

General Manager's Update

[June 2010]

Market Development Programme (MDP)

Last month's MDP conference showed real commitment to progressing initiatives to improve market performance. Although design detail can be complex, the objectives of the MDP, in concert with other sector changes, are clear – improved competition and security of supply.

A large attendance, widely representative of industry participants and related parties, took a keen interest in progress on core projects in the programme (scarcity pricing, default buyback, locational price risk, transmission pricing and dispatchable demand) and our thinking on the linkages between them. Constructive panel discussions and a range of considered input from participants made for a productive day and a half (see below for an update on individual projects).

As we have discussed in earlier forums, to make the MDP work, two 'conversations' need to be held. The first is a collective one – involving sector constituents and the Commission. The second is within individual market participant companies. The package of changes will have a substantial impact on participants and we are therefore intent on progressing MDP projects at a pace that permits participants to adapt their operations to changing commercial opportunities and risks.

At this point, our timetabling (see below) is indicative. As work progresses on detailed design, the timetable will firm up. We will be looking to simplify initiatives where possible, phase implementation, and provide participants with appropriate lead time. Conference participants expressed a general willingness to proceed relatively quickly with a default buyback scheme and a dispatchable demand scheme. The complexity and level of detail in scarcity pricing needs to be worked through over a longer timeframe. Work on locational price risk, as shown in the table below, is comparatively well advanced and detailed proposals may possibly be completed later this year, ahead of schedule.

Project	Consultations	When
Locational price risk management	Detailed proposal (with outline of draft rules) package includes related details of scarcity pricing	Aug 2010
	Detailed proposals (with full draft rules)	Jan/Feb 2011
Scarcity pricing/ Default buyback	Detailed proposal (with outline of draft rules) DBB – possible advance	Oct 2010
	Detailed proposal (with full draft rules)	Mar/Apr 2011
Transmission pricing	Stage two consultation	July 2010
	Preferred option	Nov/Dec 2010
Dispatchable demand	Proposed design	June 2010
	Detailed proposal (with full draft rules)	Nov 2010
	Possible advance	

It is important to recognise that there can be a difference in timing between when rules are developed and when they come into effect. For example, when rules are made about locational hedges, it will be necessary to tender and contract for providers, develop clear software specifications and set up a system. The time required for this implementation phase will be part of the notice participants will have before the rules actually come into effect.

There was a general sense at the conference that the current market is unsustainable. Although cautious about unintended consequences, there was a broad consensus that MDP initiatives are heading in the right direction, consistent with the findings of the Market Review.

In proceeding, we will be looking to maintain the high degree of industry engagement demonstrated at the conference. This builds on the suite of consultation documents released late last year, and the earlier sector conference, as well as extensive interaction via technical groups. Technical group inputs will be maintained, but it is apparent that further workshops in specific areas, for example, locational hedge design and draft rules, will play an important part in the process.

Scarcity pricing

The general feedback was one of comfort with direction of the design and policy development work on scarcity pricing. However, a note of caution was apparent regarding a floor price.

A detailed proposal is marked down for industry consultation in September/October 2010. This will address the main design elements, proposed safeguard mechanisms, cost benefit analysis, proposals for staged implementation, draft rules, and a timetable for implementation. Rule changes will be finalised around June 2011, with the changes potentially taking effect prior to winter 2012.

www.electricitycommission.govt.nz/opdev/mdp/scarcity-capacity

Default buyback

Because of its more standalone nature, some participants felt that this initiative could proceed more quickly than other projects. Design and policy decisions will continue to be developed on advice received through the Scarcity Pricing and Default Buyback Technical Group and internal modelling.

It is intended to have a proposal ready for consultation in October 2010, which will incorporate the main design elements, including coverage, determination of triggers and payment levels, a proposed process for customised buyback applications, a process to assess compliance with default buyback obligations, cost benefit analysis, draft rules, and a timetable for implementation.

www.electricitycommission.govt.nz/opdev/mdp/scarcity-capacity

Locational price risk

Although being developed as part of the overall package, the locational price risk project is at a more detailed design phase than other projects. Options for managing locational price risk prompted robust discussion at the conference, including some residual support for a Locational Rentals Allocation (LRA) approach.

The outcome of discussions involves determining the most cost-effective locational hedge. Following which, consultation, including workshops to facilitate full explanation and examination of the proposal, will take place on a number of design and policy recommendations, in July/August 2010.

www.electricitycommission.govt.nz/opdev/wholesale/Hedge/transmission-hedges

Dispatchable demand

Conference participants generally favoured progressing a dispatchable-demand regime to enhance demand-side participants' ability to respond actively to wholesale-market conditions. The proposed design would treat electricity users more symmetrically with generators and provide them with greater confidence about the rewards to be received for demand response. Consultation has just been completed on proposed design options, with the aim of enabling the Electricity Authority (EA) to consult in November 2010 on detailed rule changes.

www.electricitycommission.govt.nz/opdev/wholesale/demand/dispatch

Transmission pricing

We are continuing with analysis of the potential benefits of price-signalling and transmission-pricing options and issues. Consultation on Stage two options is planned as soon as possible. All going well, there should be a decision on the preferred option by the end of this year.

If the preferred option is a new approach to transmission pricing, it will be detailed in an issues paper most likely incorporating the draft process to be followed and draft guidelines to be used by Transpower in preparing the new transmission pricing methodology (as required by the Rules).

www.electricitycommission.govt.nz/opdev/transmis/tp

Market information and monitoring

Concern expressed by some participants at the conference about market power in certain circumstances and the need for closer monitoring and greater availability of information is picked up in the Electricity Industry Bill, currently before the House, with the EA being given a monitoring function. Many of the analytical tools being used by the modelling team to support MDP work will be useful later in furthering understanding of market situations.

The Electricity Industry Bill

The Electricity Industry Bill was reported back from the Finance and Expenditure Select Committee to the house on 9 June.

www.legislation.govt.nz/bill/government/2009/0111/latest/versions.aspx

Draft Electricity Industry Participation Code briefing

MED held a well-attended briefing in Wellington earlier this month on the draft initial Code which will come into effect with the establishment of the EA in October.

We have been working closely with MED on preparing the draft initial Code, which incorporates the current Rules and certain regulations, with changes only being made for consistency with the requirements of the new legislation. The draft initial Code is now out for comment. When feedback has been considered, the final Code will be made public at the beginning of September 2010, a month out from it's becoming law. The draft initial Code is available on MED's website.

www.med.govt.nz/templates/ContentTopicSummary___43215.aspx

Quarterly updates

The Commission publishes detailed quarterly updates on progress against the Government Policy Statement (GPS) work programme. These can be found at www.electricitycommission.govt.nz/publications/index.html#reports