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UTS draft decision

The Electricity Authority released today its draft decision that the events leading to spot market prices of around \$20,000/MWh (megawatt-hour) on 26 March 2011 were an Undesirable Trading Situation (UTS). The Authority considers that multiple factors combined to create the UTS.

Wholesale electricity (spot market) prices exceeded \$19,000/MWh between 10:30am and 5:30pm on Saturday 26 March for Hamilton and regions north of Hamilton. Prices in the lower North Island were \$6,000/MWh to \$8,000/MWh over the same time period. Thirty five parties lodged UTS claims with the Authority following these events.

The Authority proposes to reset offer prices for 26 March at levels reflecting the cost to purchasers of alternative sources of supply or the cost of curtailing demand. These are the estimated costs purchasers would have incurred to avoid the exceptionally high spot market prices had they received accurate price forecasts.

The Authority's estimates suggest the new offer prices should be set somewhere between \$1,500/MWh to \$3,000/MWh. The Authority believes that an offer price in this range will address the UTS, while preserving incentives for electricity purchasers to hedge their risks from exposure to spot prices.

The Authority's draft decision that a UTS occurred is based on the fact that Genesis' offer prices at its Huntly power station set exceptionally high spot market prices, and parties exposed to those prices had good reason to believe Genesis' offers would not translate into spot prices, until it was too late for them to take any action to avoid paying those prices.

A particular issue for electricity consumers is that, if they had been aware of the high prices in advance, they would have in many instances reduced demand or secured other sources of generation, as occurred on Saturday, 2 April at the prospect of a repeat of the exceptionally high prices of the previous weekend.

Although Genesis submitted its \$20,000/MWh offers to the market on Friday 25 March, forecast prices failed to consistently predict actual prices, due to demand forecast inaccuracies.

Although \$20,000/MWh prices were forecast at 2pm and 2:30pm on 25 March, price forecasts fell to \$160/MWh later in the afternoon on 25 March in response to Mighty River Power's decision to offer an additional 125MW at Southdown. Thereafter, there was no indication of the forthcoming exceptionally high prices on 26 March until almost real time.

The Authority notes that Contact's decision to withdraw 425MW from its Stratford power stations at around 1pm on 25 March was also crucial in putting Genesis in a position where its offers at Huntly determined spot prices in a large part of the North Island. Reductions in grid constraint limits by the system operator also contributed to the outcome.

The Authority points out in its draft decision that exceptionally high offer prices, and exceptionally high market prices, do not necessarily constitute a UTS. In this instance, the key questions are whether such prices arose from unwarranted speculation, or an undesirable practice or trading situation, or were at variance with generally accepted principles of trading or the public interest. These considerations come down to whether prices were so removed from underlying supply and demand conditions, and exceeded underlying or avoidable costs to such an extent, that they caused market participants to lose confidence in the integrity of the spot market.

Considering all the factors together, including the lack of consistent and timely forewarning of exceptionally high spot prices, the Authority's preliminary view is that the events on 26 March threaten to undermine confidence in, and threaten to damage the integrity and reputation of, the wholesale electricity market.

There were also several allegations from UTS claimants that Genesis materially breached the law, engaged in manipulative or attempted manipulative trading activity, and engaged in conduct in relation to trading that was misleading or deceptive, or likely to mislead or deceive. Based on its modelling and analysis, the Authority's preliminary view is that these allegations are not substantiated.

The Authority is consulting interested parties about its draft decision and proposed actions, and is expecting to make a final decision in mid-June. The Authority will not discuss or comment on the draft decision or any aspect relating to the events of 26 March 2011 pending its final decision on the matter.

The Authority is continuing with its market performance investigation, and intends to issue a report around the time it releases its final decision on the UTS.

The Authority's work programme contains several pro-competition and pro-hedging initiatives for amending the market rules by the end of the year. The Authority believes that had these measures been in place, they would have materially affected the events of 26 March.

The draft decision document is available at:

- <http://www.ea.govt.nz/our-work/consultations/uts/26Mar11>

A summary of the draft decision is available at:

- <http://www.ea.govt.nz/our-work/consultations/uts/26Mar11>

Details on the Authority's work programme are available at:

- <http://www.ea.govt.nz/our-work/programmes/>

Market Commentary, due out this afternoon, discusses the pro-competition focus of the Authority's work programme in more detail.

Submissions on the draft decision

Under the Code, the Authority is required to consult with participants on any remedial actions it intends to take to correct a UTS. Participants and interested parties are invited to make submissions on the draft decision, as well as the draft remedial actions to correct the UTS.

Submissions should be emailed to submissions@ea.govt.nz and must be received by 3.00pm on Friday, 13 May 2011.

Submissions will be published on the Authority's website as soon as possible following the closure date, with provision for cross-submissions, which must be received by 3.00pm on Thursday, 19 May 2011.

Please note that late submissions and cross-submissions are unlikely to be considered.

Subscription

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