



State Highway 1
Private Bag 6
Tokoroa
New Zealand
Telephone
64 7 886 3999
Facsimile
64 7 886 3615

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www.chh.com

Electricity Authority
Level 7 ASB Tower
2 Hunter Street
WELLINGTON

By email to submissions@ea.govt.nz

CARTER HOLT HARVEY PULP & PAPER SUBMISSION ON SCARCITY PRICING AUGUST 2011

Carter Holt Harvey Pulp & Paper Ltd (CHH) appreciates the opportunity to provide a submission on the Electricity Commission's consultation paper dated 13th July 2011 concerning scarcity pricing in the NZ wholesale market.

Introduction

CHH owns and operates a number of pulp and paper mills at Kinleith, Kawerau, Whakatane and Penrose (Auckland). These mills produce bleached and unbleached softwood kraft pulp and a range of linerboards and paperboards used in packaging. CHH uses over 1000GWh per annum of electricity, of which some 360GWh per annum is internally generated.

Electricity is a key input into the processing of wood and we cannot stress how much the price paid for electricity impacts on the company's operating costs.

CHH is a major export earning business for the New Zealand economy and it is absolutely essential to the viability of our operations that electricity supply is obtained at a fair and reasonable price.

As a major user of electricity, CHH is significantly impacted by spot prices and the availability of energy hedge contracts. As a direct consequence of this, CHH has adopted a conservative approach to its electricity purchases, with a high level of hedge cover for its energy needs to provide price stability and to manage spot market volatility risk. Even at times of extreme spot price levels we often must meet the delivery expectations of our customers by continuing to make our product.

CHH is a member of the Major Electricity Users Group (MEUG) and supports the comments made in the MEUG submission.

CHH wishes to make the following specific comments on the scarcity pricing proposal for the Commission's consideration.

Proposed stress test

We are thankful that the Authority has decided not to introduce a price floor during public conservation campaigns or rolling outages.

We also consider that the adoption of clear pre-defined triggers for starting and stopping conservation campaigns will provide a high level of confidence to the market in general as to when one might expect such campaigns to be adopted. These pre-defined triggers in our view will effectively negate the impact of any lobbying for early adoption of a conservation campaign.

We are entirely unconvinced however, by any of the assertions in the consultation paper as to what the benefits of putting in place the proposed stress test regime might be.

The primary benefit claimed appears to be an expectation of stronger economic growth due to greater confidence in security of supply, and correcting the perception that New Zealand is unduly vulnerable to supply crises.

We can see no positive linkage whatsoever between this claim and the proposed stress test. In fact, we consider that it is entirely possible that the imposition of this test every three months and involving the directors of the large manufacturing companies targeted will have the impact of drawing their attention in a negative way, every three months, to the fragilities of an electricity market that appears to require such an extraordinary demand for information.

Directors are being asked to put their name to unaudited financial information that will be relied on by an external Regulator. There are various statutes like the Companies Act 1993 (director duties and responsibilities) and the Financial Reporting Act 1993 (reporting of accurate information) which understandably will make directors feel very nervous about doing this. Directors will then seek to have the information audited and this of course will incorporate time and cost not to mention complexity into the running of private (ie non public /listed) entities.

For privately owned entities like CHH, the information is sensitive and of course confidential. There will always be a risk that, once disclosed by CHH to the Authority, such sensitive information will find its way into the wrong persons' hands by being subject to The Official Information Act and disclosable to anyone requesting it.

The consultation paper asserts that the imposition of a stress test will in some way reduce the ability for some parties to "talk up" security risk in times of dry-year shortage risk. We cannot see any valid reasoning at all in the consultation paper for this assertion and it signals a complete lack of trust between the Authority on the one hand and market participants on the other. This is concerning for CHH as a major user of electricity in NZ.

The consultation paper also asserts that another benefit of the stress test will "*strengthen incentives for parties to prudently manage their exposures to spot price risk, with flow-on benefits in terms of more procurement of voluntary demand-side response, improved fuel management, investment/retention of energy reserve capability etc.*"

We entirely reject this. As a matter of sensible business prudence, we already consider carefully our exposure to spot price risk and the threat of a stress test will have no material impact on our behaviour in this regard.

The proposed requirements for

- quarterly disclosure;
- the signature of two directors;
- confirmation of consideration by the Board; and
- independent audit of the information, if required

Seem to us to be unbelievably bureaucratic and draconian and will not provide the answer to the problem the Authority is seeking to address. In addition, we are not aware of any other regulatory requirement for disclosure of information similar to that proposed at 3 monthly intervals. CHH is therefore in complete disagreement with the Authority's "stress test" proposal.

We have provided answers to some of the Authority's specific consultation questions and these are attached as Appendix A.

We thank you for the opportunity to submit on this important issue and are happy to discuss this matter further.

Yours sincerely



Brice Landman
Chief Executive Officer
Carter Holt Harvey Pulp & Paper Ltd

Appendix A Specific matters

The Authority seeks feedback on the issues and proposals discussed in this Consultation Paper, and the draft proposed Code amendments set out in Appendix C.

Question	Response
1 Do you agree with the problem definition?	Only for the supply emergency issues.
2 Do you agree that the proposed narrowing of scarcity pricing (to be applied for short-term emergencies and not for extended shortages) would be more consistent with the Authority's statutory objective?	Yes
3 Do you agree that scarcity pricing should be applied as a price floor and cap, rather than simply a price floor during emergency load shedding?	Yes
4 Do you agree that scarcity pricing should include a stop-loss mechanism, at least on a transitional basis?	Yes
5 Do you agree that scarcity pricing should not apply for AUFLS per se?	This is a complex issue that might be better resolved using a small technical group.
6 Do you agree with the proposed geographic threshold for initial application of scarcity pricing, and if not why?	Yes. This reduces local risk for what should essentially be an wide area issue.
7 Do you agree that an amendment should be made to final pricing processes when an infeasible solution arises following an IR shortfall?	No comment
8 Do you agree with the proposed implementation timetable?	The timetable for the regime for unexpected outages seems satisfactory. Since we reject the stress test proposal, any timetable for this aspect we consider to be irrelevant.
9 What is your view of the proposed review provisions for key scarcity pricing parameters?	No comment.
10 What is your view of the trigger	The crucial point to us is that there is a

	mechanism for declaring a national or island shortage?	clearly transparent trigger point and mechanism.
11	What is your view of the trigger mechanism for revoking shortage declarations?	See above.
12	What is your view of the proposed pre-dispatch and real time indicators for scarcity pricing?	We support pre-dispatch indicators in principle, but would urge the Authority to consider carefully how they could make this information more user friendly to users who not have 24/7 attention to these matters.
13	Which approach do you believe will best meet the Authority's statutory objective (and why): <ul style="list-style-type: none"> - a common value for the GWAP floor and cap of \$10,000/MWh; or - a GWAP floor of \$10,000/MWh and a cap of \$20,000/MWh? 	No comment
14	Which approach do you believe will best meet the Authority's statutory objective (and why): <ul style="list-style-type: none"> - scaled pricing approach; or - flat pricing approach? 	No comment
15	What is your view of the proposed approach to applying scarcity pricing across trading periods?	No comment
16	What is your view of the proposed approach to treating differences between forecast and actual conditions?	No comment
17	What is your view of the proposed approach to HVDC rentals, and what alternative (if any) would you support and why?	No comment
18	What is your view of the proposed approach to implementing a scarcity pricing stop-loss mechanism?	No comment
19	What is your view of the proposed modification to final pricing when an IR shortfall occurs and an infeasible solution arises in final pricing?	No comment

20	What is your view of the proposed information to be disclosed?	We consider as noted earlier that the proposed information disclosure is unnecessarily intrusive and will not achieve anything useful.
21	What is your view of the indicative stress test parameters?	See above
22	What is your view of the proposed level of guidance to be provided to participants?	See above
23	What is your view of the proposed frequency of reporting?	Very onerous especially considering the likely frequency of the events in question, estimated at approximately 10 years in the consultation paper. If the stress test proposal is implemented, then the information request should only be triggered by an impending public conservation campaign, with trigger points clearly defined.
24	What is your view of the proposed coverage of a disclosure obligation?	Onerous and unnecessary for all potential parties included.
25	What is your view of how information disclosed could be used?	Since we do not believe there is any legitimate purpose for gathering the information proposed, we will not comment on how it might be used.
26	What is your view of the proposed compliance and auditing arrangements?	Overkill.
27	What is your view of the proposals when assessed against the Authority's statutory objective?	We cannot find the problem that the stress test will resolve let alone achieve the Authority's objective
28	What is your view of the alternative means of achieving the objectives of the proposed scarcity pricing and stress-testing regime?	We have no comment on the alternative means proposed. However, a disclosure of percentage hedge position on an impending public conservation campaign may be of some use.
29	What is your view of the costs and benefits of the proposed scarcity pricing changes?	We consider that it is very likely that the imposition of a stress test as proposed will have a negative NPV as directors are reminded regularly of the apparent fragility of the New Zealand electricity system and make strategic decisions accordingly.
30	What is your view of the costs and benefits of the proposed stress	The cost to the affected parties of implementing such an onerous regime

	testing regime?	seem to have been ignored. The estimated benefits as we have noted previously are tenuous to say the least.
31	Do you propose any changes to the proposed Code amendments set out in Appendix C?	Remove the stress test