

Submission on UTS draft decision

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I believe that the events of 26 March 2011 did not constitute an Undesirable Trading Situation. They merely demonstrated what should have been known to everyone associated with the electricity market. That, as McDiarmid (*A Modest Proposal: Revoke the Nobel Prize? Recognize the Limitations of Theory? Or Grant a License to Steal?* Robert C. McDiarmid, Lisa G. Dowden, and Daniel I. Davidson) has said, "When constraints exist, the price is a trade-off between Greed and Guilt."

In fact, in this case, I do not even believe that the problem was greed. It seems to me that a plausible explanation is that Genesis, based on the fact that the "last" unit at Huntly is not earning its keep, took (aided and abetted by Contact?) quite understandable advantage of a situation where they could recover some of their losses. The fact that, as a result, vast amounts of money finished up in the hands of other generators who were also generating at the time, is simply a consequence of the fact that the electricity market design is fatally flawed.

It is fundamental to the operation of a power system that there be adequate reserve capacity. This is particularly so in the case of a New Zealand system where we have periodical droughts and a high dependence on hydropower. (And now, to an increasing degree, windpower.)

In normal commerce, people protect themselves against unusual risks by purchasing insurance. There is a blind belief that hedges provide the necessary insurance in electricity markets. 10 years of operation of the market demonstrates—to me at least—that they don't. And, from the perspective of major users it is simply not possible for any large industry in New Zealand to predict its electricity demand in the same time frame that is required to first build, and then ensure the income for, a new power station. This would be a minimum period of 25 years.

But insurance is designed so that "The burden falleth lightly on many rather than heavily upon a few." To do this in the electricity market, hedging would have to be universal, uniform and long-term rather than by individual actions by a few participants.

Such insurance can be achieved easily in a coordinated electricity market in which competition is ensured—and is real—because the market is for building and operating individual power stations against long-term contracts offered by the Central Buyer.

I believe that, by declaring the incident as a Undesirable Trading Situation the Electricity Authority has dodged this central issue and come up with a solution that is incompatible with his own statements regarding the need for pricing to be, at times, high enough to reward people for holding reserve generation.

While there are good reasons for the Electricity Authority coming to this decision, there is no reason whatsoever that the Electricity Authority should have also evaded the implications of the decision and looked to providing New Zealand with a real electricity market that could provide a reliable supply of electricity at a realistic—and predictable—price.