

Wholesale Advisory Group

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

July 2011 to December 2011

31 January 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 This half-yearly report outlines the WAG's activities for July 2011, when the WAG first met, to December 2011. The WAG's terms of reference require the Chair to report every six months to the Authority Board on the WAG's progress against its work programme.

## 1.2 Role of the Wholesale Advisory Group

1.2.1 The role of the 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.

## 2 Membership of the Wholesale Advisory Group

2.1.1 The WAG met for the first time on 1 July 2011, and held four meetings between July and December 2011.<sup>1</sup> All meetings were held in Wellington, at the offices of the Authority.

2.1.2 Table one gives details of WAG's membership, and members meeting attendance for July to December 2011.

**Table 1: Wholesale Advisory Group membership details**

Member	Affiliation	Appointed (term)	Meeting attendance
James Moulder, Chair	Independent	March 2011 (two years)	4
Bruce Rogers	Pricing Manager, Orion	May 2011 (two years)	4
Jason Franklin	Chief Executive, PowerNet (previously with Rio Tinto Alcan)	May 2011 (two years)	2
John Carnegie	Manager, Energy, Environment and Infrastructure, Business NZ	May 2011 (two years)	3
John Woods	General Manager, Contact Energy	May 2011 (one year)	4
Neal Barclay	General Manager Markets and Production,	May 2011 (one year)	2

<sup>1</sup> The WAG met on 1 July, 7 September, 14 October and 16 December.

Member	Affiliation	Appointed (term)	Meeting attendance
	Meridian Energy		
Richard Spearman	Operations Manager, Trustpower Limited	October 2011 (two years)	4
Stephen Peterson	Chief Executive, Simply Energy	May 2011 (one year)	4

Kevin Small of Transpower has been invited to attend meetings of the WAG to observe and take part in discussions, but is not a member.

## 2.2 Resignations

2.2.1 No members have resigned from the WAG.

## 3 2011-12 work programme

3.1.1 The WAG's 2011-12 work programme was developed following discussions between the Authority and the WAG, including an initial discussion of possible tasks with the Chair.

3.1.2 The agreed 2011-12 work programme comprised two projects:

- a) consideration of the provision of wholesale market information; and
- b) consideration of wholesale settlement and prudential security arrangements.

3.1.3 As part of the consideration of the wholesale settlement and prudential security arrangements, two senior staff members of the Australian Energy Market Operator (AEMO) were invited guests at the fourth meeting of the WAG. The AEMO has recently undertaken a review of the Australian market's prudential system, and therefore our visitors were able to share their experience and advice in a most helpful and useful manner. Much of the Australian experience was readily transferred to the New Zealand situation.

3.1.4 Mr Small of Transpower presented to the third meeting of the WAG on the System Operator's Planned Outage Co-ordination Process (POCP). This was very pertinent for the WAG's work in the area of the wholesale market information project.

3.1.5 Mr Livengood of NZX attended the second meeting of the WAG to provide the members with the Clearing Manager's observations on the operation of the current settlement and prudential security system. This was directly relevant to the work being carried by the WAG in the settlement and prudential security review.

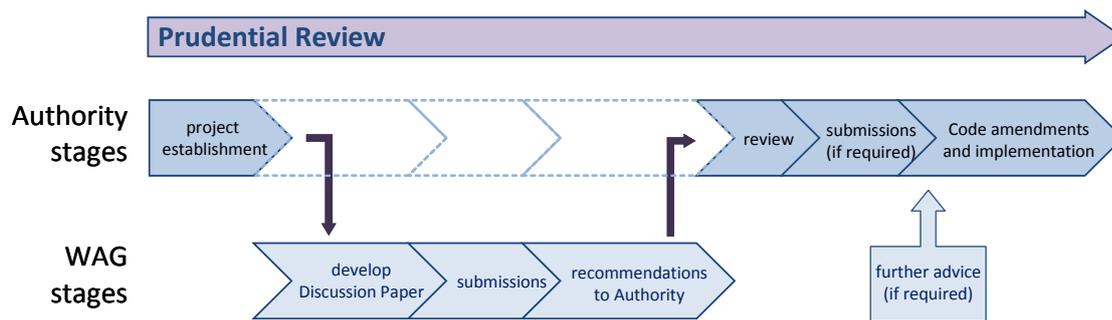
3.1.6 Throughout the WAG's tenure, it has relied on support from the secretariat, provided by the Authority. Support for the WAG has included external resources, procured by the Authority, such as Concept Consulting Group and Buddle Findlay for legal advice.

## 3.2 Review of wholesale prudential and settlement arrangements

3.2.1 The WAG agreed to include the review of wholesale prudential and settlement arrangements (Prudential Review) as an item on its work programme at its first meeting (20 July 2011).

3.2.2 The prudential review is being conducted in stages as illustrated in Figure 1. The WAG is currently preparing a discussion paper on a range of prudential and settlement issues.

Figure 1: Approach to undertaking the prudential review



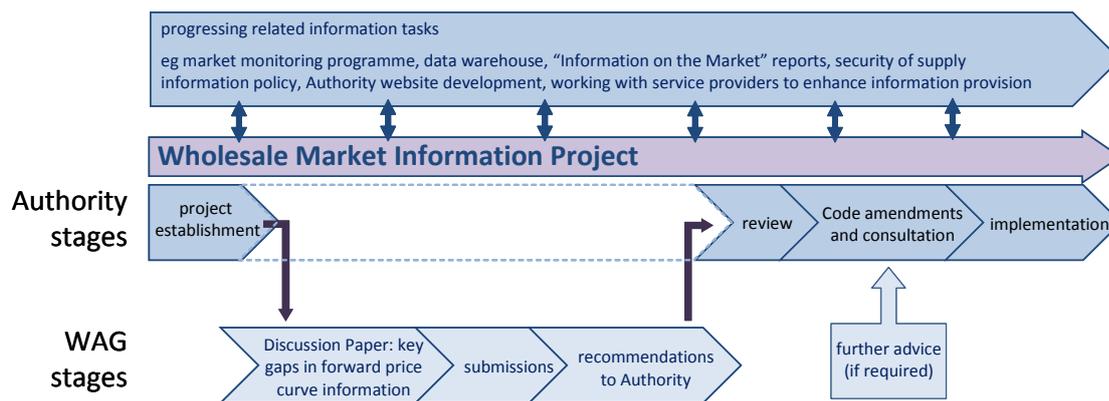
- 3.2.3 The purpose of the prudential review is to check whether existing wholesale prudential and settlement arrangements are consistent with the advancement of the Authority's statutory objective. If they are not new arrangements will be proposed which improve the market's level of competition, reliability and efficiency for the long term benefit of the consumer.
- 3.2.4 As part of the prudential review legal opinions have been sought on the ability of the Clearing Manager to set off unpaid amounts due on settlement day with monies due to the same participant. In addition an opinion was sought on the issues which may arise if prudential securities are held in the form of cash if the participant who supplied them is either placed into receivership or the liquidation process. It had been noted that the Australian market's view was that cash held as a prudential security may be subject to "claw back" in some circumstances. The WAG will take these legal opinions into account in their settlement and prudential security review discussion paper.
- 3.2.5 Work to date suggests that significant efficiencies are available. Particular areas of focus for the WAG have been on:
- assessing required security levels in a more dynamic fashion. At present, security is required to cover the clearing manager's expected net exposure to a payer over a fixed 57 day period. Efficiencies may be available by covering accrued exposure plus a prudential margin period of around 7 days;
  - setting security levels to cover a reasonable worst case risk over the prudential margin period, whereas presently only expected exposure is covered;
  - providing for more frequent prudential assessments that recognise past pricing events more quickly, and are more transparent; and
  - ensuring that defaulting wholesale payers can be exited from the market smoothly and relatively quickly, so as to minimise the amount of security the clearing manager needs to hold.
- 3.2.6 As this review has a strong connection with the Retail Advisory Group's (RAG) work on arrangements for managing retailer defaults, the WAG has been working with the RAG's secretariat to ensure that both work streams are cognisant of the other's views and intentions.
- 3.2.7 **Progress**
- 3.2.8 The WAG expects to consider a draft discussion paper on Settlement and Prudential Security late in February 2012, and to then refer the paper to the Board's April meeting for information

purposes. In support of the preparation work for the paper, the secretariat has undertaken an extensive modelling process. The Clearing Manager has provided the Authority with very detailed data from the daily historical operation of individual participants covering each GXP, in terms of quantities and price. Individual participants' data and information has been kept confidential where data and the results of modelling have been shared with the WAG. This selection of data was decided on after the WAG's discussion with the AEMO staff who visited recently. Also the secretariat discussed data requirements and analytical approaches with the people who had carried out the equivalent work for the AEMO. From this historical data a range of possible settlement and prudential arrangements have been modelled to inform the work of the WAG. It is expected that the paper will be released for consultation in mid April 2012. Consultation is intended to close in mid May, with the WAG making recommendations to the Board at their meeting in June 2012.

### 3.3 Wholesale market information project

3.3.1 The WAG agreed to include the Wholesale Market Information Project (WMI Project) as an item on its work programme 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 work streams is also shown.

**Figure 2: Approach to undertaking the WMI Project**



3.3.2 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. The emphasis of the work done is to assist interested parties to draw conclusions about the forward price curve of electricity. For the purpose of the project:

- *Availability* means wholesale market information that is published in some manner or provided under agreed conditions (as opposed to information that is not produced or is held confidentially by one or more parties); and
- *Accessibility* means the ease with which stakeholders can find and use the available wholesale market information. It includes factors such as convenience, ease of understanding and cost of access.

3.3.3 The WAG considers that the focus of its work should be to identify wholesale market information enhancements that enable improved forward price curve evaluation especially by less well resourced stakeholders. This is assumed to be the price of wholesale electricity for the immediate

period through to the next 3 years. WAG has stressed that an initiative should only be pursued if it is targeted at a clearly identified market failure and where the intervention delivers a net public benefit.

- 3.3.4 To assist the WAG's progression of this project, the Authority's Wholesale Team has provided it with preliminary analysis and evaluation aimed at:
- identifying any significant gaps in the availability or accessibility of information which could inform traders' views of the forward price curve; and
  - assessing possible options to address those gaps in order to determine what, if any, cost-effective enhancements the Authority could consider pursuing.
- 3.3.5 The WAG has undertaken a stock-take of available and accessible data and considered the preliminary analysis provided and reached an initial view that the following gaps exist in wholesale market information:
- information on fuel quantities and contracts (coal stockpiles, gas availability);
  - information on snow pack;
  - information on the Planned Outage Co-ordination Process;
  - transmission and generation availability and outage information; and
  - information on electricity contracts including recent hedge contract prices, overall contract position of the market and level of net hedge cover.
- 3.3.6 Section 13.2 of the Code already provides direction on the provision of information, by participants, to the market. The Authority has obtained a legal opinion on the operation of s.13.2 and believes that it needs to be improved because its operative ability is in question.
- 3.3.7 The secretariat has developed a listing of "Quick" or "Guided Links" for inclusion on the Authority's website to direct interested parties to data and information available in the market, where its availability and location may not be widely known.
- 3.3.8 The WAG has noted the generic options for information disclosure, including laissez-faire, facilitated disclosure, contractual disclosure and regulated disclosure. There was some discussion about how the partial sale of state-owned enterprise generator-retailers could itself result in more information entering the public domain, particularly due to the disclosure requirements associated with NZX listing rules.
- 3.3.9 The WAG has identified a number of areas where change is deemed to be important to the setting of the electricity forward price curve. The next question is which of the approaches are best to apply to a particular issue. After discussion, the WAG decided that one issue which requires attention is the wide provision of snowpack information. This is largely in response to the hydrological and market events of December 2010, where there was confusion in the market over the appropriate value of water when most of the market was unaware that there was less than usual snowpack for that time of year. The WAG decided that the best approach here was one of facilitated disclosure. The Chair has been leading discussions with a range of users of fossil fuels and hydro power to make quantities of contracted and stored fuels and snowpack available to the market with a voluntary and standardised procedure and data format.

**Progress**

- 3.3.10 At the February 2012 WAG meeting, there will be consideration of the tentative arrangements the Chair has developed in his conversations with generators that use fossil fuels or monitor snow pack. The intention is that an agreement be reached on the form of a facilitated arrangement for the voluntary regular disclosure of fuel quantity and snowpack information to better enable the market to form views on the forward price curve for electricity.
- 3.3.11 The WAG expects to consider a paper on Wholesale Market Information in February 2012 and to refer that paper to the Board's 7 March 2012 meeting, for information. It is expected that the paper will be released for consultation in mid March. Consultation is intended to close in late April, with the WAG making recommendations to the Board by their meeting on 5 September 2012. The planned delay between the end of consultation period and when the WAG makes its recommendations is intended to allow the WAG and the secretariat to concentrate on the Settlement and Prudential Security paper which is the more complex and is the higher priority of the two. In addition, there are a number of consultation papers due to be released in the March/April time period. It may be preferred to delay the release of the wholesale market information consultation until May/June 2012. Such a change would still allow the WAG to make its recommendations within the September 2012 timeframe.