

Wholesale Advisory Group

Chair's half-yearly report to the Electricity Authority Board

January 2012 to early July 2012

12 July 2012

Note: This paper has been prepared for the purpose of the Wholesale Advisory Group. Content should not be interpreted as representing the views or policy of the Electricity Authority.

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1 Introduction

- 1.1.1 The Wholesale Advisory Group (WAG) was established by the Electricity Authority (Authority) in May 2011 to provide independent advice to the Authority on the development of the Electricity Industry Participation Code 2010 (Code) and market facilitation measures, focusing on the relationships between the generator/retailer/large customer and service providers.
- 1.1.2 The role of WAG is to provide independent advice to the Authority on the development of the Code and on market facilitation measures, focusing on:
- a) Development of the wholesale electricity market, including matters relating to the generator/retailer interface, the generator/large customer interface;
 - b) Priorities for developing:
 - i) The Code, especially in regard to Parts 13 (Trading arrangements), 14 (Clearing and Settlement); and
 - ii) Market facilitation measures in regard to wholesale market services.
- 1.1.3 WAG's terms of reference require the Chair to report every six months to the Authority Board on the Group's progress against its work programme. This is WAG's second half-yearly report, and it covers WAG's activities for January to June 2012. Although strictly speaking outside the reporting period, the outcome of WAG's 5 July meeting is included here, as the agenda included WAG consideration of submissions received on its two major Discussion Papers published during the reporting period.

2 Membership of the Group

2.1 Membership and meetings held

- 2.1.1 WAG has met three times during the six month period covered by this report (9th February, 8th March, 20th April) and on 5th July, just outside the reporting period but included here. All meetings were held in Wellington, at the offices of the Authority. Table 1 gives details of WAG's membership, and members' meeting attendance for the four meetings covered by this report.

Table 1: Wholesale Advisory Group membership details for 1 January to 30 June 2012

Member	Affiliation	Date and term of appointment		Meeting attendance
James Moulder Chair	Independent	March 2011	2 years	3 of 4 ¹
Bruce Rogers	Pricing Manager, Orion	May 2011	2 years	4 of 4
Jason Franklin	Chief Executive, PowerNet (previously with Rio Tinto Alcan)	May 2011	2 years	resigned on 2 March 2012

¹ Bruce Rogers was appointed Acting Chair for the 20 April meeting in James Moulder's absence.

Member	Affiliation	Date and term of appointment		Meeting attendance
John Carnegie	Manager, Energy, Environment and Infrastructure, Business NZ	May 2011	2 years	2 of 4
John Woods	General Manager, Contact Energy	May 2011	1 year	4 of 4
Neal Barclay	General Manager Markets and Production, Meridian Energy	May 2011	1 year	2 of 4
Richard Spearman	Operations Manager, Trustpower Limited	October 2011	2 years	4 of 4
Stephen Peterson	Chief Executive, Simply Energy	May 2011	1 year	3 of 4

2.1.2 At the invitation of WAG, senior representatives from Pulse Utilities attended the meeting of 9 February to outline their concerns with the existing settlement and prudential security arrangements and discuss possible future development paths.

2.2 Resignations

2.2.1 Jason Franklin resigned from WAG on 2 March 2012, citing his change in employment from Rio Tinto to PowerNet as being a key factor in his decision to resign from the group.

2.3 New appointments

2.3.1 In its Market Brief dated 7 May 2012, the Authority called for nominations for the WAG to fill the vacancy created by Mr Franklin's resignation and vacancies that would be created when the terms of three members expired at the end of May 2012.

2.3.2 The Authority announced the following appointments in its 19 June 2012 Market Brief:

- Neal Barclay (Meridian - second term)
- John Woods (Contact - second term)
- Stephen Peterson (Simply Energy - second term)
- Graeme Everett (Norske Skog - first term)
- Bob Weir (Genesis - first term)
- Scott Harnett (Abacus Consultants - first term)

2.3.3 These members were all appointed for a two year term starting on 1 August 2012. They join the other members of the group whose terms have another year to run (refer Table 1 above).

2.3.4 The Authority also announced that it had amended the WAG's Terms of Reference to increase its maximum membership by two. The Wholesale Advisory Group now has a maximum membership of ten members including the chair.

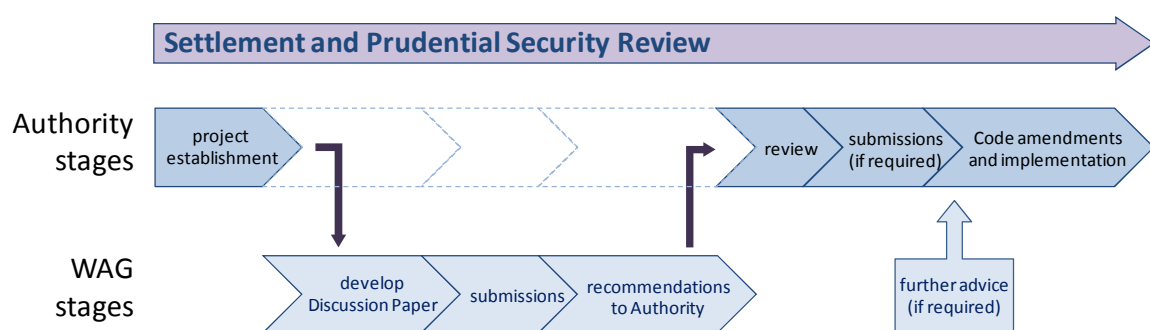
3 WAG work plan

- 3.1.1 As reported in the Half Yearly Report submitted in January this year, WAG's 2011-12 work plan was developed following discussions between the Authority and WAG, including an initial discussion of possible tasks with the Chair.
- 3.1.2 The agreed 2011-12 work plan comprised two projects:
- consideration of the provision of wholesale market information; and
 - consideration of wholesale settlement and prudential security arrangements.
- 3.1.3 Both of these projects are well advanced, and it is expected that WAG will have made recommendations on both by the end of September 2012. Progress with each project over the reporting period is discussed in the following sections (refer sections 4 and 4.1.1 respectively).
- 3.1.4 The Authority wrote to the WAG Chair in June requesting WAG consider adding three new projects to its work plan for 2012-13, and advising that the first of these was the highest priority:
- Improving pricing efficiency when a generator is pivotal;
 - Improving forecast and settlement pricing; and
 - National instantaneous reserves market.
- 3.1.5 WAG considered the Authority's request at its meeting of 5 July 2012 and agreed that all three items should be added to the work plan. The Chair advised the Group that he would recuse himself from the pivotal pricing project due to work he has undertaken for Transpower.

4 Review of wholesale settlement and prudential security arrangements

- 4.1.1 The WAG's review of wholesale settlement and prudential security arrangements is being conducted in stages as illustrated in Figure 1. WAG developed and published a Discussion Paper² in May 2012.

Figure 1: Approach to undertaking the settlement and prudential security review



- 4.1.2 The purpose of the settlement and prudential security review is to check whether existing wholesale settlement and prudential security arrangements are effective and efficient and,

² Available at <http://www.ea.govt.nz/document/16564/download/our-work/consultations/advisory-group/settlement-prudential-security-review/>

if not, to propose arrangements which improve the market's level of competition, reliability and efficiency for the long term benefit of consumers.

4.1.3 WAG identified a number of significant underlying concerns with these arrangements, and outlined the concerns in the discussion paper. The concerns revolve around two key issues:

- a) **inefficient prudential security methodology and mechanisms** – the existing prudential security methodology and mechanisms are imposing greater costs on parties than necessary to achieve the current overall level of prudential security. For example, the current methodology leads to significant over-procurement of prudential security at times (and under-procurement at other times) and the range of acceptable security mechanisms appears unduly restrictive; and
- b) **overall level of prudential security appears low** – in aggregate, the level of prudential security in New Zealand appears low relative to that observed in other broadly comparable markets. In other words, if a purchaser default event were to occur in New Zealand, there is a greater likelihood that prudential security held for such a contingency would be inadequate to cover the payment shortfall.

4.1.4 With these issues in mind, the discussion paper considered the following four high level options:

	Option 1 Status quo	Option 2 Generator secure	Option 3 Retailer efficient	Option 4 Secure and Efficient
Settlement and prudential security methodology	No change	No change except higher prudential security margin	Changes to improve efficiency (e.g. introduce weekly settlement, address over-procurement, broaden range of mechanisms for providing prudential security), but no retailer of last resort (ROLR) scheme	Changes to improve purchaser efficiency (those improvements outlined in Option 3) plus ROLR or similar
Mechanisms for providing prudential security	No change	No change		
Level of prudential security	Current level	Increased significantly	Increased	Increased significantly

4.1.5 The discussion paper provided a broad assessment of the options and suggested that there is a clear case for moving away from the Status Quo and adopting a variant of Option 3 or 4. The analysis also indicated the importance of providing a swift and clear exit process for any defaulting retailer. While this issue lies outside the scope of the settlement and prudential security review, it is likely to have major implications for the design of prudential security arrangements.

4.1.6 WAG received 17 submissions from the following parties:

Generators / Retailers	Lines Companies	End users	Others
<ul style="list-style-type: none"> • Contact Energy • Genesis Energy • Meridian Energy • Mighty River Power • TrustPower • NL & CE Wensley³ • Opuha Water⁴ • Opunake Hydro⁵ • Pulse Utilities • Simply Energy 	<ul style="list-style-type: none"> • Orion New Zealand • Vector 	<ul style="list-style-type: none"> • Norske Skog Tasman • Pacific Aluminium⁶ 	<ul style="list-style-type: none"> • Major Electricity Users' Group • NZX • OMF⁷

4.1.7 Submissions were received by members on Monday 2 July, and the Group discussed those submissions at its meeting on 5 July 2012.

4.1.8 After considering submissions, WAG has outlined a recommended package based largely on Option 3. These focus on the core elements of Option 3, plus a number of enhancements recommended by submitters. This recommended package is expected to provide tangible benefits, and provide a firm foundation for considering any further potential changes, which might occur once key issues in other areas such as retailer exit arrangements are clearer.

4.1.9 A paper setting out the recommended package for the September 2012 Board meeting is being reviewed by the WAG at its August meeting, where members that have a generator and independent retailer perspective will reflect on this “bi-partisan” effort and result.

5 Wholesale market information project

5.1.1 WAG agreed to include the Wholesale Market Information Project (WMI Project) as an item on its work plan at its first meeting (20 July 2011). The WMI Project is being undertaken in a staged manner, as depicted in Figure 2 below. The relationship to other Authority information workstreams is also shown.

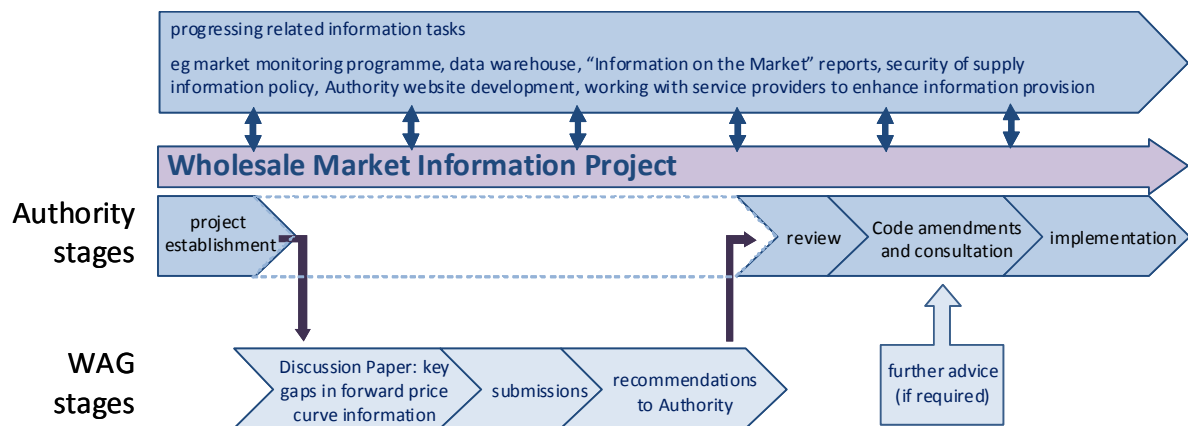
³ Owners of a small hydro generator (approx 1.5 GWh pa).

⁴ Owners of generation and a storage dam for irrigation and hydro power (approx 25 GWh pa).

⁵ A purchaser and generator class market participant.

⁶ Submission on behalf of Rio Tinto Alcan (New Zealand) Limited, RTA Power (N.Z.) Limited and New Zealand Aluminium Smelters Limited (NZAS).

⁷ A broker in the NZ electricity market and provider of a trading platform for over-the-counter electricity contracts.

Figure 2: Approach to undertaking the WMI Project

- 5.1.2 The purpose of the WMI Project is to identify and recommend to the Authority a prioritised set of cost-effective initiatives that enhance the availability and accessibility of wholesale market information for target users, with the aim of improving competition, pricing and security of supply in the electricity market. WAG considers that the focus of its work should be to identify enhancements that enable improved forward price curve evaluation, especially by less well resourced stakeholders.
- 5.1.3 WAG focussed on identifying key gaps in publicly available information that it considered is required for forward price curve evaluation. It then explored what, if any, cost-effective enhancements could be pursued to address the information gaps it had identified⁸. WAG considered there was merit in exploring the prospects for a Facilitated Disclosure arrangement, and tasked the WAG Chair with progressing this. Discussions were held with each of the major generators about the development of a voluntary disclosure standard for thermal fuel storage information, future thermal fuel contracted volumes and snowpack. WAG also considered the existing wholesale market information disclosure regime in the Code and identified some possible enhancements to clause 13.2 of the Code.
- 5.1.4 WAG published a Discussion Paper⁹ in late March 2012 and invited submissions on its conclusions and recommendations.

⁸ The Discussion paper identified four generic options: laissez-faire (status quo / no intervention); facilitated disclosure (eg. publishing source list, guidelines for voluntary disclosure); contractual disclosure; and regulated disclosure.

⁹ Available at <http://www.ea.govt.nz/document/16256/download/our-work/consultations/advisory-group/wholesale-market-information-wag-discussion-paper/>

5.1.5 WAG received 7 submissions from the following parties:

Generators / Retailers	Others
<ul style="list-style-type: none"> • Contact Energy • Genesis Energy • Meridian Energy • Mighty River Power • TrustPower 	<ul style="list-style-type: none"> • Major Electricity Users' Group • Transpower

5.1.6 WAG is now considering the submissions it has received and developing its recommendations to the Authority Board regarding wholesale market information.

5.1.7 The key observations, conclusions and recommendations can be summarised as follows:

- a) the Authority should pursue amendments to the existing disclosure regime in the Code (clause 13.2) that clarify certain aspects of the obligations, scope and exclusions;
- b) the Authority should pursue a “facilitated disclosure” approach to enhancing the availability and accessibility of thermal fuel quantity information and snowpack information, and should review the effectiveness of the arrangement after 12 to 18 months of operation;
- c) a case could not be made for including thermal fuel price information in the facilitated disclosure arrangement, largely as a result of the commercially sensitive nature of pricing information;
- d) the Authority and Transpower should initiate a review of the Planned Outage Co-ordination Protocol (POCP) and associated Red Spider database of outage information, with a view to enhancing transmission and generation availability and outage information that is of relevance to forward price curve evaluation as well as to security of supply;
- e) the Authority should review the use of system agreements for access to systems such as WITS (NZX) and EM6 (EMS) to ensure these agreements are not unduly limiting access to pricing and generation data;
- f) other avenues such as the Authority’s hedge disclosure website and the stress-testing regime, provide a more appropriate avenue at this time for enhancing information on the market’s contract cover; and
- g) no case could be made for the Authority pursuing enhancements in the other areas explored by WAG, notably AXS contract trading prices and hydro/climate outlook information.

5.1.8 WAG intends making its final recommendations to the Board at its September meeting, having first considered a final draft of its report at the WAG meeting scheduled for 9 August.

6 Concluding remarks

6.1.1 The past six months have seen a tremendous effort from WAG members as the Group dealt with some highly complex and vexing issues. The way it was able to take a “bi-partisan” approach in delivering credible and considered improvements to legacy arrangements is testament to the strength of the advisory group approach, the WAG membership, and the exceptional support of Authority staff.

James Moulder
Chair, Wholesale Advisory Group