

27 April 2021

James Stevenson-Wallace  
Chief Executive  
Electricity Authority  
Wellington

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

Dear James,

## The independents support offer price caps to correct the UTS, but the correction should fully compensate for over-pricing

Ecotricity, Electric Kiwi, Flick Electric, Haast Energy Trading (Haast), Oji Fibre Solutions, and Vocus (the independents) welcome the Electricity Authority's Proposed Actions to Correct Undesirable Trading Situation 2019, dated 11 March 2021.<sup>1</sup>

We reiterate our acknowledgement of the substantial amount of analysis the Authority and its staff have undertaken for the UTS investigation. We appreciate the engagement we have had with Authority staff including at the workshops.

### Summary of the independent retailers' views on the correction action the Authority should take

- **The remedy should not reward market participants who contributed to and/or caused the UTS and should not penalise consumers:** A key principle we consider should be applied when determining the remedy for a UTS is that no party, whose actions contributed to a UTS and/or was responsible for a UTS, should be compensated, financially gain or profit, from the UTS.
- Philosophically, the UTS remedy should not reward or compensate parties whose actions contributed to the "confluence of factors" and/or caused the UTS.
- **3-27 December 2019 spot prices need to be reset:** We support "the Authority [proposal] that spot electricity prices and the prices of instantaneous reserves be reset for the period 3 to 27 December 2019 inclusive". We also agree with the Authority proposal not to "use its powers under Part 5 of the Code in relation to financial derivatives".
- **We agree both Contact and Meridian's offer prices should be capped:** The remedy needs to reflect both Contact and Meridian set offer prices too high (effectively withdrawing hydro generation capacity while spilling water) resulting in unnecessary hydro spill. If Contact and Meridian had not acted in this way there would not have been a UTS and spot prices would have reflected the forces of supply and demand, notwithstanding the "confluence of [other] factors". We agree with Meridian "It is ... incorrect to suggest that Clutha was not marginal. Market data

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<sup>1</sup> Responses to the Authority questions are provided in the Appendix, with more detail provided in the main body of the submission.

... shows that Clutha offers were in fact marginal in 12% of trading periods between 3 and 27 December 2019 (about what might be expected given the scale of Clutha generation)".<sup>2</sup>

- **The offer price cap should apply to Manapouri:** Late night high offer prices at Manapouri also caused artificially high spot prices and spill. Based on information provided by the Authority, 1.5% of Manapouri's offered quantity (in terms of megawatts offered) during the UTS period was offered at prices greater than \$13.70/MWh.<sup>3</sup> There were 108 trading periods where an offer was made with a price above \$13.70/MWh.<sup>4</sup> The Authority also observed "there were occasional spikes in QWOPs for several hours at a time".
- Manapouri offer pricing contributed to the overall scale and magnitude of the UTS. The Authority has implicitly applied a plant level test with a hurdle for determining which plant is included in the reset, but the UTS was fundamentally caused by participant conduct, in Manapouri's case Meridian's behaviour. The Authority should reset the offers for all of Meridian's hydro plant that were spilling during the UTS period, which includes Manapouri.
- For the avoidance of doubt, we support the application of the price cap to Manapouri as well as the South Island generation stations proposed by the Authority: Clutha/Mata-Au and Waitaki rivers: Aviemore, Benmore, Ōhau A, Ōhau B, Ōhau C, Clyde, Roxburgh, and Waitaki.
- **An SRMC-based offer price cap is the first best remedy:** Setting the offer prices at SRMC (or closer to \$0/MWh) would have been the safest and only reliable way for Contact and Meridian to ensure water was not unnecessarily spilt in real-time. Both Meridian and Powershop have previously provided compelling reasons why SRMC is a suitable benchmark. During the current UTS investigation, Meridian submitted "South Island spill would only be reduced ... at prices closer to \$6/MWh".<sup>5</sup>
- **An SRMC-based offer price cap produces outcomes which better reflect the market outcomes that should be expected when water is spilling, and excess capacity should result in stronger competition:** An offer price of \$13.70/MWh is not efficient or what should be expected during the normal operation of the market when hydro inflows are at record levels and hydro dams are spilling water. A \$13.70/MWh offer price when water was being spilled would only be profitable for a generator with significant market power at that time, who could increase profits by withholding supply and increasing price. A \$13.70/MWh price effectively says the Authority considers normal operation of the market can result in offers nearly twice as high as they would be in a fully competitive market.
- While the modelling that the independents has undertaken is not precisely 'like for like' with the Authority's UTS modelling, it shows a \$7.42/MWh offer cap, applied also to Manapouri, would result in a materially superior consumer remedy than the Authority's draft remedy:

**Table 1: 3-27 December 2019 spot price reductions**

	Manapouri excluded	Manapouri included
\$7.42/MWh cap	\$65.571m	\$67.810m
\$13.70/MWh cap	\$56.908m	\$58.715m

<sup>2</sup> Meridian, Preliminary decision on claim of an undesirable trading situation, Supplementary consultation, 27 November.

<sup>3</sup> E-mail from Christie Smith, RE: UTS workshop questions: Manapouri [EIAut-ELCOMM.FID43998], 18 March 2021.

<sup>4</sup> E-mail from Christie Smith, RE: UTS workshop questions: Manapouri [EIAut-ELCOMM.FID43998], 19 March 2021.

<sup>5</sup> Meridian, Preliminary decision on claim of an undesirable trading situation, Supplementary consultation, 27 November.

Our modelling also shows the market outcomes would have been materially better (to the long-term benefit of consumers), in relation to South Island unnecessary spill, unnecessary CO<sub>2</sub> emissions from Huntly and North Island hydro storage levels, if Contact and Meridian (including Manapouri) had capped their offer prices at \$7.42/MWh during 3-27 December 2019.

**Table 2: 3-27 December 2019 reduction in unnecessary South Island hydro spill if Contact and Meridian had applied the cap in real time**

	Manapouri excluded	Manapouri included
\$7.42/MWh cap	41,382MWh	42,848MWh
\$13.70/MWh cap	29,367MWh	30,235MWh

**Table 3: 3-27 December 2019 reduction in CO<sub>2</sub> emissions if Contact and Meridian had applied the cap in real time**

	Manapouri excluded	Manapouri included
\$7.42/MWh cap	5,224 tonnes	5,396 tonnes
\$13.70/MWh cap	4,021 tonnes	4,147 tonnes

**Table 4: 3-27 December 2019 increase in North Island hydro storage if Contact and Meridian had applied the cap in real time**

	Manapouri excluded	Manapouri included
\$7.42/MWh cap	13,624MWh	13,703MWh
\$13.70/MWh cap	11,674MWh	11,794MWh

- **If the Authority deviates from SRMC it should apply a ‘best estimate’ of the offer prices if there had been no UTS:** If the Authority does not adopt an SRMC-based cap, the cap should be set no higher than a ‘best estimate’ of what the offer prices would have needed to have been in real time to avoid spill and reflect the excess generation capacity in the market.

The ceiling on potential prices should reflect how far the Authority considers the “normal operation of the electricity market” differs from a fully competitive market.

- **Contact and Meridian should not receive “constrained on” payments as part of the remedy:** We agree with the Authority proposal that “only generators that did not have their offers reset would be eligible for constrained on payments”.<sup>6</sup> However, under the Authority proposal Meridian is rewarded for setting high prices for its hydro generation with “constrained on” payments to Manapouri. Meridian should not be eligible for constrained on payments for Manapouri.
- If the \$13.70/MWh price is applied, it should be scaled down to ensure retailers/end-consumers are not penalised (higher prices than if there was no UTS) because the UTS resulted in high-cost generation plant being unnecessarily dispatched.

<sup>6</sup> Based on clarification at the Authority’s 18 March 2021 workshop, we understand this was meant to refer to individual generation stations.

## **An appropriate UTS correction would more fully compensate for the harm caused by the UTS**

We interpret clause 5.5 of the Electricity Industry Participation Code – “The Authority must attempt to correct every undesirable trading situation and, consistently with section 15 of the Act, restore the normal operation of the wholesale market” – as meaning the Authority must correct for the UTS to the full extent it can.<sup>7</sup>

We acknowledge there may be limitations such as that spilt water cannot be unspilt, but “material computational burden” does not justify a “conservative” approach that the Authority has expressly acknowledged understates the magnitude of the over-pricing/UTS.<sup>8</sup> We are concerned the Authority is favouring simplicity over robustness and precision.

If the Authority wants to adopt a simplified approach due to “material computational burden” etc it needs to ensure it does not result in a bias which undercorrects for the UTS. The Authority could achieve this simply by using a lower offer price cap.

Our expectation of what an appropriate UTS correction looks like is minimisation of the harm caused by the unnecessary spill/excessively high spot prices during the UTS period to affected participants and end-consumers. We agree with Meridian that “the remedy should not punish end users ...”.<sup>9</sup> The remedy can go further in correcting the harm caused by the excessively high spot prices than the draft remedy.

In short, the Authority should not rely on a “conservative” estimate of excess spot prices for the correction.

The Authority should, instead, as it has indicated itself, “correct the spot electricity market payments made or received by approximating the spot market prices that would have prevailed if the UTS had not arisen”. The \$13.70/MWh price retrospectively calculated to determine the maximum price Meridian could have offered at Benmore to avoid unnecessary spill does not achieve this.

We agree with Meridian “where a UTS has been declared by reason of a generator taking advantage of a net pivotal position in circumstances where there is no energy or capacity, prices should be “normalised” by being returned to workably competitive levels”.<sup>10</sup> Consistent with Meridian, Genesis submitted “any proposed remedy should focus on attempting to arrive at what a workably competitive outcome would have been”.<sup>11</sup>

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<sup>7</sup> For the avoidance of doubt, we do not accept the Authority’s suggestion doing nothing is an option available under clause 5.5 in some circumstances: “While it may be possible for the Authority to take no action to correct the UTS, provided it has attempted to do so as required by clause 5.5 of the Code”.

<sup>8</sup> e.g. “It is worth noting that the analysis used to derive that offer price was conservative, in that it only focused on absorbing spill at Benmore, and a lower offer price, closer to a measure of marginal cost, could be argued for given that spill was occurring much more broadly across the Waitaki and Clutha/Mata-Au river systems.”

“... the Authority’s estimate of excess spill was a lower bound (i.e. a conservative estimate).”

“Using the period from 3 December to 27 December, the corresponding impact is \$70m.

“The Authority considered that this method was a robust method for estimating the scale of the excess spill. As mentioned above, this is a lower bound estimate for the excess spill.”

The Authority also acknowledged its calculations would understate the extent of over-pricing at its UTS workshops.

<sup>9</sup> Meridian, Proposed Actions regarding 26 March 2011 UTS, 21 June 2011.

<sup>10</sup> Meridian, Proposed Actions regarding 26 March 2011 UTS, 21 June 2011.

<sup>11</sup> Genesis, Re: Consultation on UTS preliminary decision, 18 August 2020.

## **What does “to correct [an] undesirable trading situation” mean?**

The Proposed Actions to Correct Undesirable Trading Situation 2019 consultation paper does not include a definition or interpretation of “to correct” or correction. The consultation paper simply states that “Under clause 5.5, the Authority must attempt to correct every undesirable trading situation and restore the normal operation of the wholesale electricity market as soon as possible” [emphasis added].

The consultation paper makes reference to the actions the Authority “may” take under clause 5.2(2) but this includes an element of circularity given 5.2(2)(d) is an open-ended clause allowing “any actions that will ... correct”: “directing a participant to take any actions that will, in the Authority’s opinion, correct or assist in overcoming the undesirable trading situation”.

The consultation paper also effectively narrows the potential scope of the correction with statements such as “Steps to prevent or mitigate similar outcomes in future would be dealt with through the Authority’s usual Code amendment processes” and “The actions to correct are not intended to penalise individual traders, though the actions to correct may have financial consequences for them”, without explanation or justification. These positions are treated as axiomatic.

Based on the plain English meaning of “correct” it includes concepts as “to make right”, “to remove or mark faults” and “to punish”. The plain English meaning of “correct” is substantially wider than the implicit definition the Authority adopted in the consultation paper and proposed remedy.

We consider the Authority should explicitly consider the meaning of “to correct”, and it is open to the Authority for the UTS correction to include:

- Clear direction of any market manipulation, use of market power or other specific conduct that directly caused the UTS. We consider that making right includes mitigating against repeat of similar outcomes. By way of an analogy, we do not consider that a plumber would have corrected a fault if the same fault reoccurs on a repeated basis.
- Penalties for any identified market manipulation, use of market power or other specific conduct that directly caused the UTS. We consider that it would be unusual for rules to specify “manipulative or attempted manipulative trading activity” is “undesirable” but contain no element of penalty where there has been manipulative behaviour.

## **We agree both Contact and Meridian’s offer prices should be capped**

We agree with the Authority that the UTS should be remedied by capping Contact and Meridian offer prices. This reflects the simple fact that if Contact and Meridian had not offered tranches of hydro at high prices that did not reflect the opportunity cost of water then prices would have reflected the forces of supply and demand and there would not have been a UTS. The UTS was clearly not “attributable to four different generators”<sup>12</sup> as Meridian has attempted to suggest.<sup>13</sup> We

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<sup>12</sup> <https://www.energynews.co.nz/news-story/undesirable-trading-situation/60359/meridian-flick-react-further-uts-consultation#comments>

<sup>13</sup> The Authority was explicitly clear there was nothing the other generators could have done to avoid or prevent the UTS, at the video announcement of the UTS final decision.

agree with the Authority, Meridian's conduct "was right at the front and centre of the confluence of factors that came together".<sup>14</sup>

The recognition both Contact and Meridian's offer prices need to be corrected to remedy the UTS is consistent with our original UTS and HSOTC complaint and evidence in our subsequent submissions about the impact of Contact's offer strategy. It is also consistent with Dr Small's observation "both Contact and Meridian were deliberately structuring their offers to avoid transmission constraints binding".

Capping both Contact and Meridian's prices also addresses Meridian's concerns about what it saw as an arbitrary distinction between Contact and Meridian's offers: "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".<sup>15</sup>

### **Manapouri should be added to the list of hydro power stations the offer price cap will apply to**

We consider the UTS remedy should reflect the high night-time prices that resulted from Manapouri offer prices / operation and the price cap adjustment should also apply to Manapouri offers. The "constrained on" payments Meridian would receive under the remedy proposal for Manapouri simply reflects that the offer prices for Manapouri were also too high during the UTS period confirming that Manapouri's offer prices should also be capped.

Our modelling shows high Manapouri offer prices, resulted in greater spill and higher spot prices amounting to \$1.807m to \$2.239m depending on whether the \$13.70/MWh or SRMC benchmark is applied.

### **The UTS remedy should not reward parties whose actions contributed to the "confluence of factors" and UTS**

A key principle we consider should be applied when determining the remedy for a UTS is that no party, whose actions contributed to a UTS and/or was responsible for a UTS, should be compensated, or financially gain or profit, from the UTS.

The Authority has been clear Meridian withheld generation from its hydro scheme on the Waitaki River to avoid power cables between the South and North Islands reaching capacity, "they did that to stop South Island prices reducing" and "That was right at the front and centre of the confluence of factors that came together".<sup>16</sup>

Meridian's warning "If there is no consequence for [use of transient market power], then it would be irrational for generators not to consider doing so"<sup>17</sup> applies to situations where the remedy only partially addresses the financial gain or profit from the UTS.

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<sup>14</sup> Select committee expresses concern over Meridian evidence, Tom Pullar-Strecker, 5 April 2021, at: <https://www.stuff.co.nz/business/124718335/select-committee-expresses-concern-over-meridian-evidence>.

<sup>15</sup> Meridian, Meridian Submission, Preliminary decision on claim of an undesirable trading situation, 18 August 2020.

<sup>16</sup> Select committee expresses concern over Meridian evidence, Tom Pullar-Strecker, 5 April 2021, at: <https://www.stuff.co.nz/business/124718335/select-committee-expresses-concern-over-meridian-evidence>.

<sup>17</sup> Meridian, Draft Decision regarding alleged UTS on 26 March 2011 – Cross Submission, 19 May 2011.

## **An SRMC-based offer price cap is the first best remedy**

We agree with the Authority “a lower offer price, closer to a measure of marginal cost, could be argued for given that spill was occurring much more broadly across the Waitaki and Clutha/Mata-Au river systems”.

If the Authority adopted a pure efficiency test, consistent with its interpretation of its statutory objective, to determine the remedy the cap would be set at SRMC.<sup>18</sup> While Meridian has emphasised it is not required to offer at SRMC, setting offer prices at or below SRMC would have been the safest and most reliable way for Contact and Meridian to ensure they did not needlessly spill water.

The Authority’s estimate of SRMC of \$7.42/MWh is the most appropriate cap on offer prices to apply to remedy the UTS.<sup>19</sup>

**Table 5: 3-27 December 2019 spot price reductions**

	Manapouri excluded	Manapouri included
\$7.42/MWh cap	\$65.571m	\$67.810m
\$13.70/MWh cap	\$56.908m	\$58.715m

**Table 6: 3-27 December 2019 reduction in unnecessary South Island hydro spill if Contact and Meridian had applied the cap in real time**

	Manapouri excluded	Manapouri included
\$7.42/MWh cap	41,382MWh	42,848MWh
\$13.70/MWh cap	29,367MWh	30,235MWh

## **Meridian and its 100%-owned subsidiary have provided sound basis for an SRMC-based cap**

We support Meridian’s 100%-owned subsidiary position that UTS remedies should be based on SRMC. The Meridian subsidiary pointed out, for example, that “SRMC provides more accurate price signals for both buyers and investors” and “The objective of the remedy should be to reset prices to an efficient level”.<sup>20</sup>

Consistent with its subsidiary, Meridian has also submitted “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”<sup>21</sup> and, “in normal traditional conditions”, “final prices should ... approximate SMRC not LRMC”. We agree with Meridian “In the absence of an energy or capacity shortage, competitive prices should approximate SMRC not LRMC”.<sup>22</sup>

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<sup>18</sup> We have previously documented Meridian’s (sound) explanation why SRMC is the appropriate efficiency benchmark and not, for example, LRMC. For example, Meridian (signatory Neil Barclay) has submitted 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”: Meridian, Draft Decision regarding alleged UTS on 26 March 2011, 13 May 2011.

The Authority also made its decision on the TPM review based on a preference that the TPM should rely on SRMC-based nodal pricing rather than LRMC price signals.

<sup>19</sup> We acknowledge the Authority assessment that \$7.42/MWh “reflect[s] the South Island Mean Injection (SIMI) rate of \$6.42/MWh from Transpower that applied in 2019/20 with an additional \$1/MWh for other operating and maintenance costs”.

<sup>20</sup> Powershop (100% subsidiary of Meridian), Proposed actions of the Electricity Authority under Part 5 of the Electricity Industry Participation Code to correct the Undesirable Trading Situation on 26 March 2011, 21 June 2011.

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

<sup>22</sup> Meridian, Draft Decision regarding alleged UTS on 26 March 2011, 13 May 2011.

Meridian's commentary on SRMC v LPMC from 2011 is sound and can be relied on to refute their and their consultants' subsequent December 2019 UTS commentary on this matter.

**If the Authority deviates from SRMC it should apply a 'best estimate' of the offer prices if there had been no UTS which reflects how far 'normal conditions' differ from a fully competitive market**

The Authority stated its "current, preferred action to correct the UTS" is to reset final prices such that the prices reflect 'normal' competitive pressures. It follows that to the extent the remedy price cap deviates from SRMC it should reflect the Authority's assessment of the extent to which normal market conditions deviate from fully competitive market outcomes i.e. the remedy should be no higher than a 'best estimate' of what prices would have been if there was no UTS, noting the Authority statement that water was "cheap" and "the abundance of fuel (water) should have increased competitive pressure".

The Brattle Group (for Meridian) made similar comment: "The concentrated structure of the New Zealand market means that many generators are potentially price-setting, resulting in prices deviating from SRMC depending on prevailing market circumstances and economic trading strategies".<sup>23</sup>

The starting point for determining the best estimate should be the prices Contact and Meridian needed to offer, based on information in real-time, to ensure they did not unnecessarily or deliberately spill water. In some trading periods during the UTS period the actual final price was less than \$13.70/MWh which indicates generators were prepared to sell their electricity at prices below the cap proposed by the Authority.<sup>24</sup>

We agree with Genesis that "any proposed remedy should take careful account of human behaviour and the fact that decision-makers acting in real time do not have perfect information. Genesis considers that any proposed remedy should focus on attempting to arrive at what a workably competitive outcome would have been".<sup>25</sup>

The Authority has stated "the \$13.70/MWh price was feasible in the context of the resource management obligations that were being managed on the Waitaki River. The \$13.70/MWh offer price cap embodies a level of South Island generation that does not penalise South Island hydro generators for river management required by resource consents" but has not provided any basis that lower offer prices would not have been feasible or would be prevented by resource consents. We are very sceptical resource consents would effectively require Contact and Meridian to monopoly price or would mean it is only OK to dispatch certain tranches if the clearing price is above a certain (extremely high) level.

**Wholesale purchasers and end-consumers should not have to pay for constrained-on payments resulting from the UTS**

We acknowledge, for example, that Genesis' Huntly plant would not have been dispatched at the prices resulting from Contact and Meridian's hydro stations offers being capped at \$13.70/MWh. If the \$13.70/MWh cap is used it should be adjusted downward to compensate consumers for the

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<sup>23</sup> The Brattle Group (for Meridian), Response to Third Party Submissions Regarding Alleged UTS of 2019, 16 September 2020.

<sup>24</sup> A \$13.70/MWh price cap when hydro was spilling, and the opportunity cost of water was zero (implicitly) indicates that the Authority considers the wholesale electricity market to be continually weakly competitive. Consumers should not have to be exposed to the outcomes of a weakly competitive market. We submit the Authority investigate how to move from a 'weakly' to 'workably' competitive generation market.

<sup>25</sup> Genesis, Re: Consultation on UTS preliminary decision, 18 August 2020.



constrained on payments. That is, spot prices should be adjusted so consumers do not have to incur the cost of constrained on payments arising from the UTS.

### **The Authority should not base its remedy on a “conservative” (high) offer price**

We are concerned a “conservative” price offer cap of \$13.70/MWh would only result in a partial remedy to the excess spot prices. A consequence is that Contact and Meridian would be rewarded/remain financially (if not reputationally) better off as a direct consequence of offering tranches of hydro at excessive prices/effectively withholding generation capacity. If the estimate is going to be “conservative” it would be more consistent with the long-term benefit of consumers for the conservatism to protect consumers rather than reward suppliers.

### **The \$13.70/MWh is more than double the \$6.35/MWh price the Authority relied on in its preliminary decision**

The caution we raised in relation to the \$6.35/MWh ex post offer price estimate the Authority came up with for the preliminary decision applies to the \$13.70/MWh price used in the final UTS decision and the remedy proposal.

The \$6.35/MWh and \$13.70/MWh offer prices are ex post estimates.

They are based on trial and error of the vSPD modelling using data that was not available in real-time. The highest offer price that would enable dispatch/avoid unnecessary spill cannot be known with certainty ex ante. More specifically, the Authority’s modelling is specific to determining the maximum price that would ensure Benmore did not spill and not other hydro plant.

If Contact or Meridian based their actual offer behaviour on estimates of this price, they would inevitably get the price wrong and there would be inefficient dispatch/unnecessary spill. Even if they knew the \$13.70/MWh price in advance and applied it they would have unnecessarily spilt water. This is a risk with any offer prices above SRMC.

Pricing up to \$13.70/MWh (and above SRMC when water is being spilled) would deviate from outcomes in workably competitive markets, allow for extraction of excess revenues and result in the various harm the Authority has identified from unnecessary spill of water.

### **There is a risk of creating a de facto ‘safe harbour’ for misuse of market power**

We share the Meridian subsidiary concern about the potential for the remedy to “establish “target prices” for all generators in similar circumstances in the future” and they were “fearful that such manipulations (albeit with lower price outcomes) may become more prevalent in the market, leading to higher and more volatile wholesale energy prices, and in turn prices faced by consumers”.<sup>26</sup> The Meridian subsidiary concern broadly aligns with the views we previously expressed that “Risk of creating a de facto ... monopoly pricing ‘safe harbour’ should be avoided” and the Authority’s decision could “create a ‘safe-harbour’” which could “leave substantial scope for ongoing market manipulation and higher prices”.<sup>27</sup>

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<sup>26</sup> Powershop (100% subsidiary of Meridian), 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.

<sup>27</sup> Ecotricity, Electric Kiwi, Flick Electric, Haast, Oji Fibre Solutions and Vocus, Response to UTS preliminary decision: Contact and Meridian both caused a UTS to arise, and it extended from 10 November 2019 to 16 January 2020, 18 August 2020.

## Environmental costs and waste of scarce resources should be quantified and taken into account

We agree with Meridian that “from an [sic] climate action perspective, spill should be avoided where possible”.<sup>28</sup>

While the remedy cannot unspill water it can include an CO<sub>2</sub> offset for the environmental harm that resulted from unnecessary operation of Huntly.<sup>29</sup> We agree with Genesis that “the impact of events like those that occurred during December 2019 is likely to be greater with an expected rise in the price of New Zealand emissions units”.<sup>30</sup>

We reiterate:

The Authority’s decision on the UTS provides an opportunity (probably the first) to demonstrate how it is going to incorporate its new strategic ambition about kaitiaki and environmental considerations in its analysis and decision-making.

The cost of the unnecessary thermal (e.g. coal) generation (productive inefficiency) and the adverse environmental impact from thermal generation are relevant costs the Authority should take into account.

A cost is a cost is a cost. It does not matter whether it is a resource cost (e.g. unnecessary use of coal) or an environmental cost (e.g. discharge of pollutants from coal-fired generation into the atmosphere). This is consistent with the Authority’s “recogni[tion] that as the regulator, our work also provides a platform for the country to achieve its aspirations for enhanced quality of life, prosperity and environment” and that low emissions is one of its core ambitions.<sup>31</sup> As noted above, we estimate there was 17,485 tonnes of additional CO<sub>2</sub> emissions due to the alleged unnecessary spilling of water between 10 November and 16 January (6,293 tonnes between 3 to 18 December), in addition to air pollution from Huntly which includes sulphur dioxide, nitrogen oxides, particulate matter and heavy metals.

The following table is our estimate of the amount of CO<sub>2</sub> emissions that were attributable to the UTS.

**Table 7: 3-27 December 2019 reduction in CO<sub>2</sub> emissions if Contact and Meridian had applied the cap in real time**

	Manapouri excluded	Manapouri included
\$7.42/MWh cap	5,224 tonnes	5,396 tonnes
\$13.70/MWh cap	4,021 tonnes	4,147 tonnes

## Other comments

For the avoidance of doubt, we agree with the Authority that it should:

- remedy the December 2019 UTS by revising offers and not by revising prices or the settlement between purchasers and generators.
- formally reset final prices rather than rely on an off-market “wash-up”: “If the wholesale market were operating normally, the derivatives market would also embody the prices that reflect normal competitive pressure. The Authority’s current, preferred action to correct the UTS is to reset final prices so that these prices reflect ‘normal’ competitive pressures. By contrast, if an off-market wash-up were adopted, derivatives markets would be insulated from the correction of the UTS”.

<sup>28</sup> Meridian, Preliminary decision on claim of an undesirable trading situation, Supplementary consultation, 27 November.

<sup>29</sup> *ibid.*

<sup>30</sup> Genesis, Re: Consultation on UTS preliminary decision, 18 August 2020.

<sup>31</sup> <https://www.ea.govt.nz/about-us/strategic-planning-and-reporting/strategy-reset-2020/>

- not reset volumes: “Resetting volumes would likely result in the spilling South Island hydro generators receiving payments for energy they did not inject into the network and other generators would not be compensated for the electricity that they injected, implicitly penalising them for their participation in the market during the UTS period. The Authority currently proposes to calibrate settlement using the volumes originally dispatched.”
- leave North Island offer prices unchanged: While it is possible that Contact and Meridian’s high offer prices resulted in change in North Island offer behaviour, it was the former not the latter that resulted in the UTS.
- use the proposed cap on offer prices to calibrate a reset of clearing prices, and that “Correcting offer prices is analogous to the approach deployed to correct the UTS of 2011”.
- “only generators that did not have their offers reset would be eligible for constrained on payments”. For the avoidance of doubt, this should mean no generation plant owner who has had any of its offers reset would be eligible for constrained on payments for any of its other generation stations.
- treat pass-through of spot prices to FTRs and derivatives markets in the way proposed in the UTS remedy paper.

### **Concluding remarks**

We welcome the Authority’s draft decision to adjust both Contact and Meridian’s offer prices. Both Contact and Meridian unnecessarily spilt water and this resulted in wholesale electricity prices being higher than they should have been in normal market circumstances i.e. prices did not reflect the forces of supply and demand.

Meridian has noted “As the main regulator in New Zealand, the Electricity Authority can ... decide if our behaviour has been fair to our competitors and to our customers”.<sup>32</sup> Meridian has also commented “In the context of the 2011 UTS, it was abundantly clear from a number of market indicators that confidence in the market had been shaken and that the Authority should recalculate final prices”.<sup>33</sup>







In our view, neither Contact or Meridian’s behaviour has been fair to its competitors or customers. Confidence in the market has been shaken and the Authority should recalculate final prices for the December 2019 UTS period based either on (first best option) an efficiency-based approach which recognises SRMC offer pricing would have been a safest way for Contact or Meridian to ensure they did not needlessly spill water or a (second best option) ‘best estimate’ of what the prices would have been absent the UTS.

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<sup>32</sup> <https://www.meridianenergy.co.nz/who-we-are>

<sup>33</sup> Meridian, MDAG review of the high standard of trading conduct provisions: Cross-submission, 27 May 2020.

Yours sincerely,

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## Appendix: Responses to the Consultation Paper questions

Question	Independents' response
Q1. What, if any, actions should the Authority undertake to address excess spill, system security, and any other consequent effects? How would such actions address the objectives of Part 5 of the Code?	<p>While it is not possible to unspill water that has been spilt, the Authority should ensure wholesale purchasers and end-consumers are fully compensated for the high prices that resulted from the UTS.</p> <p>It is possible and straightforward to reverse the impact of the unnecessary CO<sub>2</sub> emissions that arose from the UTS. The Authority should estimate the amount of unnecessary CO<sub>2</sub> that was omitted and impose a carbon offset as part of the remedy.</p>
Q2. Do you agree that the Authority should seek to correct the UTS period by resetting the payments made/received by spot market purchasers and generators? (If not, please explain your reasoning.)	Yes.
Q3. Do you agree that the Authority should attempt to correct settlement during the UTS period by resetting prices in the electricity market?	Yes.
Q4. Do you agree that injection and off-take volumes should remain unchanged in any resettlement?	Yes.
Q5. Do you agree that the Authority should attempt to correct the UTS by revising final prices in the electricity market, rather than by an 'off-market' wash-up of spot electricity payments to and from the clearing manager?	Yes.

Question	Independents' response
<p>Q6. If offer prices and offer volumes are reset, which hydro generating stations should have offers reset? (Please answer yes/no, with any additional supporting commentary.)</p> <p>a. Aviemore? b. Benmore? c. Clyde? d. Manapōuri? e. Ōhau A, B, C? f. Roxburgh? g. Tekapo A, B? h. Waitaki? i. Other stations?</p>	<p>Yes, for a to h (including Manapouri).</p> <p>The offer price cap should apply to Manapouri.</p> <p>Late night high offer prices at Manapouri also resulted in artificially high spot prices and spill. Based on information provided by the Authority, 1.5% of Manapouri's offered quantity (in terms of megawatts offered) during the UTS period was offered at prices greater than \$13.70/MWh.<sup>34</sup> There were 108 trading periods where an offer was made with a price above \$13.70/MWh.<sup>35</sup> The Authority also observed "there were occasional spikes in QWOPs for several hours at a time". While this may not have been material enough, in its own right, to cause a UTS Manapouri offer pricing contributed to the overall UTS.</p> <p>The Authority has implicitly applied a plant level test with a hurdle for determining which plant is included in the reset, but the UTS is fundamentally caused by participant's conduct, in Manapouri's case Meridian's behaviour.</p> <p>The Authority should reset the offers for all of Meridian's hydro plant that were spilling during the UTS period, which includes Manapouri.</p>
<p>Q7. If offer prices and volumes are reset, do you agree that North Island offer prices and offer volumes should remain the same as originally submitted? (If not, please identify any alternative actions.)</p>	
<p>Q8. Do you agree that resetting offer prices and volumes by imposing a cap is the preferred action to correct the UTS? If not, please identify preferred alternatives.</p>	<p>Yes.</p>
<p>Q9. If revisions to offer prices are to vary through time or across generating stations, how should the offer prices be determined?</p>	<p>We consider that the Authority should either:</p> <ul style="list-style-type: none"> <li>base its offer price cap(s) on something more closely resembling SRMC/zero water value, consistent with the excess hydro capacity and the increased competition that should have resulted (which may well be the same price for all hydro); or</li> <li>correct offers by introducing offer prices and volumes that vary through time and by generating station (5.24(iv)). We have</li> </ul>

<sup>34</sup> E-mail from Christie Smith, RE: UTS workshop questions: Manapouri [EIAut-ELCOMM.FID43998], 18 March 2021.

<sup>35</sup> E-mail from Christie Smith, RE: UTS workshop questions: Manapouri [EIAut-ELCOMM.FID43998], 19 March 2021.

Question	Independents' response
	<p>suggested this be based on a best estimate or, consistent with Genesis (2020) and Meridian (2011) submissions, set to reflect workably competitive market outcomes.</p> <p>We do not consider the Authority's comment that "Mechanism (iv) ... substantially increases complexity because there are 1200 half-hour trading periods in the UTS period, and there are nine generating stations whose offers are proposed for revision" is a sound reason to reject this option. The complexity should be weighted against the economic benefits of robustness and precision (in particular, minimising the extent to which the remedy penalises wholesale purchasers and end-consumers/rewards generators that contributed to or caused the UTS).</p> <p>The Authority has stated it "currently considers that the most direct way to correct the UTS experienced in the wholesale market in December 2019 is to correct the spot electricity market payments made or received by approximating the spot market prices that would have prevailed if the UTS had not arisen". The \$13.70MWh price retrospectively calculated to determine the maximum price Meridian could have offered at Benmore to avoid unnecessary spill does not achieve this.</p>
Q10. Do you consider that final prices should be reset directly? If so, how should they be calibrated?	We support "The Authority ... baseline proposal to correct the UTS period by re-calibrating offer prices and offer volumes, by band, and then passing these offers back through SPD to determine the impact on final (or settlement) prices".
Q11. Do you agree that the aggregate offer volumes of each generating station should equal the aggregate amount offered by that station during the UTS period? Please describe any preferred alternatives.	Yes.
Q12. Which of these mechanisms in paragraph 5.41(a) – (e), if any, should be used to calibrate 'corrected' electricity offer prices? (Please identify any other preferred alternatives.)	We consider that option 5.41(e) should be adopted.

Question	Independents' response
Q13. Do you agree that generators, other than those with 'reset offers', that were dispatched to generate electricity at offer prices above the reset final prices should be treated as constrained on? (If not, please identify preferred alternatives.)	<p>Yes.</p> <p>For the avoidance of doubt, this should exclude ALL Contact and Meridian South Island hydro generation plant, including Manapouri. Contact and Meridian should not be rewarded or compensated for actions that contributed to or caused the UTS, including the Manapouri offer pricing.</p> <p>If Manapouri had been offered in at prices that reflected the zero value of water and normal market conditions at all times during the UTS, there would be no Manapouri offer prices in excess of the corrected December 2019 spot prices.</p>
Q14. Do you agree with the Authority's proposal not to revise constrained off payments, associated with frequency keeping? (If not, please explain and identify any preferred alternatives.)	Yes.
Q15. Should offers to the instantaneous reserves market during the UTS period be corrected? If so, how should instantaneous reserve offers be corrected?	
Q16. Do you agree with the proposed approach to treatment of derivatives correcting the UTS? Please explain your answer.	Yes.
Q17. Are there any additional, feasible and lawful actions that the Authority should or could undertake in relation to derivatives markets?	No.
Q18 How should the Authority use its powers under Part 5 in relation to LCE payments?	We support "The Authority's proposal ... to require customers to pay back any over-payments to Transpower and require Transpower to reallocate residual LCE in accordance with the resettlement implied by the actions to correct the UTS".
Q19 Should the Authority use its powers under Part 5 of the Code to direct retailers to reimburse consumers that had contracts on variable price terms? What, if any, action should the Authority take in relation to variable price contracts?	We consider this is a matter that should be answered individually, rather than in a joint retailer submission.
Q20 How should any resettlement arising from the actions to correct the UTS be implemented?	See answer to Q19.
Q21 If there is a resettlement, what window of time after invoicing should be allowed for traders to meet their obligations?	See answer to Q19.
Q22 Please provide feedback on the operational implementation of the proposed actions to correct the UTS, including the interest rate that should be used to scale payments.	See answer to Q19.