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Submissions
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Dear Sir or Madam

Consultation Paper - Scarcity Pricing and Related Measures

Thank you for the opportunity to comment on the Electricity Authority's revised scarcity pricing proposals and Code amendments. No part of this submission is confidential. Mighty River Power's responses to the specific matters raised in the paper are outlined in Appendix A.

Revised Scarcity Pricing Measures

Mighty River Power believes that the Electricity Authority's revised scarcity proposals are a significant improvement over the proposals consulted on in March 2011. Mighty River Power supports the EA's current proposal to introduce scarcity pricing during capacity scarcity events only. This approach is consistent with the approach adopted in many overseas markets and is an appropriate mechanism to deal with the possibility that prices may reduce as load is shed during a capacity shortage event.

Implementation

As outlined in our previous submission, Mighty River Power considers that any scarcity price should be applied as both a price floor and a cap of equal value (of \$10,000/MWh). This approach is based on our view that the New Zealand scarcity pricing approach should be broadly consistent with other electricity markets such as Singapore or Australia.

We consider scarcity pricing should be implemented using the flat approach for the following reasons:

- Locational price signals are of limited value in a situation where the system operator has taken direct control in an emergency to restore normal system operation.
- Scaling inflates locational price differentials, potentially well beyond what is justified by the underlying physical dispatch. The magnified nodal price differences impose additional locational risk on market participants at a time when they are less likely than usual to be

able to manage this risk. A flat implementation approach makes outcomes under scarcity pricing more predictable and manageable.

- In the example presented in Section 4.5.2 of the consultation paper, nodal prices under the scaled option could range between \$8,500/MWh and \$12,800/MWh. We consider that such an outcome is inconsistent with the basic concept of imposing an administrative scarcity price at a time when the normal operation of the market has effectively ceased.
- The proposed price floor of \$10,000/MWh is at least partly based on the argument that this is the price required for hypothetical last resort peaking plant to recover costs. Under a scaled implementation approach, prices at individual nodes may be well below this level, potentially reducing the incentives for investment in capacity that the scarcity pricing regime is intended to create.

Mighty River Power also supports the proposed stop-loss mechanism. This promotes stability and certainty and is essential to place an appropriate limit on the risks faced by market participants in capacity scarcity events. The stop-loss mechanism should be a permanent part of the scarcity pricing regime.

Stress Testing Regime

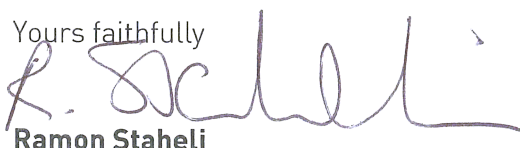
As stated in its previous submission dated 29 April 2011, Mighty River Power considers that concerns surrounding potential lobbying ('talking up supply risk') are exaggerated, particularly now that the Authority has implemented changes to the Code which require the System Operator to manage official conservation campaigns based on a set of deterministic criteria. Therefore, we believe the proposed stress testing regime is an unnecessary intervention. Lobbying may still happen, though this is a democratic right and cannot be neutralised via the Code.

Instead, the Authority should require only parties who actually lobby to disclose their exposure to the spot market. This would be superior to the proposed regime which imposes significant ongoing compliance costs on all market participants regardless of whether any lobbying occurs. As discussed at the Scarcity Pricing Forum meeting on 1 June 2011, this proposal is highly problematic, very expensive and will achieve little benefit.

Instead, we believe that the Authority could investigate the merits of a short-term forward market, as proposed by MEUG, as a means to achieve greater demand-side participation in the market.

If you have any questions about this submission, please contact me on (09)580 3623 or ramon.staheli@mightyriver.co.nz.

Yours faithfully



Ramon Staheli

Senior Market Regulatory Advisor

Appendix A: Specific Matters

Number	Question	Answer
1	Do you agree with the problem definition?	While the problem definition is significantly improved compared to the previous consultation paper, Mighty River Power continues to see scarcity pricing as a useful step in removing the potential for price-suppression during forced load-shedding and aligning the design of the New Zealand market with common practice, rather than seeing it as a solution to a significant underinvestment in capacity.
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. We consider that a stop-loss mechanism should be provided on a permanent basis.
5	Do you agree that scarcity pricing should not apply for AUFLS per se?	Yes.
6	Do you agree with the proposed geographic threshold for initial application of scarcity pricing, and if not why?	We would prefer scarcity pricing to apply only to national shortage events. Applying scarcity pricing to sub-national events involves the risk that scarcity pricing could be triggered by inadequate transmission capacity or availability, or be subject to manipulation. Mighty River Power does not support the EA's intention to review the threshold over time with a view to lowering it. Not only do such reviews create unnecessary regulatory uncertainty, they also raise the possibility that scarcity prices are increasingly applied in situations where they have no useful purpose, e.g. where a lack of transmission capacity or availability is the underlying problem.
7	Do you agree that an amendment should be made to final pricing processes when an infeasible solution arises following an IR shortfall?	Yes.
8	Do you agree with the proposed implementation timetable?	Yes.

9	What is your view of the proposed review provisions for key scarcity pricing parameters?	We support regular reviews. Any review should seek to establish whether the presence of the scarcity price had been (net) beneficial, and should start from the basic premise that the intervention is no longer necessary.
10	What is your view of the trigger mechanism for declaring a national or island shortage?	This is appropriate.
11	What is your view of the trigger mechanism for revoking shortage declarations?	This is appropriate.
12	What is your view of the proposed pre-dispatch and real time indicators for scarcity pricing?	These are appropriate.
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? 	Mighty River Power considers that only the common value approach is consistent with the broad principle of imposing an administrative scarcity price during emergency load shedding. The alternative of a floor of \$10,000/MWh and a cap of \$20,000/MWh is unnecessarily complex and fails to provide market participants with sufficient certainty around possible pricing outcomes during a scarcity event.
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? 	Mighty River Power considers that the flat pricing approach is superior as the scaled pricing approach involves imposing risk on market participants in the form of exaggerated locational price signals at a time when locational signals are unlikely to achieve any beneficial purpose. The scaling approach is also inconsistent with the scarcity pricing approach adopted in similar overseas electricity markets.
15	What is your view of the proposed approach to applying scarcity pricing across trading period.	This is appropriate.
16	What is your view of the proposed approach to treating differences between forecast and actual conditions?	This is appropriate.
17	What is your view of the proposed approach to HVDC rentals, and what alternative (if any) would you support and why?	This is appropriate.
18	What is your view of the proposed approach to implementing a scarcity pricing stop-loss mechanism?	Mighty River Power supports the proposed stop-loss mechanism. However, as outlined in previous submissions, this needs to be a permanent rather than temporary feature of the scarcity pricing regime.
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?	This is appropriate.

20	What is your view of the proposed information to be disclosed?	We do not support the proposed stress testing regime.
21	What is your view of the indicative stress test parameters?	As per Question 20.
22	What is your view of the proposed level of guidance to be provided to participants?	As per Question 20.
23	What is your view of the proposed frequency of reporting?	As per Question 20.
24	What is your view of the proposed coverage of a disclosure obligation?	As per Question 20.
25	What is your view of how information disclosed could be used?	As per Question 20.
26	What is your view of the proposed compliance and auditing arrangements?	As per Question 20.
27	What is your view of the proposals when assessed against the Authority's statutory objective?	Mighty River Power considers that the revised scarcity pricing proposals are consistent with the Electricity Authority's statutory objective. We do not consider that the stress testing regime is consistent with the Authority's statutory objective.
28	What is your view of the alternative means of achieving the objectives of the proposed scarcity pricing and stress testing regime?	We agree with the EA's assessment of these.
29	What is your view of the costs and benefits of the proposed scarcity pricing changes?	The benefits of scarcity pricing are likely to be somewhat overstated. Nevertheless, the current scarcity pricing proposals are likely to have positive net benefits.
30	What is your view of the costs and benefits of the proposed stress testing regime?	The costs are likely to be significantly higher than the benefits.
31	Do you propose any changes to the proposed Code amendments set out in Appendix C?	We believe the proposed Code amendments should be changed to reflect the points raised in this submission.

