2 emissions (unquantified);
- impact on 2020 North Island spot prices and security of supply (unquantified); and
- “Overall the outcomes in the spot market did not match our expectations of a power system with abundant cheap fuel” (emphasis added) and “Cumulatively, these factors describe spot market outcomes that are far removed from our expectations”.

There is express overlap between the HSOTC and UTS Code provisions, reflected in the fact behaviour can be in breach of both sets of provisions. It is reasonable and predictable evidence of conduct (use of offer prices to manage locational price risk) the Authority has previously determined to be in breach of the HSOTC rules could form part of its finding of whether the threshold for a UTS has been met.

It is Meridian, and not the Authority, that has “misinterpreted and misapplied the UTS test”.

Meridian’s description of the UTS Code provisions in their current submission imports language that is not found in the UTS Code provisions, for example:

- the UTS Code provisions are a “test [that] has always required aberrant behaviour or a dysfunctional market”;
- “qualitative threshold [is] required by the Code’s terms”; and
- “the concept of a UTS [is] an unusual market situation that can be immediately recognised and requires immediate rectification”.

Sapere’s criticism of the independent peer review is unsound

We do not consider Sapere’s claim that “As prices may never exactly reflect efficient costs, all markets may constantly be in a UTS, or never in a UTS, under Mr Small’s substitute test” is accurate or a valid representation of the independent peer review.

Sapere appears to have selectively cited the Wellington Airport decision statement that “Prices in workably competitive markets may never exactly reflect efficient costs” to support its claims.³⁵ This sentence in the Wellington Airport decision is immediately followed and clarified by the subsequent sentence that “But the tendencies in workably competitive markets are towards such returns and prices”.

Sapere also omitted other important riders to this sentence in the adjacent paragraphs from the Wellington Airport decision which included that “... outcomes ... are reasonably close to those found in strongly competitive markets. Such outcomes are summarised in economic terminology by the term “economic efficiency” ... Closely associated with the idea of efficiency is the condition that prices reflect efficient costs (including the cost of capital, and thus a reasonable level of profit)”³⁶ and “prices are not too much or for too long ... above costs” [emphasis added].³⁷







³⁵ WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [19].

³⁶ WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [14].

³⁷ WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [15].

It should be clear that Dr Small’s reference to “conduct that is inconsistent with workable competition” was NOT to prices that don’t “exactly reflect efficient costs”, but to market outcomes that include, by way of example, prices that “are not too much or for too long ... above costs”.³⁸

Yours sincerely,

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³⁸ WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [15].

Appendix: Genesis, Mercury, MEUG, Nova and NZ Steel identified relevant considerations for determining a UTS/HSOTC breach

Our submission detailed that when assessing whether or not there has been a UTS, and the scope and scale of the UTS, the Authority should consider behavioural or conduct issues, the market and environmental outcomes, and whether there are any extenuating (and, by inference, mitigating) factors that should be taken into account. We have considered the other UTS submissions against these factors:

	Relevant considerations for determining a UTS/HSOTC breach	What other submitters had to say on these matters
Behavioural issues	<ul style="list-style-type: none"> Price offers exceeded SRMC by too much and for too long (monopoly or oligopoly pricing) between 10 November and 16 January 	<p>We agree with Nova that “if Meridian’s offers under those circumstances are regarded as acceptable, then by extension it could withhold generation capacity and hold SI prices well above competing offers at any time, irrespective of the prevailing hydro inflows and storage”.</p>
	<ul style="list-style-type: none"> Contact and Meridian were both trying to avoid price separation 	<p>Genesis’ submission supports the Authority finding that Meridian was managing its locational price risk: “We agree with the Authority’s interim conclusion that Meridian, through the structure of its offers, was intentionally withholding supply to manage its locational price risk”. On our reading of the Meridian submission, Meridian appears to vacillate between its perspective that this is legitimate conduct and denial that it is what it was doing.</p>
	<ul style="list-style-type: none"> There should be a clear line that unnecessary spill of water is not acceptable market conduct The Authority can consider both purpose and effect 	<p>Even if the Authority accepted Meridian’s claim “the HVDC risk was not a major factor in Meridian’s decision making during the 3 to 18 December 2019” the Authority can consider both purpose and effect.³⁹</p>

³⁹ We reiterate the parallels with the Commerce Act cartel provisions under which it does not matter whether the purpose or the effect was to lessen competition for there to have been collusion. The Government has also announced changes to section 36 of the Commerce Act which will mean the test is purpose OR effect, rather than purpose AND effect: <https://www.mbie.govt.nz/business-and-employment/business/competition-regulation-and-policy/reviews-of-the-commerce-act-1986/review-of-section-36-of-the-commerce-act-and-other-matters/>

	Relevant considerations for determining a UTS/HSOTC breach	What other submitters had to say on these matters
Adverses market and environmental	<ul style="list-style-type: none"> The impact of Contact and Meridian's conduct is of a greater order of magnitude than the 26 March 2011 UTS 	<p>Nova: "Nova finds that the framework used for the analysis to be robust. If anything, the Authority has been somewhat conservative in its assessment of the period in which the UTS should apply."</p>
	<ul style="list-style-type: none"> The Authority's estimate of the harm caused by the UTS is conservative 	<p>We agree with Mercury that "situations where participants are in a position of market power and may exploit offers to earn excessive profits ... fundamentally undermine the confidence and integrity of the wholesale electricity market".</p> <p>Consistent with Mercury's views, we agree with Nova that "By its actions in December, in the absence of a response by the Authority, Meridian in effect increased expected long term average spot prices across the market, and in the SI in particular. This will have a direct impact on SI consumers through a pass through of higher prices by retailers over the long term, irrespective of whether retailers were hedged in the SI at the time or not". Nova's position is 100% aligned with Meridian's circa 2011 UTS views.</p>
	<ul style="list-style-type: none"> Spot prices were raised by too much and for too long 	<p>MEUG also commented "The magnitude of the estimated average over-charging for spot market purchasers during the alleged UTS period in both islands is staggering. North Island unhedged consumers paid almost twice the unit spot prices had there been no UTS and South Island unhedged consumers almost twice that again, at around 1.8 times the unit price had there been no UTS". NZ Steel, for example, estimate that "Based on the EA's analysis, NZ Steel has been over-charged \$950,000 for the 16 days identified in the preliminary decision report".</p>
	<ul style="list-style-type: none"> There was inefficient dispatch of electricity generation: not enough South Island hydro dispatch/too much North Island hydro and thermal was dispatched Secondary impacts on North Island security of supply, and North Island spot prices 	<p>There is a clear and direct link that less hydro generation means more thermal generation. Meridian did not deny its "unnecessary" spilling caused an increase in greenhouse gas emissions" only that the link was, for reasons left unspecified, "too remote". Given the Authority's increased strategic focus on a low emissions economy and environmental outcomes, we reiterate the Authority should take into account environmental harm as well as market outcomes.</p>

	Relevant considerations for determining a UTS/HSOTC breach	What other submitters had to say on these matters
	<ul style="list-style-type: none"> during 2020 HVDC maintenance should be taken into account 	
	<ul style="list-style-type: none"> Environmental costs and waste of scarce resources should be taken into account 	<p>The carbon emissions that were caused by the UTS conduct benefited Meridian. We agree with Genesis' comment in relation to "Coal-fired thermal generation that ran 'unnecessarily' during December 2019" and the impact on carbon emissions that "These costs do not manifest equally across the wholesale market. Increased carbon costs produce windfall gains for participants that are wholly or predominantly renewable generators, resulting in the development of a 'two-tier' market: those suffering under increased costs and those profiting from them. Ultimately these increased costs can be expected to flow through to end consumers".</p>
	<ul style="list-style-type: none"> The outcomes were made worse by Contact and Meridian unnecessarily spilling water at the same time 	
<p style="text-align: right;">Exacerbating factors</p>	<ul style="list-style-type: none"> There appears to be an ongoing pattern of behaviour that needs to be addressed 	<p>Our submission noted "there appears to be an ongoing pattern of behaviour which should be addressed" and "To the extent the Authority considers Meridian's conduct is repeated and/or ongoing should weigh against Meridian in both the UTS decision and HSOTC investigation".</p>
	<ul style="list-style-type: none"> Meridian appears to have ignored warnings by the Authority 	<p>This is confirmed by the Meridian submission which noted, for example, that "The Authority's own preliminary decision also identifies a range of instances of Pūkaki spill over the last 9 years where offers on average were broadly consistent with offers during December 2019" and "non-clearing tranches at high prices during periods of spill" is a commonplace strategy.</p> <p>Similarly, MEUG noted that "Meridian Energy's offer behaviour during the preliminary UTS decision period is a repeat of prior behaviour the EA has warned the company not to repeat" and "This is ... an important factor contributing to further erosion by many participants in their confidence in the wholesale market". We also agree with MEUG that "action to avoid a repeat of this event needs to consider the ambivalent approach by Meridian to date to the concerns raised previously by the EA".</p>

	Relevant considerations for determining a UTS/HSOTC breach	What other submitters had to say on these matters
	<ul style="list-style-type: none"> • The Authority should take into account any potentially misleading and unsubstantiated representations⁴⁰ about the trading conduct • There has been no admission of harmful conduct or remedial actions to ensure no future breaches or excess spill occurs 	<p>The closest Meridian gets to acknowledging they did anything wrong was the statement “There are some improvements that Meridian can and will make for future events to ensure we maximise the use of water as a precious renewable resource”. Meridian does not state what those improvements may be.</p> <p>Instead of taking responsibility for its own actions, Meridian has chosen to take the position that “the reputation of the New Zealand electricity market is constantly called into question reducing trust in the sector and eroding confidence, regardless of the merits of these claims” and “To the extent there has been any loss of confidence in current market arrangements (and we do not believe there has been) we suspect the real cause to be the misreporting of the comments and figures in the Authority’s preliminary decision”.</p> <p>The Meridian position contrasts starkly with Genesis’ acknowledgement its “behaviour over the period in question ... potentially [was] not completely in line with what the Authority may have expected to see under the circumstances”.</p>

⁴⁰ Under the Fair Trading Act “A representation is unsubstantiated if the person making the representation does not, when the representation is made, have reasonable grounds for the representation, irrespective of whether the representation is false or misleading”.