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Submissions
Electricity Authority
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Todd Energy Submission on Draft decision regarding alleged UTS on 26 March 2011

Todd Energy has reviewed the consultation paper regarding the alleged Undesirable Trading Situation (UTS) on 26 March 2011.

We believe that the Electricity Authority (EA) is incorrect in its draft assessment that an undesirable trading situation has occurred and further that the proposed actions to reset prices at relatively low prices will have a number of negative unintended consequences in the future.

Todd Energy does not agree with the assessment of the EA that Genesis Energy successfully applied a "market squeeze". Opportunities existed for parties to seek competitive priced hedges from at least two parties as well as notify consumers who could reduce demand or start backup generators in order to avoid exposure to the high spot prices and/or reduce the market clearing price.

If the EA confirms its views and acts to set prices at the prices levels indicated in its draft decision, which we believe are too low in any case, this will create incentives for further such claims whenever high price situations occur in the future and create slippery slope risks for the Authority due to the precedent set.

We note that a similar action by EA's predecessor, the Electricity Commission, in 2008 resulted in protection of parties who were then exposed to high spot market prices, by setting the offer price for Whirinaki at a price below the short run marginal cost of that plant. That action was criticised in the subsequent Ministerial inquiry which also recommended the creation of the EA. To now act to protect those who have consciously elected to take spot market price risk is a mistake and penalises those who have been prudent and hedged their risks.

Repeated reinforcement by the market regulator body that it will act to protect parties from the negative impacts of significant high price events in our opinion is a contributing factor in the limited hedge activity seen in the market. Those parties who do not have generation to match their retail exposure, and in some instances consumers who are fully exposed to spot prices, will have a reduced incentive to seek adequate hedge cover or manage demand. Todd Energy is a net generator, however, it has been prudent and elected to purchase hedge cover to mitigate certain risk periods. The EA's draft decision, if finalised, sends the signal that there is reduced or capped financial risk from exposure to spot market prices and we do not believe that is the correct signal to send to market participants.

A decision to reset prices as proposed would create disincentives for:

- participants who elect to take spot market price risk to manage that risk through mechanisms that are and have been readily available such as real time notifications of spot prices via SMS messaging services;

- investment in peaking generation;

- participation in future initiatives planned by the EA including demand side management, locational pricing risk and developments in hedge markets.

The EA's decision to interfere and modify genuine generation offers made by a participant is without precedent in the electricity market especially when that participant has not been found to have breached any rules or laws. Such a decision we believe will harm the integrity and reputation of the market in the same way that the EA believes that high prices due to a desirable trading practice (which we do not accept has occurred in this instance) would. This ultimately will impact on investors future decisions when considering generation or demand management initiatives.

Please find attached our response to the questions posed in the consultation paper.

Yours sincerely

Charles Teichert
Todd Energy

Todd Energy response re Draft Decision on alleged 26 March 2011 UTS

Question	Response
Has the Authority accurately recorded and interpreted all of the salient facts in regard to this matter? If not, please detail the inaccuracies.	No. Generally we agree with much of the EA's analysis and the conclusions regarding Genesis's conduct. However there are several key facts or conclusions which we believe are not correct that possibly have led to the EA's initial finding of the existence of a UTS. 1) The EA concludes that the demand forecasts (that were later proved to be inaccurate) led participants to believe that high prices were not going to occur and left them with insufficient time to respond once it became apparent that the prices would be very high. It is generally known and accepted that the demand forecasts and in particular the day ahead demand forecasts, are notoriously inaccurate and cannot be relied upon. Therefore the fact that sophisticated traders put their faith in such forecasts when considering hedge offers shows a degree of naivety or recklessness. The information regarding Genesis offers would have been apparent not only from day ahead price forecasts but also from any rudimentary analysis of the market supply curve information for 26 March available through WITS from 1300 on 25 March onwards. The fact that Mighty River Power approached Genesis and requested hedge cover indicates that Mighty River Power was aware of the risks and was in a position to mitigate them at prices far lower than the interim prices and also lower than the prices proposed by the EA. Mighty River Power and Meridian (the main direct spot market participants claiming UTS) and other participants also had the opportunity to seek hedges from Contact Energy who would be in a position to offer hedges by virtue of the peaking plant in Taranaki and Otahuhu B. We also understand that Contact Energy has a swaption with Genesis for the very purpose of mitigating locational price risk. 2) The EA also concludes that consumers exposed to spot prices were not aware of high spot prices on the day and therefore could not respond and manage their demand accordingly. Consumers that elect to take spot price risk in order to take advantage of low spot prices relative to fixed price contract prices should make use of several tools available to them directly or indirectly in order to manage price risk. Such tools as price alerts through WITS and access to real time prices through WITS FTA have been available for some time allowing participants easy access to information necessary for them to manage spot price risk. It is also incumbent on suppliers to ensure that the

Todd Energy response re Draft Decision on alleged 26 March 2011 UTS

Question	Response
	customers who elect to take such risks for the benefits of low spot prices are informed about those risks and have the opportunity to take advantage of the tools and mechanisms available to them to manage spot price risk through demand management. We note that a reasonable number of the UTS claimants include organisations that could be reasonably be expected to reduce demand in the face of high spot prices or make use of backup generators to manage risk. It is up to those parties to put in place the appropriate arrangements to ensure that they are in a position to do that If consumers believe that they have been misled with regards to the risks that they have been exposed to and without the prospect of mitigating those risks then they should seek redress with their supplier as their may well have been breaches of the Fair Trading Act. Generally consumers that seek full or partial exposure to the volatile spot market see value in purchasing lower price power for significant periods of time rather than enter into fixed price variable volume (fpvv) contracts that are the standard for most consumers. Over the last two years, electricity spot prices have been significantly lower on average than the prices available on an fpvv basis. It would be wrong to review one day of high spot prices in isolation from all the other time periods where spot prices have been relatively low. **HLY2201 Daily Average** — **Interim** — **$1,500** — **$3,000** 26 March 2011 — $5,941.85 — $1,126.79 — $689.29 1 April 2010-31 March 2011 — $70.44 — $57.25 — $56.05 1 April 2009-31 March 2011 — $63.76 — $57.17 — $56.57 As can be seen above the long term average spot price movement between the three scenarios is not that significant and spot prices are still lower than fixed price contract prices available over the same period of time if Interim prices were retained. Certainly, if Interim prices are discarded in favour of EA set prices, this will send signals to participants who would normally hedge spot price risk that spot price exposure is capped by the EA and will discourage parties from entering in fixed price contracts or hedge agreements in the future. We note that there is no proposal to set a floor price to compensate those parties that took action either historically in the way they managed risk contractually or during the day to mitigate their risk through demand curtailment or operation of high price

Question	Response
	backup generation.
Do you agree with the Authority's draft decision that the situation existing on 26 March 2011 constitutes a UTS? Please give reasons for your answer.	No. Genesis has been found to not been in breach of any law, regulation or rule and that there was no deceptive or manipulative conduct. The reasons articulated by the EA for their initial views that a UTS has occurred is that Genesis were able to apply a "squeeze" to the market and that was an undesirable trading practice resulting in high prices that should be corrected. The EA also found that parties had "good" reason to believe that the Genesis's attempt at a squeeze would not be successful and that it was too late for them to take action to mitigate losses when that was found to be incorrect. The EA's explanation of a "squeeze" provided by consultants of Mighty River Power says that in order to apply a squeeze a party must have control over a very large proportion of long (bought) futures and the parties that are short in futures are unaware of this until it is too late. Todd Energy does not believe that the March 26 prices resulted from a market squeeze. 1) Genesis was not the only party that could have supplied and controlled price on 26 March. Contact Energy could also have run TCC and/or the Stratford peaking plant resulting in much lower prices depending on their incentives to generate. It appears that neither Meridian or Mighty River Power approached Contact Energy on or before 26 March for hedge prices. 2) It is a well known fact that demand forecasts and in particular day ahead forecasts are notoriously inaccurate. That two large and sophisticated participants would rely on such forecasts to manage what would have been a significant financial exposure appears at best naïve and at worst negligent. Mighty River Power sought and received hedge offers on Friday 25 March and could also have sought hedge offers from other parties such as Contact who would have been in a position to prevent Genesis applying a squeeze. It is also notable that the prices Genesis offered to Mighty River Power were far lower than the caps proposed by the EA presumably because Genesis understood that its ability to determine prices on a day was subject to competitors actions such as Contacts operations at TCC and/or Stratford again casting doubt on Genesis's ability to apply a squeeze from which affected parties could not escape. It appears that not all market participants (Trustpower, Contact

Question	Response
	Energy, Todd Energy and King Country Energy) were affected by the high price events presumably because they had arrangements in place or physical supply to mitigate their exposure. In Todd Energy's case, generation in the Taranaki region mitigated exposure to the high prices of 26 March. In summary, we do not believe that the situation can be accurately characterised as market squeeze by Genesis given that affected participants should: a) have reasonably been expected to foresee the potential for an attempted market squeeze on Friday 25 March; b) have acted to mitigate those risks by seeking competitive hedge offers from Genesis as well as Contact. That Mighty River Power sought hedges on Friday 25 March indicates that they had indentified the risk and made a conscious decision to decline offers and accept the risks instead; c) even if there was uncertainty about what prices would be on the day before, affected parties still had the opportunity to seek competitive offers from Contact and Genesis (or even Todd for that matter) on 26 March which they did not or if they did it was very late in the day. d) MRP and Meridian could and should have notified their customers exposed to spot prices and make them aware them of the situation. Demand response from customers may well have been sufficient to not only mitigate the affects of the high prices for their customers but also may well have had the affect of reducing the clearing price to the benefit of Mighty River Power and Meridian as well. The fact that they did not do so shows a high level of disregard for their customers and a lack of preparation. The EA also concludes that letting the high interim prices become final prices resulting from an undesirable trading practice such as the application of a market squeeze undermines the integrity, reputation of and confidence in the electricity spot market. We disagree with this assessment on the basis that there was no market squeeze and to proceed with the proposed resetting of prices would do exactly that which the EA is trying to avoid. There would also be the unintended consequences of creating an environment where parties expect to be shielded from market risks through the UTS regime and reduce the incentives for participation in some of the market initiatives currently being develop by the EA such as hedge market liquidity, locational price risk management tools such as FTR's and demand side management.

Todd Energy response re Draft Decision on alleged 26 March 2011 UTS

<table>
<tr><th>Question</th><th>Response</th></tr>
<tr><td>Do you agree with the draft remedial actions that the Authority intends to take to correct the UTS? Please give reasons for your answer.</td><td>No for the reasons provided above.

In addition we do not believe that the price levels prescribed are appropriate for a number of reasons including:

1) The $1,500 and $3,000 price levels are based on modeling of prices required to justify hypothetical peaking plant investments. The assumptions underlying the economic modeling have several flaws including but not limited to:

Huntly Model
• NPV analysis is for 10 years with no capital expenditure which is significantly at odds with statements from Genesis in the media regarding their plant and the future O&M costs required to maintain it in a working order.
• Delivered coal costs are significantly lower than delivered prices for thermal coal based on international coal prices. Todd Energy's internal modeling of delivered coal prices excluding carbon is $5.20/GJ based on international coal prices of $US100/tonne at todays exchange rates. We understand that thermal coal prices are currently trading at $US150/ton resulting in a delivered coal price of $7.50/GJ excluding carbon.

OCGT model
• NPV analysis is based on a long term fully variable delivered gas price of $6.50/GJ for the next 25 years. This appears to be considerably understated compared to Contact Energy's published gas costs of circa $10/Gj delivered which better represents current gas market prices. Long term gas prices also need to reflect take or pay terms and/or costs of storage. We think a better assumed long run gas price for a peaking plant and its variable offtake profile would be the same as the imported LNG price of around $15/GJ.

2) There have been other high price events in recent times that have not attracted UTS claims. For example, on 17 March 2011 an HVDC outage resulted in North Island prices of $4,200 for several trading periods. We would therefore expect prices to at least exceed $4,200/MWH;

3) The Whirinaki reserve generation plant has been offered into the spot market at a price of $5,000/MWh since March 2010 and has been dispatched at that price very sporadically. The EA recently confirmed the Whirinaki offer price at $5,000 after initially proposing the plant to be offered at its SRMC. The decision to retain the $5,000 price offer was based on fears potential incentives on peaking plant generators who may withdraw plant from service as a result.</td></tr>
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Question	Response
	4) The EA's scarcity pricing paper dated 28 March 2011 proposes a *minimum* price floor of $10,000/MWh for shortages of generation capacity in real time which this event has the most similarity with in relation to the 4 scenarios depicted in the scarcity pricing paper. We would therefore expect prices during 26 March to at least equate to the minimum price floor of $10,000/MWh given that if Transpower did not dispatch Huntly short term involuntary load shedding would have been the likely outcome. If the Commission does impose a price cap for March 26 then we believe a price cap of at least $10,000/Mwh should be adopted consistent with the EA Scarcity Pricing proposal.
Are there any other remedial actions that the Authority should take to correct the UTS? If so, please detail the other actions and give reasons for your answer.	No. There was no UTS.