

5 November 2020

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By email to MDAG@ea.govt.nz

Dear Sal

Review of the Trading Conduct provisions – Supplementary Consultation Paper

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Market Development Advisory Group (MDAG) supplementary consultation paper (slides) "Review of the Trading Conduct Provisions" dated 22nd October 2020.¹
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Some members may make separate submissions
3. MDAG's process since the last consultation round closed at the end of May has comprised:
 - Employing two separate independent expert panels to consider how the current HSOTC rules and the MDAG proposal would work for different case studies. Several submitters, including MEUG in our cross-submission, suggested further worked examples should be provided and discussed with the sector to assist in developing any code changes. MEUG appreciates MDAG taking up that suggestion and going further by innovating with the two independent expert panels. In our view this has been a helpful approach and advanced the discussion closer to a robust solution.
 - Opportunities for bi-lateral discussions with interested parties. Unfortunately dates and times for discussion with MEUG members kept changing and we cancelled the last proposed discussion because by that time this consultation had commenced.

We mention these recent processes because missing has been a multi-party open workshop discussion. MEUG members find workshops helpful for complex topics because they can hear directly from other parties on aspects of an issue not considered in detail or at all. This is important given there are no MDAG members from three of the largest suppliers, and in prior workshops Meridian Energy has assisted discussions by making expert advisors available.

¹ Refer URL <https://www.ea.govt.nz/assets/dms-assets/27/MDAG-supplementary-consultation-on-trading-conduct-v2.pdf> at <https://www.ea.govt.nz/development/work-programme/pricing-cost-allocation/review-of-spot-market-trading-conduct-provisions/consultations/#c18717>.

4. Missing from the slides is reference to MDAG undertaking a cost-benefit-analysis (CBA) comparing the revised MDAG proposal with a feasible counterfactual or as a default, the status quo.² Slide 14 mentions the expert panels had views on “on the comparative costs and benefits of the proposed and existing provisions from an applied perspective, which has strongly informed our (MDAG’s) revised proposal.” However, there is no summary of MDAG’s view on costs and benefits. The issue of MDAG having a CBA in support of its recommendations to the EA Board has been a hot topic to date. MEUG continues to recommend MDAG provide the EA at least some guidance, if a quantitative assessment is not possible in time, of the benefit and cost attributes to be compared. This is not trivial. But given the risks of unintended consequences we think a CBA is essential. For example, we think MDAG should support its final recommendation to the EA on its view of factors such as (these examples are not intended to be exhaustive or ranked in any way):
 - Incremental benefits.
 - Incremental compliance costs on participants and monitoring costs by the EA.
 - Will there be a change in the risk of vexatious breach allegations? (refer slide 12) and what is the probability and cost of that risk?
 - Will there be a change in the risk that the proposal “could unintentionally introduce de facto price control”? (refer slide 12 and further discussed in slide 14).
5. De-coupling the above benefits and costs from those associated with related work such as implementing new Market Making arrangements, improving wholesale market information disclosure, and more active monitoring by the EA of retailer internal transfer pricing, retailer profitability, contract prices and new generation costs will be complex but necessary. Consideration may also be needed to consider new regulatory precedents set by the final Undesirable Trading Situation (UTS) decision due by the end of this year on the UTS claim lodged December 2019.
6. On the details of the revised proposal MEUG notes:
 - Slide 14 reports that “Both panels considered that the current code was unsatisfactory due (among other things) to its lack of legal meaning and ambiguity.” On that basis we accept the status quo is unworkable and not a viable option for the future.
 - Slide 14 reports that “Both panels supported the adoption of an economic based test (as proposed by the MDAG), in preference to the current code.” MEUG agrees to the extent the phrase “economic based test” is a subset of and does not limit the interpretation of required outcomes to meet the “competition” limb of the EA’s statutory objective.
 - MEUG has no reason to disagree with proposed changes to the operative “rule” clauses 13.5A(1) and (2) on slide 17, i.e. these are the rules that apply to supplier offers and ancillary service agent reserve offers.

² Or the counterfactual might have to be a modified status quo given the report back by the expert panels that the status quo is likely to be unworkable.

- On the proposed revised purpose clause that is now a preamble clause (new clause (1)) and after the relevant operative “rule” clauses, a new clause (3) that explains when market power becomes “significant” (refer slide 18). MEUG notes, but has no view at this stage, on the discussion on slides 19 and 20 titled “Significant market power” and slides 21 to 23 titled “General observations” that are also largely about the use of “significant” market power compared to alternative measures of material changes in conduct. Once we have read the submissions of other parties to this consultation and if or when a cost-benefit-analysis has been undertaken, then MEUG will be in a better position to take an informed view on the use of significant versus other measures of market power.

One observation we can make is to confirm our agreement with the statement on slide 24:

“In our February 2020 consultation paper (Part D), we [that is MDAG] agreed with Prof Stephen Littlechild that from a first principle perspective, it is better to deal with potential market power ex-ante rather than ex post, focusing on structure and incentives in designing remedies (new entry, enforced divestment, contracts markets and the like), rather than on conduct.”

There is an argument that the work by the EA on the workstreams discussed in paragraph 5 of this submission are more likely to uncover innovative and needed interventions or facilitate market participants to voluntarily adopt new approaches to improve the wholesale market, than can be expected from trying to find the perfect form of a trading conduct rule.

MEUG’s current pilot analysis of Meridian Energy’s economic performance over the last two decades will, if the pilot proves worthwhile, complement the EA’s work monitoring and market facilitation work listed in paragraph 5. That pilot analysis could, for example, lead to voluntary adoption of standardised disclosures to allow longitudinal sector and individual company comparative economic performance monitoring of the large vertically integrated suppliers. Trends from a multi-year analysis of economic performance will assist policy makers and interested parties understand if ex ante interventions need to be considered and monitor ex post the effects of major policy steps, e.g. did the 2010 structural changes to Meridian Energy change the trend of economic performance by the company and the sector as a whole after compared to before 2010?

7. We look forward to reading MDAG’s recommendation to the EA.

Yours sincerely



Ralph Matthes
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