

# Proposed actions from final UTS decision in relation to 26 March 2011

Submission to the Electricity Authority



From Contact Energy Limited

  
**contact**<sup>™</sup>

This submission is provided by Contact Energy Limited (“Contact”) in response to the *Consultation Paper – Proposed actions of the Electricity Authority under Part 5 of the Electricity Industry Participation Code to correct an Undesirable Trading Situation that occurred on 26 March 2011* (the “consultation paper”) issued by the Electricity Authority (the “Authority”) on 15 June 2011.

For any questions relating to our submission, please contact:

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# Comments on proposed actions

## Prices should be determined by actual market forces, not regulatory intervention

Contact is disappointed that the Authority has largely confirmed the proposed actions from its draft Undesirable Trading Situation (“UTS”) decision; to reset prices relating to 26 March 2011 after the fact.

The Authority’s proposed actions are based around simulating what prices may have been under certain conditions that didn’t actually exist on the day. Prices should, however, reflect conditions that were actually present, particularly in relation to how plant was offered and actual demand (including actual demand response).

## Ex post price resetting will send the wrong messages to participants

Retrospective resetting of prices will:

- create regulatory uncertainty;
- risks disincentivising parties from putting appropriate risk management in place<sup>1</sup>; and
- could dampen investor confidence in projects that support security of supply.

The Authority has asserted a different view about the likelihood of these outcomes eventuating, even though that is not consistent with comments made by other market participants. The final decision does not give adequate support for the Authority’s position in relation to its potential ramifications.

## Focus should be on informing participants about appropriate risk management and facilitating provision of information

Rather than insulating parties from risk via price resetting, the electricity market would be better served if the Authority focussed on initiatives that help inform participants to put risk management arrangements in place that are appropriate to their circumstances.

Even though the Authority identifies significant issues around information provision (e.g. the accuracy of forecasting information), the final decision offers no solutions in this regard. The failure to include or reflect such a significant and important workstream in the Authority’s list of actions is concerning, and is only likely to further entrench existing inadequate risk management choices and practices.

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<sup>1</sup> This could be in relation to management of water, thermal unit commitment or financial hedges.

## **Additional comments on UTS process**

### **UTS as a remedy for adjusting the outcomes of risk positions**

Contact has outstanding concerns around the use of the UTS process as a remedy for parties who have consciously taken on certain risk positions. Contact has previously outlined the potential consequences that it believes could arise from such intervention.

### **Pro-actively engaging with the sector**

The Authority has indicated<sup>2</sup> that a key element of its strategic focus for its first year is to pro-actively engage with the sector. Contact did not experience such engagement in relation to the Authority's consideration of the UTS. Contact requested to meet with the Authority on a number of occasions, but this opportunity was not taken up (even though we understand meetings were held with other parties). Contact also asked several times for the position relating to its Stratford plant to be clarified but the final decision does not do this.

Other submitters' comments that don't support the decision have also apparently been ignored, given the lack of reference to them in the decision.

Reliance on formal information requests, with short response timeframes for participants, also created an unnecessarily formal and stilted process.

Notwithstanding the foregoing, Contact remains committed to engaging proactively with the Authority on an ongoing basis.

### **Timing between key steps in UTS process**

The Authority has acknowledged that the amount of time it has taken to make the UTS decision was frustrating<sup>3</sup>, but says that it was necessary to enable it to assemble all the facts and do rigorous analysis. Given the lack of changes, however, between the draft and final UTS decisions (in both substance and actual changes to the drafting); Contact is not convinced the process was as efficient as it should have been, and questions whether much of the consultation was meaningful.

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<sup>2</sup> Refer to page 2 of the Authority's 16 June 2011 briefing to Regulatory Affairs Managers & Consumer Representatives

<sup>3</sup> Refer to page 7 of the Authority's 16 June 2011 briefing to Regulatory Affairs Managers & Consumer Representatives.

## Consideration of feedback from participants whose actions contradict the Authority's assumptions

The Authority's final decision, including the proposed actions, relies heavily on its assumptions about what participants (particularly on the demand side) would have done differently if they had been aware that prices could reach ~\$20,000/MWh (and be confirmed as final). This appears to be used as justification for the decision to set Huntly offer prices to \$3,000/MWh for the relevant trading periods.

However, Norske Skog and King Country Energy both submitted to the Authority<sup>4</sup> that they *did* take action in response to price signals. Instead of making use of these real time responses though, the final decision uses a proxy for *possible* demand response<sup>5</sup> based on 2008 grid support contract offers. Even then, the value of this proxy is hugely subjective, with the UTS Committee simply deciding to take \$1,000/MWh off the low end of the offer range for these contracts, to reach the proposed \$3,000/MWh figure (we can only conclude that this was done so it matched the upper end of the draft UTS decision range of \$1,500/MWh to \$3,000/MWh).

As a result, the proposed actions do not adequately deal with the actual experiences of submitters where they differ from the Authority's assumptions based position, or give adequate weight or significance to them.

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<sup>4</sup> See Contact's cross submission on <http://www.ea.govt.nz/our-work/consultations/uts/26Mar11/submissions-for-draft-decision-regarding-alleged-uts-on-26-march-2011/>

<sup>5</sup> Refer final UTS decision, page 45.

## Specific answers to consultation questions

<p>Q1 - Do you agree with the proposed actions that the Authority intends to take to correct the UTS?</p>	<p>No. Contact believes retrospective resetting of prices will create regulatory uncertainty, risks disincentivising parties from putting appropriate risk management in place, and could dampen investor confidence in projects that support security of supply.</p> <p>Contact believes final prices should reflect the conditions that were actually present, particularly in relation to how plant was offered and actual demand (and demand response).</p>
<p>Q2 - Are there any other actions that the Authority should take to correct the UTS? If so, please detail the other actions.</p>	<p>Contact believes that the Authority should continue to pursue workstreams which will improve parties' ability to manage risk (e.g. scarcity pricing, dispatchable demand etc.) and work to address the information issues identified in the final UTS decision. For example, errors in forecast prices were identified as contributing to the outcomes of 26 March 2011. Information on bid accuracy over time could be produced to help improve the accuracy of those forecasts, at a very low cost.</p>