

Stress Testing Regime – Summary of submissions and Authority Response¹

Purpose

On 26 July 2011, the Electricity Authority (Authority) published a paper entitled *Consultation paper - Scarcity pricing and related measures - proposed amendments to the Code* (the “consultation paper”). That paper set out proposals to introduce:

- a stress testing regime that would require certain types of wholesale market participant to apply a set of standard stress tests to their electricity market positions and report the results on a confidential basis to the Authority; and
- scarcity pricing during emergency load shedding.

This paper summarises the issues raised by submitters in relation to the proposed stress testing regime and sets out the Authority’s responses. The Authority is proposing a number of refinements to its earlier stress testing design to address issues raised in submissions. Those refinements and associated Code amendment proposals are set out in a separate consultation paper² released on 11 October 2011.

¹ A glossary of abbreviations appears at the end of this document

² See <http://www.ea.govt.nz/our-work/consultations/priority-projects/Stress-testing-regime-proposed-code-amendment/>

| Q1 | Do you agree with the problem definition? | | |
|------|---|-------------------------------|--|
| Ref. | Issue | Submitter | Authority Response |
| 1.1 | The report by Sapere identified the policy problem as being a missing market and proposed a short term forward market (STFM) to improve price formation. | MEUG | <p>The Authority considered this proposal in the July 2011 consultation paper.</p> <p>The STFM proposal doesn't address the time consistency (lobbying) issues being addressed by the stress testing regime. Moreover, an STFM may simply shift the focus of lobbying to the STFM price. The Authority may consider a STFM in the future but would need to consider how it would dovetail with hedge markets which provide short-term prices on a voluntary basis. The Authority notes that both the Scarcity Pricing Technical Group and the Scarcity Pricing Forum considered the STFM proposal would not address the issues that scarcity pricing was aimed at addressing.</p> |
| 1.2 | There is a concern that competition can break down in times of tight supply, and that the demand-side is not able to respond sufficiently to act as a discipline on prices. | Pan Pac | <p>Competition and security of supply are both important priorities for the Authority. This is reflected in the pro-competitive initiatives that are underway (e.g. hedge market development, introduction of financial transmission rights, and provision of a dispatchable demand product).</p> <p>While these measures should provide more options for managing risks, they still rely on participants making proactive decisions about their level of exposure. If participants perceive that the adverse effects of spot exposure can be reduced by lobbying for policy change, they are less likely to use contractual or physical means to manage their risks, even when they are available.</p> <p>For this reason, the Authority considers the availability of broader options for managing risk will not of itself address the time consistency issue.</p> |
| 1.3 | The problem definition does not identify the root cause of the issues. Spot price suppression is likely to be the symptom of a | Pan Pac Rio Tinto Alcan | See refs 1.1 and 1.2. See also the further clarification of the problem definition in section 2 of the consultation paper entitled "Proposed refinements to the stress testing Code amendments". |

| | | | |
|-----|--|---|---|
| | deeper issue of inefficient spot-price formation. | | |
| 1.4 | It is difficult to see how lobbying could accelerate the timing of an official conservation campaign given that campaigns now have a trigger point defined in the Code, based on the physical supply situation. | Contact Norske Skog Tasman Pan Pac | <p>The Authority agrees recent Code amendments to include pre-defined trigger points for starting and ending public conservation campaigns significantly reduce the scope for lobbying.</p> <p>However, the amended Code still includes discretion for the Authority to alter these trigger points by agreement with the system operator, because it is impossible to foresee all future circumstances when a public conservation campaign may be required.</p> <p>Even if trigger conditions were to be fixed in absolute terms, debate could continue to occur about whether the conditions have been met because the triggers are defined in terms of hydro risk curves, which are themselves subject to a number of areas of judgement.</p> <p>Finally, the incentive to seek ad hoc policy change is not confined to the triggering of public conservation campaigns. Experience from previous periods of tight supply indicate that pressures can emerge on a variety of fronts, but are generally directed at changing arrangements to reduce spot prices.</p> |
| 1.5 | The proposed stress test is designed to overcome policy problems that have not been articulated, or those that have been suggested such as the ability of lobbying to advance the timing of official conservation campaigns, are simply incorrect. | BusNZ MEUG NZ Steel | <p>The consultation paper explicitly referred to past experience during periods of tight supply, and noted that policy makers in those periods typically come under intense pressure to alter arrangements. The paper noted that it can be very difficult to determine whether these pressures reflect systemic issues or not, increasing the risk of ad hoc policy change. This, in turn, undermines wider investment confidence because parties are not sure whether to act on the basis of existing policy.</p> <p>Although the previous consultation paper did not use the economic term, this issue is widely recognised in economic literature as the problem of ensuring time consistency. In this context, buyers and sellers are free to decide their hedging levels, but need to accept the risks associated with this. Relatively light hedging may suit some buyers but when system conditions become tight their incentives are to change the bargain ex post (i.e. seek to alter market arrangements to lower spot prices), and past experience suggests they can successfully do so at times. Due to the particular features of electricity noted above, additional regulatory measures regarding risk-taking are needed, over and above</p> |

| | | | |
|-----|---|---|--|
| | | | that required for many other markets, to ensure parties know that they are accountable for the consequences of their decisions and won't be able to change the bargain ex post. |
| 1.6 | The analogy drawn with stress testing in the banking sector is misguided. | Bus NZ NZ Steel | The banking reference was included to help explain the proposed stress testing regime, and was not presented as a justification in its own right. Nevertheless, as in the banking industry, the proposed stress testing regime could serve to improve confidence within the electricity industry about the likely performance of the market during periods of stress. |
| 1.7 | The stress testing regime is not a matter covered by section 42 of the Electricity Industry Act. | NZ Steel | Section 42 of the Act does not refer to stress testing, and does not limit the Code amendments that the Authority can make. It requires the Authority to amend the Code to include "a floor or floors on spot prices for electricity in the wholesale market during supply emergencies (<i>including public conservation campaigns</i>)" (emphasis added) but provides for the Authority not to amend the Code only if it reports to the Minister explaining why it has not amended the Code and what if any alternative it intends to implement to address the matter. The stress testing regime is considered as an alternative to adopting a pricing floor during public conservation campaigns. |
| 1.8 | The mechanism seems to be designed to stifle lobbying and legitimate debate | Norske Skog Tasman NZ Steel Pan Pac Smart Power | The regime is not intended to eliminate lobbying. It doesn't discriminate between parties that lobby and those that don't lobby, for example. Rather, the stress testing regime is intended to ensure all parties are accountable for the risk decisions they have made and that they have better information about their risk decisions relative to the rest of the market. The regime is also intended to provide useful information for media commentators and relevant policy makers, not just the Authority, to critically assess the credibility of lobbying by parties that chose high risk positions. This should increase the durability of the policy framework, creating a more stable platform for investment for both demand and supply side participants. |
| 1.9 | Disclosure or stress testing is not a substitute for scarcity pricing in rolling outages and public | Genesis | The Authority recognises that <i>energy</i> security remains an important issue for New Zealand. However, it proposed the narrowing of scarcity pricing because it was not convinced that this mechanism would be effective at addressing sustained periods of tight energy supply. In particular: |

| | | | |
|------------|--|---------------------|---|
| | conservation campaigns | | <ul style="list-style-type: none"> • the mechanism would be intrusive on market operation; • setting an appropriate price floor for sustained energy related shortages is challenging as the value of energy will be changing over time during a shortage event; • price floors will only alter behaviour if they are perceived as durable. However, there is more doubt about the durability of price floors for extended energy shortages due to their very long return period (limiting opportunities to build credibility) and potentially severe financial consequences; and • the absence of any international precedent for scarcity pricing to address sustained energy shortages increases the level of design risk and potential for unintended outcomes. |
| Q20 | What is your view of the proposed information to be disclosed? | | |
| 20.1 | A company's Board is ultimately responsible for how risk is managed. The Authority has no role in determining a company's risk appetite or how it assesses risk. | Contact NZ Steel | The stress test regime is not intended to force a standard approach or set a maximum exposure level. Indeed, the consultation paper stated that "participants would retain full responsibility for managing their risk exposures". |
| 20.2 | Some businesses are philosophically opposed to financial hedging. Instead, they choose to manage risk in non-financial ways (such as through load shedding), or take a longer term "swings | NZ Steel | The Authority appreciates the diversity of approaches to risk management and did not intend the stress testing regime to limit risk management options. Indeed the consultation paper recognised voluntary load reduction as a legitimate risk management instrument. It noted that the participants should include the effect of demand reduction in their risk disclosure statements to the extent that it was available on a reliable basis. See also ref 20.1. |

| | | | |
|------|--|--|---|
| | and roundabouts” approach. | | |
| 20.3 | The proposal does not consider how listed companies’ obligations to the NZX could potentially conflict with the stress test. | Contact Meridian | The Authority has sought legal advice on this issue. In light of this advice, no conflict is expected to arise between the proposed stress testing regime and continuous disclosure obligations. |
| 20.4 | Some of the information sought is publicly available and could be accessed by the Authority without increasing the compliance burden on participants. | Contact | The Authority would prefer to rely on participants to supply certain defined items of information to minimise the scope for misinterpretation of public sources or collection of information that is out of date. |
| 20.5 | Prefer to certify (at an appropriate level) that company had applied stress tests and considered results (as determined to be appropriate). Participants would not provide any confidential numerical information to the Authority | Contact Genesis Meridian TrustPower | <p>The Authority has given consideration to this alternative proposal. It agrees that a key benefit of the regime is the increased level of assurance about board consideration of risk exposures. However, if disclosure was limited to an annual statement of compliance the Authority would have no means of monitoring the pattern of risk exposures across the wider market or trends through time. Moreover, the regime is also intended to provide useful information to media commentators and other policy makers to critically assess the credibility of lobbying by parties that chose high risk positions. Only by receiving the numerical information can these outcomes be achieved.</p> <p>However, the Authority accepts that it does not need to receive identifiable participant information to achieve these outcomes. Indeed, the Authority believes that accountability for risk management decisions will more clearly remain with individual boards if the Authority does not have access to identifiable participant information.</p> <p>For these reasons, the Authority is proposing a modified Code amendment which would provide it with generic information on risk exposures, but would not allow it to identify the risk exposure of any individual party. To achieve this outcome, the Authority is proposing</p> |

| | | | |
|------|---|---|--|
| | | | to appoint an independent party to act as a registrar for stress testing information. |
| 20.6 | The stress test will be a projection of possible outcomes, based on the position of a participant at a particular time. | Meridian NZ Steel | While results will clearly reflect conditions at a particular point, many submitters stated that they actively manage their forward risk position to ensure it stays within strict guidelines approved by their board. This suggests that their risk position is likely to be relatively stable through time, except when unexpected events occur (such as a plant failure). Periodic reporting of stress test results should therefore provide useful information. |
| 20.7 | Regarding the stress testing regime, provision needs to be made in the assessment for other funding facilities and shareholder support where these are available to participants. | Powershop | The Authority agrees that the extent of shareholder support may be a relevant issue in some cases. In part to address this issue, the Authority intends to allow closely related disclosing participants to apply to submit a consolidated risk disclosure statement. As regards other funding facilities, the ability to access these will generally be influenced by the value of shareholders equity (since the net value of the company is the ultimate source of security for creditors). More generally, disclosing participants will be free to submit additional information if they believe that the required information in a risk disclosure statement is insufficient to form a proper view. |
| 20.8 | If the Electricity Authority needs to understand relative size implications then it could assess the stress tests based on GWhs purchased. | Pulse | An electricity purchase volume measure is useful, but by itself does not provide information on the level of risk that a participant is exposed to, or its capacity to bear that risk. Given that electricity trading risk is ultimately a financial issue, it is best assessed relative to some measure of a participant's financial profile – hence the proposal to disclose financial measures based on the latest audited set of financial statements. |
| 20.9 | Opposes the publication of any information that is not already in the public domain. Even if anonymous, it increases the risk of | TrustPower Meridian MEUG NZ Steel Norske Skog | See refs 20.5 and 25.1. Further, the Authority notes that the summary chart included in the consultation paper was only included for illustrative purposes. Further consideration is being given to the form of any published summary, including the suggestion that information be provided in the form of statistical measures (e.g. quartiles). Publication of results will only take place after participants have been consulted on the proposed format. |

| | | | |
|-------|--|------------------------|---|
| | other parties being able to back-calculate participants' book positions | Tasman Pan Pac | |
| 20.10 | The Authority should consider adding prudential payments to the stresses over and above net spot market purchases. | Meridian TrustPower | While the Authority acknowledges the importance of prudential requirements during stress events, it believes that including cash calls would introduce undesirable complexity in the reporting measure at this point. |
| 20.11 | Net cash from operating activities (NCFO) and net assets are likely to be subject to some interpretation issues. Responses will therefore be inconsistent. | MEUG NZ Steel | The Authority is seeking to minimise compliance costs by avoiding highly prescriptive arrangements and relying instead on broad guidelines. Net cash flow from operations (NCFO) is a term that is widely used within businesses and is defined within financial reporting standards. |
| 20.12 | There will be a lag in receipt of information and historic information will not be based on a common financial reporting year for all participants. | MEUG NZ Steel | Participants would report the NCFO results based on common timing and stress test scenarios. These are the crucial parameters for stress testing purposes. |
| 20.13 | Disclosure of NCFO and Shareholders' Equity ignores other factors affecting the business, particularly where cash earnings | NZ Steel | The intent has been to develop electricity market tests that have relatively low compliance costs. The proposed tests should provide a reasonable indicator of the financial impacts from stressful electricity market events. |

| | | | |
|------------|--|-----------------|--|
| | are volatile depending on world commodity prices. | | |
| 20.14 | The proposed Code amendment gives the EA freedom to publish any stress test, and is an inappropriate use of tertiary legislative powers. | MEUG | <p>The Authority has considered this issue and believes the draft Code is consistent with the Electricity Industry Act. While there are no specific limits in the Code regarding stress test scenarios, the Authority's power to publish stress tests would have to be used reasonably. Disclosing participants are able to seek a review of the Authority's exercise of this power.</p> <p>Finally, the proposed Code provides for disclosing participants to have at least 30 working days to consider any new stress test before a disclosure statement is due.</p> |
| Q21 | Question 21: What is your view of the indicative stress test parameters? | | |
| 21.1 | It is not clear why a capacity shortage scenario is required. | Genesis MEUG | The regime is designed to test exposure to risk, which can arise from sustained energy or short term capacity shortages. |
| 21.2 | Scenarios should provide guidance on treatment of nodal pricing effects | Powershop | The Authority has noted this issue for when it compiles stress test guidelines. |
| 21.3 | Any price series provided to participants must be at the half-hourly level of granularity. | TrustPower | The Authority has noted this issue for when it compiles stress test guidelines. |
| 21.4 | The regulator must provide a basecase against which tests are applied. This means it is in the business of forecasting expected | MEUG | Other regulatory bodies that administer stress tests face a similar issue. Furthermore, in terms of the base case itself, it is likely that the Authority would adopt a projection that is already in the public domain, such as the forward curve quoted on the ASX. The Authority is not seeking to forecast expected spot prices and will not portray the base case in those terms. |

| | | | |
|------------|---|--|---|
| | spot prices, which is inappropriate. | | |
| 21.5 | Despite any disclaimers to the contrary the stress tests will be perceived as worst case scenarios by participants – and yet it is possible for more extreme events to occur. This will put the Authority in an awkward position if one of these events arises. | Smart Power | The Authority acknowledges this risk, but notes that it also applies without a stress testing regime. When system conditions have been tight in the past it has been common for some participants to express surprise and pressure a wide range of policy makers (through private and public channels) for market changes or related interventions. Due to the particular features of electricity and the relative newness of spot electricity markets, it can be difficult for policy makers not deeply involved in electricity matters to appreciate the earlier choices made by these parties or to effectively communicate those choices to the electorate at large. Leaving these parties with the consequences of their choices can carry significant political risk for policy makers, especially when tight supply situations occur. The stress testing regime will be presented as a mechanism for ensuring accountability lies with participants. |
| Q22 | What is your view of the proposed level of guidance to be provided to participants? | | |
| 22.1 | Participant will have to make assumptions specific to their business that could undermine consistency of results of their modeling. | Genesis MEUG NZ Steel Norske Skog Tasman | The Authority has sought to avoid prescription on all issues to allow parties to use existing tools and processes and reduce compliance costs. It has therefore focused on what it regard as key issues and considers the proposed level of guidance is a reasonable balance in this respect. The proposed Code provides some flexibility in this area and the Authority will keep this issue under review as experience develops with the regime. |
| 22.2 | The Emergency Management Policy (EMP) may need amendment due to the customer compensation scheme and scarcity pricing proposals. | Meridian | The Code requires the system operator to draft a revised EMP and consult affected parties by 1 November 2011. Any concerns about the existing EMP are best addressed through that consultation process. |

| | | | |
|------------|---|--|---|
| | Any amendment could affect parties' operations and therefore their risk positions. Does the Authority intend to review the EMP? | | |
| 22.3 | The Authority could consider calculating and publishing wind generation <i>capacity credits</i> for different regions at different times of year. | TrustPower | The Authority has noted this issue for when it compiles stress test guidelines. |
| Q23 | What is your view of the proposed frequency of reporting? | | |
| 23.1 | The frequency is too high, and will create undue costs (especially for those with overseas-based directors) | Carter Holt Harvey Contact Genesis MEUG NZ Steel Norske Skog Tasman Pan Pac Rio Tinto Alcan Smart Power | <p>The Authority has considered a reduction in frequency of reporting but believes it will significantly compromise the regime because:</p> <ul style="list-style-type: none"> the reporting horizon would reach further into the future with greater likelihood that stress test results will cover periods when participants are yet to establish their hedge positions; it will make it harder to identify issues or trends through time. <p>To address compliance costs, the Authority intends to modify the certification aspects of the regime since these appear to be a key area of concern. Under the previous consultation paper proposal, disclosing participants would be required to report and certify the following on a quarterly basis:</p> <ol style="list-style-type: none"> stress test results and forecast wholesale purchase volumes; a statement that information on the stress tests has been provided to any retail customers with contracts linked to spot prices; and a statement that the board has considered the risk disclosure statement. |

| | | | |
|------------|---|----------------------------------|---|
| | | | <p>The Authority now intends that only item (a) would be reported on a quarterly basis. The level of sign-off for the quarterly results would be altered to allow for sign-off by a director, the CEO or CFO.</p> <p>There would be an annual requirement for the disclosing party to certify that the board of the disclosing participant has considered every risk disclosure statement made in the preceding 12 months and the projected change in net cash flows from operating activities as a result of applying the stress test (or stress tests).</p> <p>A split of the reporting and certification obligations should reduce compliance costs while allowing the Authority to collect information that it regards as important to monitor risk exposure. This split of reporting and certification requirements is similar to that which currently applies in respect of the hedge contract disclosure regime.</p> |
| 23.2 | There is a significant risk of the EA requesting updated information as part of information fishing expeditions. This risk arises because the draft Code fails to set out the parameters guiding when and specifically what information can be requested. | MEUG Pan Pac | The regime would only allow the Authority to seek the items of information (change in net cash flow from operations etc) defined in the proposed Code amendments. |
| Q24 | What is your view of the proposed coverage of a disclosure obligation? | | |
| 24.1 | A measure targeted at parties that lobby might be more appropriate (even on an ad hoc basis), rather than a wide ranging | Contact Mighty River Power | <p>This suggested modification appears to be based on a belief that the regime is intended to deter lobbying activity, per se. That is not the case, as discussed in our response at 1.8.</p> <p>In any case the Authority also has doubts about the practicality of applying a disclosure requirement only to parties that engage in lobbying. For example, would it be triggered only by the direct action of participants or would it include lobbying undertaken on behalf of</p> |

| | | | |
|------------|--|------------------------------------|--|
| | intervention such as that proposed. | | participants by industry associations? Likewise, how would lobbying be defined? |
| 24.2 | The Authority could achieve much of its aims by a focussed education campaign rather than requiring certification by retailers that they have informed spot-exposed customers of the stress tests. | Contact Meridian TrustPower | This Authority wishes to ensure that spot-exposed customers have an awareness of the nature of spot price risk at the time they enter into contracts. That said, the Authority agrees that targeted education could be useful and will consider this issue further as part of its forward work programme. It would not require any Code amendment. |
| 24.3 | Has the Authority considered possible interactions with the Financial Service Act 2008 | Meridian TrustPower | The Authority has received legal advice on this issue and does not expect any conflict to arise between the proposed Code and the Financial Advisers Act 2008. |
| Q25 | What is your view of how information disclosed could be used? | | |
| 25.1 | The Authority should place strict controls on how information is managed and used. | Meridian NZ Steel TrustPower | The Authority is proposing a modified Code amendment which would provide it with generic information on risk exposures, but would not allow it to identify the risk exposure of any individual party. To achieve this outcome, the Authority is proposing to appoint an independent third party to act as registrar for stress-testing information. Disclosing participants would be required to provide their risk disclosure information to the registrar. The registrar would use this information to compute a set of summary risk measures that would not identify any individual participants. These summary measures would be provided to the Authority. This would allow the Authority to monitor the overall pattern of risk exposure across the market and trends through time, but without identifying individual parties. To protect the commercial interests of participants, the registrar would return each risk |

| | | | |
|------|---|-----------------------------------|---|
| | | | disclosure statement to the participant who submitted it after one year (and not retain a copy of it). In addition, while the data was still in its possession, the registrar would not be permitted to release individual risk disclosure data to any party including the Authority ³ . These obligations would be reflected in the Code so they could not be overturned without explicit Code amendment. |
| 25.2 | Information provided by participants could be subject to a request under the Official Information Act. | Norske Skog Tasman NZ Steel | See ref 25.1 |
| 25.3 | Stress testing could helpfully inform the Authority on the appropriate level of prudential requirements for the wholesale electricity market and distribution services. | Vector | The Authority will give this further consideration. |
| 25.4 | Unless participants are publicly named the information will have no value beyond satisfying the interest of the Authority, which already has the power to obtain this material. | MEUG Rio Tinto Alcan | Refer to 1.8. |

³ Noting that these requirements would not over-ride the Official Information Act. However, that Act provides that information may be withheld where release would be likely to unreasonably prejudice the commercial position of the person who supplied or who is the subject of the information (unless there is a public interest that outweighs the prejudice).

| Q26 | What is your view of the proposed compliance and auditing arrangements? | | |
|------|--|--|---|
| 26.1 | Director certification should guarantee the validity of the results. If auditing were deemed to be necessary, it should be mandatory for all participants, rather than simply those selected by the Authority. | Meridian TrustPower | <p>Director certification provides a high level of assurance, but does not 'guarantee' the integrity of results. The right to require an independent audit provides a safeguard. It does not intend to implement a selective audit programme.</p> <p>The Authority is also proposing a change to provide for the direct costs of audits to be met by the Authority where no material non-compliance is identified. This will act as a check on any potential for the Authority to seek an audit without good reason.</p> |
| 26.2 | The requirement to obtain sign-off from two directors is onerous and costly (especially for participants with overseas based directors) | Contact Meridian MEUG Norske Skog Tasman NZ Steel | The Authority acknowledges the concern and has altered the authorised signatories for quarterly risk statements to be one director, or the CEO or CFO or their equivalents. |
| 26.3 | Disagree with the requirement for the board to consider the stress test results | Smart Power | <p>The Authority wants assurance that boards have considered the effect of applying the stress tests, since each board is ultimately responsible for risk management decisions.</p> <p>This should not be an onerous obligation as boards consider risk management issues as part of their core role. Further, there is flexibility for the signoff by the Board to be conducted at any time of year to avoid the need for a special meeting. Finally, the obligation is limited to "consideration" so each board would retain full responsibility for its risk management decisions.</p> |
| 26.4 | Boards will not necessarily understand stress test results, meaning that additional | Pulse | <p>Boards already actively consider a company's exposure to spot price risk (as noted by many submitters). They should therefore be reasonably placed to understand the stress test results without significant additional effort or cost.</p> <p>Furthermore, to the extent that any additional cost did arise, it is likely to be because a</p> |

| | | | |
|------------|---|--|--|
| | costs may be incurred for third party review | | board wants to obtain more assurance about risk exposure, which is likely to be positive from an overall perspective |
| Q27 | What is your view of the proposals when assessed against the Authority's statutory objective? | | |
| | | | Q27 and Q28 are closely related and are considered in consolidated form below. |
| Q28 | What is your view of the alternative means of achieving the objectives of the proposed stress-testing regime? | | |
| 28.1 | Participants should certify that they had applied stress tests and considered results, but should not provide any confidential information to the Authority | Contact Genesis Meridian TrustPower | See ref 20.5. |
| 28.2 | We consider that a more complete implementation of scarcity pricing would be the best approach. | Genesis | The Authority has considered scarcity pricing for rolling outages and public conservation campaigns but does not favour them at this time for the reasons set out in ref 1.9. |
| 28.3 | Disclosure of percentage hedge position on an impending public conservation campaign may be of some use. | Carter Holt Harvey | With this approach, information is unlikely to be publicly available until a public conservation campaign is underway (given the time required for participants to run stress tests). This means the media and other policy makers, not just the Authority, would unlikely to be any better informed than under current arrangements. Furthermore, this approach would provide no information on risk exposure at other times. |
| 28.4 | The status quo is a better alternative. | MEUG Norske Skog Tasman | Reliance on existing arrangements is not considered sufficient to address the pressures around time consistency that are expected to arise during a period of tight supply. Nor would the concerns be adequately addressed by other proposals that are actively being pursued by the Authority at present (e.g. development of hedge market arrangements). |

| | | | |
|------------|---|-----------------------------------|---|
| | | NZ Steel | |
| 28.5 | The single supplier model is a better alternative | Pan Pac | The consultation paper noted that this option would require widespread changes to existing arrangements and create significant transition costs and risks. Nor is it clear that centralised decision-making would yield economic benefits (recalling that supply shortages occurred under central decision making in the past). |
| 28.6 | A price cap could apply for PCCs and rolling outages to help identify the boundaries of risk that participants should seek to manage. | Contact | The Authority does not favour this approach for the reasons set out in ref 1.9. |
| 28.7 | Addressing immature market arrangements (including demand side response) is a better alternative | Rio Tinto Alcan Smart Power | The Authority agrees that strengthening demand side response and risk management arrangements are important, and it has initiatives underway in these arenas (e.g. introducing a locational hedge product, improving the hedge market, introducing dispatchable demand product). |
| Q30 | What is your view of the costs and benefits of the proposed stress testing regime? | | |
| 30.1 | Commercial harm may arise from disclosure of sensitive information – this would be a detriment and inconsistent with the Authority’s statutory objective. | Contact Genesis Meridian | See ref 25.1. |
| 30.2 | Stress testing will have a cost as directors are reminded regularly of the apparent fragility of | Carter Holt Harvey MEUG | It is not clear why stress testing would lead to this outcome if directors are regularly considering the exposure of their business to spot price risk. Moreover, the focus of the stress test is on financial risk arising from spot market exposure, which directors can directly control via their hedging decisions. Many participants have no or very little |

| | | | |
|------|--|---------------------|--|
| | the New Zealand electricity system | | exposure to the spot market because they seek to hedge 100% of their spot market risks. |
| 30.3 | The assumed benefits may have already been achieved by other measures (codifying the triggers for PCCs and introducing the customer compensation scheme) | MEUG Smart Power | As noted in ref 1.4, the recent codification of PCC triggers reduces but does not eliminate the time consistency problem. Nor does the customer compensation scheme entirely address this problem as the customer compensation scheme only applies to retailers and does not affect other net purchasers in the spot market. |
| 30.4 | The costs of director sign off may be higher than assumed | MEUG Smart Power | <p>The costs are not expected to be high given that directors already consider risk exposures and participants should be able to use their own existing systems to generate stress testing results.</p> <p>Nonetheless, to further address concerns about compliance costs the Authority has resolved to allow more time flexibility for the sign-off of annual compliance certificates and to expand the level of sign-off required for the quarterly reports to allow either a director, the CEO, or the CFO to sign them off.</p> |
| 30.5 | Costs may be underestimated because further Code amendment will be required as the EA discovers the quality of information is poor | MEUG | <p>The cost benefit assessment needs to reflect the current Code amendment proposal rather than a hypothetical future change.</p> <p>If a proposal to amend the Code arises in future it would be given separate consideration at the time.</p> |
| 30.6 | The cost is underestimated because there is a risk the mechanism will be used for information fishing expeditions | MEUG | <p>It is not clear how the proposed Code amendment would allow “fishing expeditions”. The information required from disclosing participants is specifically defined in the Code. The Authority is also now proposing that it only receive anonymous or aggregated information via a registrar.</p> <p>Nor would the audit provisions allow for fishing expeditions. The Code states “the disclosing participant may require that the auditor does not provide the Authority with a</p> |

| | | | |
|-------|---|------|---|
| | | | copy of any information that the disclosing participant has provided to the auditor” |
| 30.7 | The benefit of improved economic confidence is overstated because the regime will not stop parties complaining about the level of security risk and competition when the system is tight | MEUG | See ref 1.8. |
| 30.8 | The benefit of stronger risk management incentives is overstated because parties already have strong incentives to manage risk. | MEUG | The concern is not about the <i>strength</i> of incentives to manage risk – but rather the choice of instrument. In particular, the Authority wants to ensure that parties do not perceive lobbying for ad hoc policy change as a legitimate tool to “manage” their risk. |
| 30.9 | The benefit of improved information for the Authority on systematic risk exposure is overstated because it should be a routine function of the Settlement and Clearing Manager to ensure the prudential integrity of the market | MEUG | Do not agree. A wide range of policy makers and media are subjected to the lobbying that occurs, not the clearing manager. |
| 30.10 | The benefit of providing information to assist | MEUG | The cost benefit analysis noted this issue for completeness. It is not regarded as one of |

| | | | |
|------------|---|-----------------------|--|
| | Authority in fulfilling its broader market monitoring functions under s.16 of the Electricity Industry Act is not attributable to the stress test proposal. | | the primary benefits of the proposed regime |
| Q31 | Do you propose any changes to the Code amendments? | | |
| 31.1 | The Code should be amended to take account of policy revisions following submissions | A range of submitters | The Authority has noted this point and revised the draft Code in light of policy decisions following the consultation process. |

Glossary

| | |
|-------|-------------------------------|
| BusNZ | Business New Zealand |
| DEUN | Domestic Energy Users Network |
| EMP | Emergency Management Policy |
| MEUG | Major Electricity Users Group |
| NCFO | Net cash flow from operations |
| STFM | Short term forward market |