

1 March 2021

James Stevenson-Wallace
CEO
Electricity Authority

By e-mail: tradingconduct@ea.govt.nz

Dear James,

The proposed HSOTC rules should help mitigate abuses of significant market power in the spot market

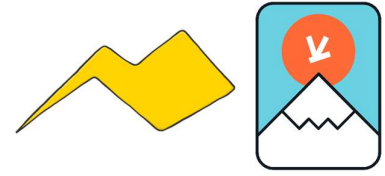
Electric Kiwi and Haast Energy Trading (Haast) support the proposed HSOTC Code amendment. Please find attached our submission to MDAG on this proposal. Our views haven't changed, and the MDAG submission should be treated as part of our submission to the Authority.

Electric Kiwi and Haast support the Authority's proposals

In summary:

- We support the proposals (for the reasons provided in our submissions to MDAG);
- We agree with the Authority that MDAG ran a sound process for review of the HSOTC rules (as reflected in our submissions to MDAG);
- We consider that both MDAG and the Authority have provided sound basis for the proposed Code amendment;
- We support the Authority's warning that if reforming the trading conduct rules doesn't result in "a marked improvement on the status quo ... the Authority will consider more direct interventions to address this issue";
- We support the Authority's commitment to strengthen its monitoring, enforcement and compliance functions. We welcome that the Authority has now clearly stated Genesis' offer behaviour between 6-9 August 2018 at Tekapo A was in breach of the (current) HSOTC rules. However, we are worried the decision not to take the matter to the Rulings Panel "because ... the cost of Rulings Panel proceedings would outweigh the financial harm caused by the breach" will result in a de facto safe-harbour for low level offending. The cost of this de facto safe-harbour will exceed any cost of undertaking compliance enforcement;
- We support the Authority engaging with the Ministry for Business, Innovation and Employment on its review of the Electricity Industry Act 2010, including the level of penalty for breaches under the Act. We agree with the Authority "In the context of the wholesale market, the current maximum penalty of \$200,000 per breach has a limited deterrence effect". We support penalty provisions similar to those under the Commerce Act (see extract below), and provision for undertakings that could include divestment of generation assets.¹

¹ <https://comcom.govt.nz/news-and-media/media-releases/2020/wilson-parking-agrees-to-divest-car-parks-in-settlement-agreement-with-commerce-commission>



- (2B) The amount of any pecuniary penalty must not, in respect of each act or omission, exceed,—
- (a) in the case of an individual, \$500,000; or
 - (b) in any other case, the greater of the following:
 - (i) \$10 million;
 - (ii) either,—
 - (A) if it can be readily ascertained and if the court is satisfied that the contravention occurred in the course of producing a commercial gain, 3 times the value of any commercial gain resulting from the contravention; or
 - (B) if the commercial gain cannot readily be ascertained, 10% of the turnover of the person and all its interconnected bodies corporate (if any) in each accounting period in which the contravention occurred.

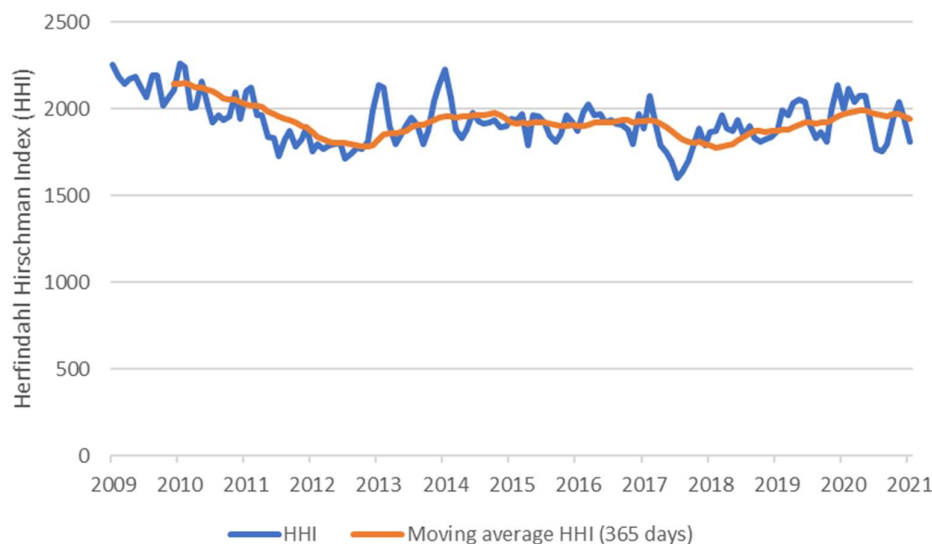
The Authority should target the underlying market power problem and not just the symptoms

If the Authority is successful in promoting thriving competition in the wholesale electricity market it will result in lower occurrences of significant market power, and less scope for breach of the HSOTC rules.

At present there does not appear to be anything on the Authority work programme that would result in increased wholesale electricity market competition. The EPR reforms the Authority is working on, for example, are principally retail market facing.

We have previously commented that the HHI and Concentration Ratios for the wholesale electricity market has changed very little since the Authority was established, and the HHI deteriorated around 2017/18 (see Figures 1 to 4 below). The Commerce Commission uses a threshold for market concentration of 3 largest suppliers having 70% or more market share (CR3) which is the case in the wholesale electricity market (70.23% over the last 12 months).² The UK Competition and Markets Authority uses a stricter definition under which an HHI of 2,000 is the boundary between concentrated and highly concentrated.

Figure 1: Wholesale electricity market HHI trend



² Up to 31 January 2021.

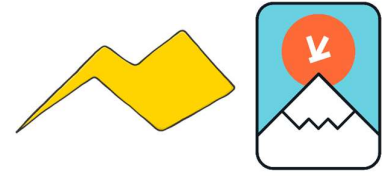


Figure 2: Wholesale electricity market CR1 trend

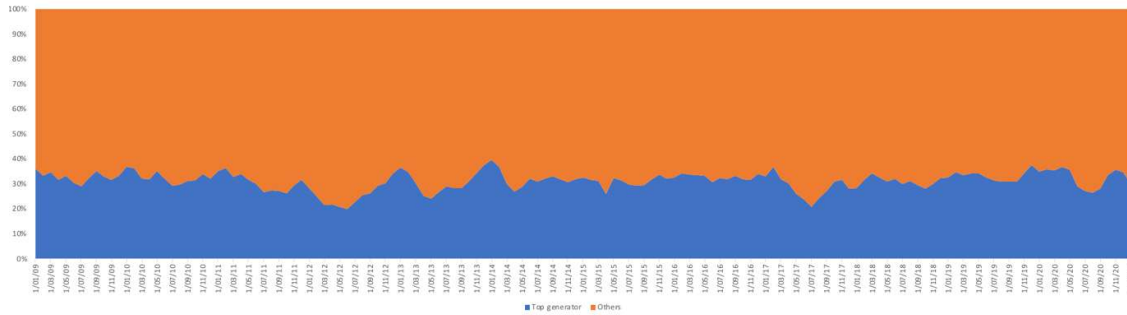


Figure 3: Wholesale electricity market CR3 trend

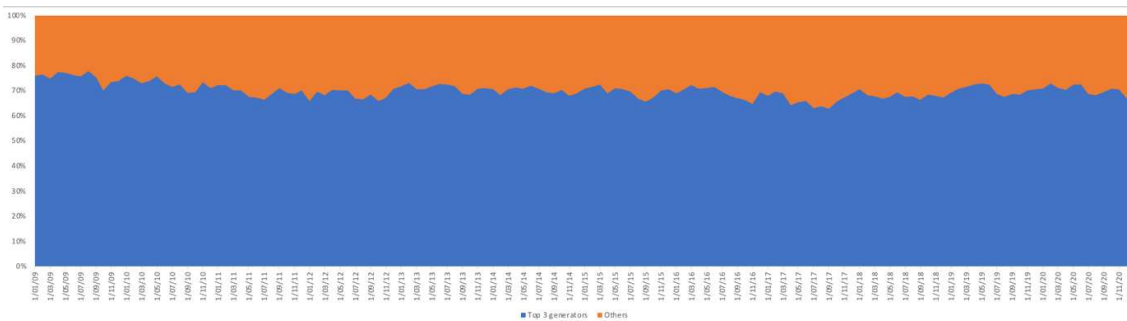
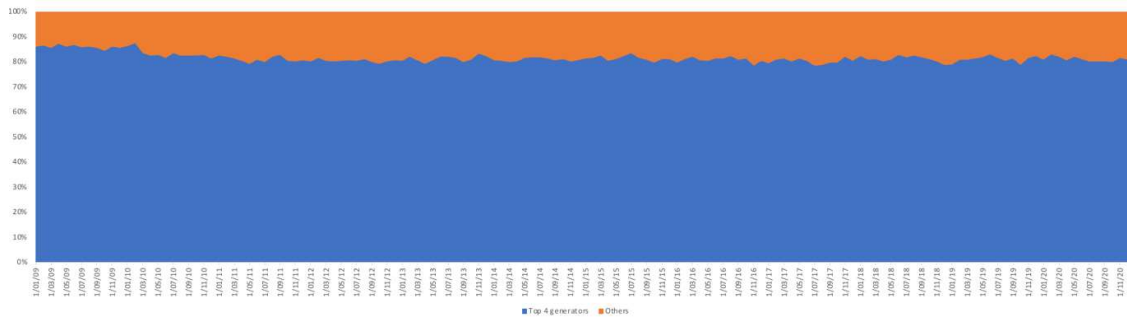


Figure 4: Wholesale electricity market CR4 trend



Concluding remarks

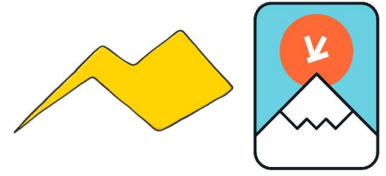
We reiterate a market rule is only as good as its enforcement. We support the Authority's commitment to adopt stringent market monitoring and enforcement of the trading conduct rules.³

We strongly support a much larger, well resourced and pro-active Compliance Team. This appears to be a position largely supported by stakeholders, with the possible exception of Mercury.⁴ It also accords squarely with the Authority's new strategic direction.

Ultimately, if the HSOTC rules – current or replacement – and enforcement fail to ensure abuses of significant market power, including transient market power, are curbed the Authority may be left with

³ We consider the Authority should adopt more stringent monitoring and compliance enforcement for all elements of the Code, including HSOTC and wholesale information disclosure.

⁴ Mercury, Cross Submission on Discussion Paper – High Standard of Trading Conduct Provisions: A Review by the Market Development Advisory Group, 27 May 2020.



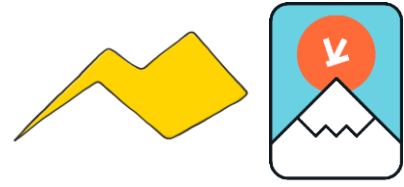
the choice of: (i) accepting non-competitive market outcomes, contrary to its statutory objective and strategy, or (ii) structural reform, including the break-up of Meridian.⁵

Yours sincerely,

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⁵ <https://businessdesk.co.nz/article/election-2020/luke-blincoe-time-to-break-up-meridian>



24 October 2020

Tony Baldwin
Chair
MDAG
Electricity Authority

By e-mail: MDAG@ea.govt.nz

Dear Tony,

MDAG's revised HSOTC proposals should help mitigate abuses of significant market power in the spot market

Electric Kiwi and Haast Energy Trading (Haast) support MDAG's revised HSOTC proposals.

We agree with MDAG that the revised HSOTC proposal is superior to the original MDAG proposal and the current HSOTC rules. We support the independent retailer recommendations to revise the definition of significant market power, but our support for the MDAG proposal is not contingent on these changes being made.

In finalising the MDAG recommendations, it will be important for the group to satisfy itself they capture all limbs of the statutory objective, including promotion of competition and reliable supply.¹ MDAG should also satisfy itself there are appropriate provisions for dealing with all forms of undesirable trading conduct, including that the HSOTC rules continue to capture transient market power (as implied by the specification that "there may be ... periods when, one or more generators, or ancillary service agents, as the case may be, has significant market power").

MDAG has run a sound review of the HSOTC rules

MDAG's consultations and stakeholder engagement on the HSOTC review over the last year have been of a very high standard.

MDAG has appropriately drawn on relevant economic literature and legal precedent.

The analysis MDAG has undertaken is fundamentally sound.

The reasons for not undertaking quantified CBA were well explained and justified. We consider the use of independent Panels to test how the MDAG proposals would be interpreted was innovative and provides compelling alternative evidence in support of the revised proposals. We also consider that MDAG has provided compelling prima facie evidence of ongoing trading conduct problems.

There is nothing in any of the submissions, or cross-submissions, which should cause MDAG or the Authority to doubt the efficacy and direction of the Advisory Group's thinking. Quite the opposite.

The quality of the MDAG HSOTC review and proposals is reflected in the fact no substantial changes have been advocated in submissions (or cross-submissions).²

¹ It would not be sufficient to treat "economic efficiency" as a catch-all for efficiency, competition and reliable supply. Such an approach would effectively be contrary to the statutory objective in section 15 and render the important references to competition and reliable supply superfluous. The fact that section 15 included efficiency, competition and reliable supply as three separate, and unranked, limbs reflect that each has separate meaning and is important to the long-term benefit of consumers in their own right.

² Similarly, it is notable that no objections were raised in cross-submissions to the independent retailers' recommended revisions to the MDAG original proposal.



The main objection to the original MDAG proposals appears to have been in relation to the purpose statement. Meridian, for example, offered tentative support for “MDAG’s proposed option of a counterfactual test so that offers must be consistent with offers that the generator or ancillary service agent would have made where no generator or ancillary service agent could exercise significant market power”, but “Most importantly, Meridian does not support the “purpose statement” that is proposed to accompany the test”. The revised MDAG HSOTC proposal addresses the incumbent concerns, including the unfounded claims the proposals amount to price control, by replacing the purpose statement in its entirety.

Concluding remarks

We reiterate that a market rule is only as good as its enforcement. The Authority needs to adopt stringent market monitoring and enforcement of the trading conduct rules (regardless of whether the current HSOTC rules are changed or not).³ Going forward, enforcement needs to occur and it needs to occur in a timely manner.

We strongly support a much larger, well resourced and pro-active Compliance Team. This appears to be a position largely supported by stakeholders, with the possible exception of Mercury.⁴ It also accords squarely with the Authority’s new strategic direction.

Ultimately, if the HSOTC rules – current or replacement – and enforcement fail to ensure abuses of significant market power, including transient market power, are curbed the Authority may be left with the choice of: (i) accepting non-competitive market outcomes, contrary to its statutory objective, or (ii) structural reform, including the break-up of Meridian.⁵

Yours sincerely,

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