



21 June 2011

Dr Brent Layton
Chair
Electricity Authority
PO Box 10041
Wellington

(via email)

Dear Dr Layton

Proposed actions of the Electricity Authority under Part 5 of the Electricity Industry Participation Code to correct the Undesirable Trading Situation on 26 March 2011

Powershop appreciates the opportunity to comment on the Authority's proposed actions regarding the undesirable trading situation (UTS) on 26 March 2011. Powershop's submission is contained in this letter.

Discouraging manipulative behaviour

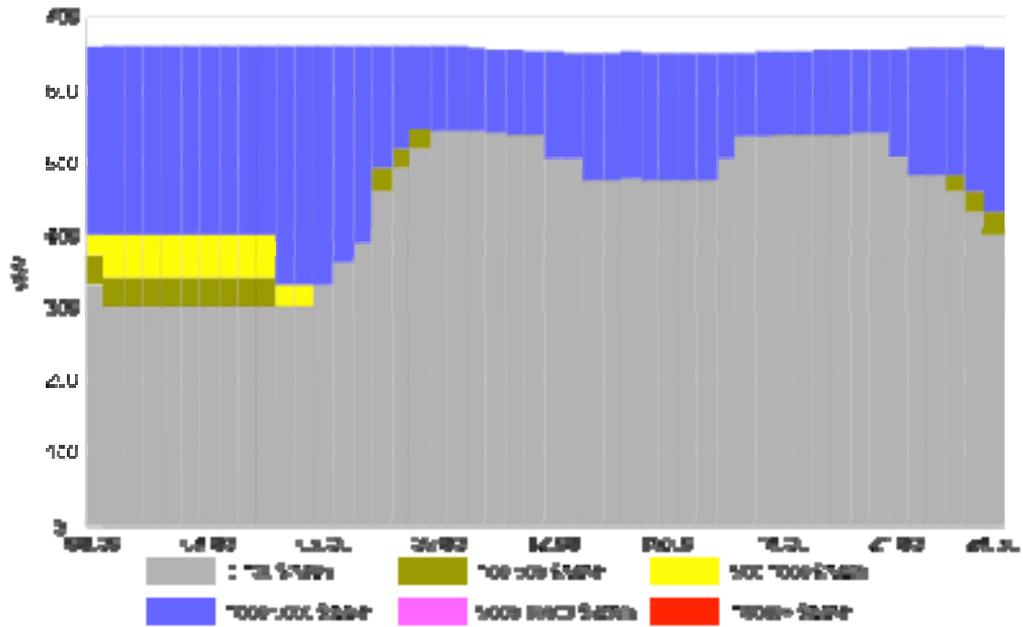
Powershop supports the Authority's finding that there was a UTS on 26 March 2011, however we're concerned that the Authority has concluded that Genesis's behaviour wasn't manipulative. Genesis took advantage of the transmission outage and changed their offer strategy to exploit market conditions to their own advantage as plainly demonstrated in the charts of their Huntly offers below. The extreme pricing outcome was clearly an intended consequence; this is an example of prima facie market manipulation:



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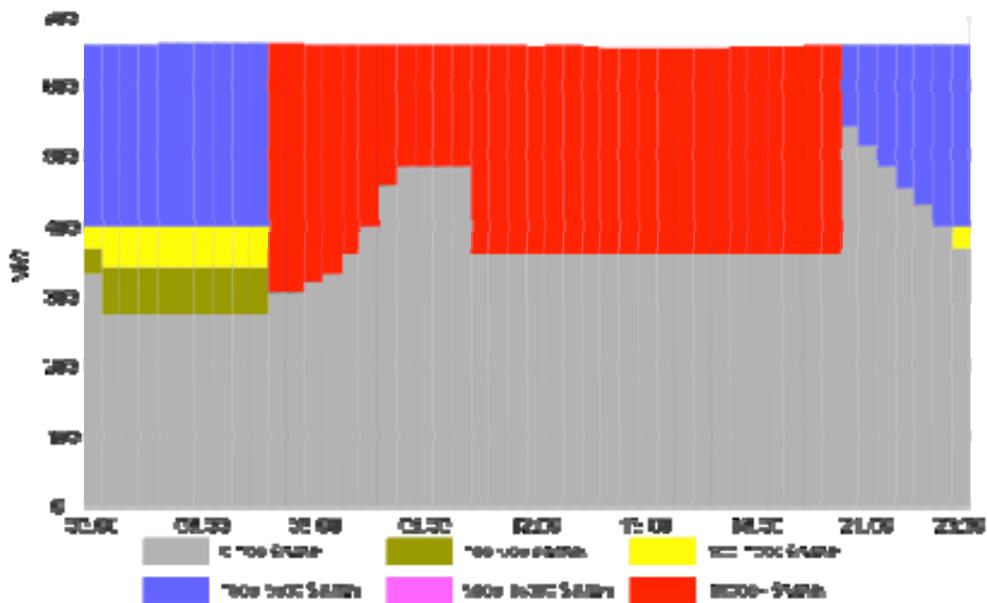
The Smarter Way to Buy Power

Figure 2 Hourly offers for 25 March 2011 valid at 00:01 hours, Friday 25 March 2011



Source: Electricity Authority

Figure 4 Hourly offers for 26 March 2011 valid at 00:01 hours, Saturday 26 March 2011



Source: Electricity Authority



The Authority's decision is rash in concluding that the facts don't support the claim that Genesis engaged in manipulative activity and is at odds with economic and legal tests (*Pirrong, Energy Market Manipulation: Definition, Diagnosis and Deterrence, in the Energy Law Journal, 2010*). The decision fails to outline what it considers manipulative activity to be and why the facts don't support the claim.

To restore confidence in the wholesale market we recommend the Electricity Authority revise its finding and declare Genesis' behaviour as an unacceptable act of manipulation.

Resetting prices to an efficient level

Powershop supports the Electricity Authority taking action to revise prices for 26 March, however we consider there is an error in the Authority's logic that:

'To this end, the design of the remedy ought to be directed at restoring prices in the wholesale market for electricity to the level they would have been had buyers been aware that Genesis Energy would be net pivotal on 26 March 2011 and those buyers had had the opportunity to arrange an alternative source of supply or to curtail demand.' (Para 162)

The objective of the remedy should be to reset prices to an efficient level, which is the price in the absence of the transmission outage where Genesis faced competitive pressures. This is not the cost of alternative supply or the cost of curtailing demand. In fact the decision describes arranging alternative supply as a market inefficiency arising from extreme prices resulting from the UTS:

'The exceptionally high interim prices on 26 March 2011 are not the result of an underlying supply- demand imbalance, e.g. inadequate capacity or fuel, and they appear to bear no resemblance to any underlying or unavoidable cost. It is in the public interest to have an electricity market in which all participants can be confident prices are competitively determined. If participants observe that prices are greatly divorced from supply-demand conditions and are excessively higher than underlying costs, they will lose confidence in the integrity of the market arrangements and the incentive structures surrounding the wholesale market for electricity may be greatly damaged.

For example, a lack of confidence in the wholesale market for electricity could result in highly inefficient investment signals – consumers in the upper North Island might **install emergency generation to be used at times of exceptionally high prices**. It would be highly inefficient, and contrary to the public interest, if this were to occur in the presence of existing generation that could otherwise be operated profitably.' (Para 147 -148)

Similarly, unnecessary demand curtailment will have wider economic impacts that don't reflect a true demand supply balance

Resetting prices at the cost of alternatives also encourages this behaviour in future which is highly undesirable in a small market, where transmission outages are an everyday event.



Powershop strongly submits that Huntly offers during periods when there was no transmission constraint should be used as a proxy for SRMC. SRMC provides more accurate price signals for both buyers and investors. SRMC will also have the highly desirable effect of discouraging generators from exploiting transmission outages which is in the long term interest of consumers.

If you have any questions about this submission please contact me.

Yours sincerely

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