

From: Ralph Matthes
To: Andy Doube; S9(2)(a); Doug Watt
Cc: S9(2)(a)
Subject: MEUG - EA Market review - EA response to written MEUG questions and clarification of process
Date: Friday, 5 November 2021 4:43:21 pm
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Thankyou Andy, cc S9(2)(a) and Doug
cc MEUG members and advisors S9(2)(a) (NZIER) and S9(2)(a) (FL)

Appreciated the phone call and informal discussion clarifying process that you have summarised in the email below.

Will work through the detailed written answers and follow up as appropriate.

S9(2)(a) will talk directly with S9(2)(a) and Doug for access to data as you have offered. In relation to the profit analysis information, can you email a copy of the generic s.46 letter and the blank spreadsheet template. Once seen that will decide if we want to take next step of asking for data provided by suppliers. No point asking you and suppliers to incur those transaction costs if what you provide is sufficient for us to gain more understanding of the analysis in the review report to assist us in making relevant submissions.

Have copied this to all MEUG members and our advisors S9(2)(a) (NZIER) and S9(2)(a) (FL). Members and advisors please note that attached are (1) EA written reply to our questions (.doc) and (2) MEUG's original questions in .pdf that contains some additional explanatory/background information.

If members have further questions on the EA reply, please email/call either me or S9(2)(a).

Kind regards

Ralph

M S9(2)(a)

From: Andy Doube S9(2)(a)
Sent: Friday, 5 November 2021 4:01 PM
To: Ralph Matthes S9(2)(a)
Cc: S9(2)(a); Doug Watt S9(2)(a)
Subject: Authority responses to written MEUG questions (1)

Hi Ralph

Thanks again for the call just now. As I said, your members raised a few questions yesterday that looking back I could probably have done a better job at replying to in-session. It's always a bit hard talking in big meetings via zoom though.

I got your note yesterday evening about the questions you had sent though too. The team spent a bit of time going through them in detail this morning and we've tried to answer in as much detail as we can – see attached (get a hold of **S9(2)(a)** if you have anything more, he's probably a good first port of call). I hope these help – and if there is anything further you need let me know and we'll come back to you (it's a tad busy at the moment – so apologies now if it takes a few days though).

Just to reiterate around process:

- There are two papers – research paper (the review paper) and issues paper (Tiwai paper). Looking for submissions on both
- I think the way to think about the research paper is that it forms the focus for our work on the wholesale market going forward – at the heart of it the question is how we turn the red and amber traffic lights from page 8 onwards green.
- The Tiwai paper is just the first cab off the rank in our response to the research paper – it's not supposed to be a full response, but really is just the first thing. We think it's important to deal to this issue as a first step though because of the size of the potential issue and the size of impact on consumers (including many of your members).
- But the Tiwai paper (and the potential options in there) is only a first step. As well as getting feedback on that paper, we really want to better understand the relative priorities of those other issues, and whether there are ones we're missing.

Give me a bell if you want to chat more about process.

Thanks Ralph, talk again soon, Andy

Andrew Doube
General Manager Market Policy

+**S9(2)(a)**

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What new initiatives are proposed in the consultation papers for further investigation or implementation that will lower prices between 2022 and 2024 to those expected in a workably competitive market compared to the status quo policy settings?

With the Review (information paper) and the Issues paper (discussion paper) the Authority is consulting on actions or interventions that could be taken to improve market outcomes. At this stage the Authority does not have specific views on interventions or actions that would resolve short-term concerns over the next 2-3 years.

The options identified in the discussion paper are targeted at inefficient price discrimination, and are not intended to be exhaustive. The intent is to obtain the views of stakeholders on the materiality of the issue and possible solutions.

As discussed, we are also seeking stakeholders' views on the wider Review. The aim is to get interested parties' views on the completeness or otherwise of the indicators used, new evidence to improve our understanding of the performance of wholesale markets, and future workstreams that have the potential to transition red and orange observations into the green (see [Table 2: Summary of Structure, Conduct and Performance Indicators](#).) The issues you raised below are all legitimate topics (e.g. economic withholding analysis, unpicking the dummy variable, profit analysis in the Information paper and modelling the effect of generation investment on generator incentives) for inclusion in your submission.

Submissions will be received in December 2021, and form the basis of advice to the Board in Q1 2022. That advice will encompass the Authority's future work programme in wholesale markets, and possibly any shorter term actions for consultation (over and above those already being considered with respect to inefficient price discrimination) where the Authority believes it has sufficient information to consult. Until that time it is premature to suggest specific proposals that could have the effect of lowering prices in the short term.

Finally, the behavioural responses of generators in reaction to the new trading conduct rules introduced post the review period are still playing out. The Authority will be monitoring these closely including the implications for the wholesale review's findings and the Authority's future work priorities.

Has the EA a view on the GIC recommendations?

The Authority is still considering the GIC recommendations.

Is the EA able to provide upper and [lower] bounds for the estimated effect of withholding on wholesale prices in the same way as the EA did for the Meridian/Tiwai contract?

The paper presents a series of indicators as a way of drawing a picture about offer behaviour relative to proxy measures of cost. The review paper does not conclusively find that economic withholding occurred. Three things make quantifying economic withholding difficult:

- Any generator with storage makes an inter-temporal trade-off between generating or storing, and that decision depends on their (unobservable) expectations of future outcomes. This is true of the vast majority of NZ generation.
- It is difficult to distinguish between withholding to maintain sufficient fuel for future generation, and withholding to increase the price.
- Since the Pohokura outage there has been less effective capacity in the market as some thermal generation could not access gas at any price, providing less discipline on pricing from other generators. This implies that the market clears at a steep part of the supply curve

and hence small changes in behaviour can have a material effect on price. This sensitivity contributes to the difficulties in attributing outcomes to 'fundamental' supply drivers or the exercise of market power.

We would welcome feedback on how to think about these issues and quantify their effects.

Is the EA planning to continue investigation on this unexplained shift in prices of almost \$40/MWh?

To provide some additional context on the analysis, the dummy variable starts when Pohokura went on outage. We published this analysis in 2020 and considered the dummy to be a proxy for gas supply risk. As it is significant, we concluded we had evidence that gas supply risk was affecting the spot price. However, the reviewers pointed out that this dummy could include some exercise of market power. We have tried to identify this, but we have been unable to disentangle these two effects.

We can assure you that the Authority is committed to seeking to better understand what might be driving this change, and to the extent these causes have policy implications, seek to address them. The invitation for stakeholders to provide submissions is the first step in trying to better understand what might be behind the unexplained variation. As discussed, above the work programme and any additional immediate policy responses will be developed post this submissions process. We would welcome any ideas on the drivers of this unexplained shift, and on how we could develop better analytical frameworks to address such issues. Evidence-based submissions on the drivers of this unexplained shift that are supported by data are useful as they allow us to test the drivers in our model.

Will the EA:

- 1. Release spreadsheets for the data used in the charts and equation fitting in the 'INFORMATION PAPER'?*

We can provide the specific data and the code that underpinned this work, though the analytics were not undertaken in spreadsheets. Please get in touch with Doug directly about the best way to make this data and code available.

- 2. Provide briefings and opportunities to ask questions about the analysis techniques used in Appendixes A to E of the 'INFORMATION PAPER'?*

The Authority is happy to hold follow up one-on-one meetings to discuss technical issues. Additionally, feel free to direct any questions about the analysis to Doug.

- 3. Issue a list of consultation questions that expands on the statement 'feedback on our analysis, including the indicators used.' To a level of detail that is comparable to questions for the options?*

Your observations in this regard have been helpful. To avoid any potential confusion, we intend to release an expanded set of questions that will provide greater clarity around the types of feedback we are seeking on the Review paper. Specifically, we are seeking feedback on the completeness of the set of indicators, further evidence stakeholders have to inform the Review, what the observations in the Review imply the Authority's work programme, and possible solutions.

Following on from the prior question, a topic of particular interest to MEUG is identifying and implementing useful metric to monitor aggregate sector economic profit trend. Can the EA publish

the letter sent to the 4 largest suppliers requesting information in terms of section 46 of the Act, the data provided by suppliers to that request and other information used by Concept for the profitability analysis in the 'INFORMATION PAPER', and the analysis? The 42 questions in Appendix A of the 'DISCUSSION PAPER' do not include a request for feedback on the profitability analysis in the 'INFORMATION PAPER.' Is this consultation an opportunity for feedback on the profit analysis or should we engage separately with the EA?

The data used for the Authority's analysis of profitability is confidential. We would need to check with the generators as to whether we can provide it. We can provide the blank spreadsheet template we gave to the generators for this non-public information.

The profitability analysis is one of the indicators used in the Review paper, so we expect feedback as part of the submission process for the Review paper (Information paper). The Discussion Paper is concerned solely with the indiscriminate price discrimination issues, and therefore does not relate to the profit analysis in the Review paper.

We are happy to receive feedback from MEUG on the economic value added analysis that you have undertaken for Meridian and are in the process of undertaking for Contact. We would appreciate it if the methodology used could be described in sufficient detail to make it possible for others to replicate what you have done. We would also welcome insights from you about the policy implications that you identify from this analysis, both in isolation and in the context of our review.

The EA comments in the 'INFORMATION PAPER' about investment in generation include 'A reasonable number of signalled projects remain unbuilt, but only a small number of projects seem likely to proceed to the commissioning stage.' and 'The total quantity of definitely committed investment projects is not enough to replace existing thermal generation. And at least 75 percent of this committed generation is from generator-retailers.' These comments seem to be based largely on an interview-based analysis completed by Concept Consulting for the EA.

- 1. Does the EA intend to model scenarios for the potential effect of this outlook for generation investment on generator incentives and capacity for economic withholding in the short to medium term?*

MDAG are looking at the transition path to 100% renewables, and the implications for market outcomes. Staff are happy to discuss near- and longer-term incentives with you if that is useful.

- 2. Has the EA compared the comments on the short-term outlook for generation in the Wholesale Market Review with the generation investment rules used in the TPM CBA modelling?*

The cost-benefit analysis of the TPM has a 28 year horizon. In contrast, the Review surveyed current and near-term intentions.