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27 April 2021

Submissions
Electricity Authority
PO Box 10041
Wellington 6143
By email: UTS@ea.govt.nz

Re: Consultation paper - Proposed actions to correct Undesirable Trading Situation 2019 (UTS)

I refer to the consultation paper of 11 March 2021. Nova Energy (Nova) makes submissions on its own behalf as well as agent on behalf of its related company, Todd Generation Taranaki Limited, owner of the peaker plants McKee Power Plant and Junction Road Power Plant. A reference to "Nova" in relation to the peakers may include a reference to Todd Generation Taranaki Limited, unless the context otherwise requires. Nova's submission is attached to this letter.

In summary, Nova supports the general approach proposed in the consultation paper to recalculate nodal spot prices based on revised, capped offer prices on the Waitaki and Clutha hydro systems given they were deemed to be setting their offer prices at a higher price than was justifiable in the circumstances at the time.

Nova is surprised, however, with the lack of discussion on the impact on the peaking plants if spot prices are reset using capped offer prices. This point was highlighted by Nova in its submission on the Preliminary Decision Paper. This is acknowledged in Table 9 in the consultation paper. Mercury also identified this as an issue "…in this case such a remedy would involve the imposition of below short run marginal cost revenues on Nova ex-post, which would not be an outcome expected under normal market conditions."

This point is raised again in this submission, together with a proposal that, as well as providing constrained on compensation to generators outside those to be capped, the offer prices for the McKee Power Plant should be adjusted to reflect the prices it received for the generation it produced during the period of the UTS consistent with the Authority's view (which Nova agrees with) that *"it is important to compensate high price generators for supporting system security and wants to ensure that the actions to correct the UTS do not create perverse incentives to withdraw from providing those services"* (paragraph 5.47 of the consultation paper).

Nova also points out that the prices that apply during periods of hydro spill have an important influence on the long-term settings for hydro security of supply. This should be taken into consideration when determining the level of the cap on hydro offer prices.

Yours sincerely

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Nova submission

Consultation paper – Proposed actions to correct UTS 2019

Question		Response
Q. 1	What, if any, actions should the Authority undertake to address excess spill, system security, and any other consequent effects? How would such actions address the objectives of Part 5 of the Code?	It is appropriate for the Authority to determine the methods to correct a UTS claim (which will likely depend on the particular circumstances of the UTS scenario). Nova is concerned that the corrective actions must be done in a way that: a) minimises any potential negative financial impact on parties that traded in good faith at that time, and b) does not create unintended adverse consequences for future market activities. With respect to the Authority's proposed method, Nova's primary concern is that in re-setting hydro generator offer prices at the levels proposed, without revising the peakers' offers, will result in Todd Generation Taranaki Limited's (TGTL) peaker, McKee Power Plant (MPP), operating at a substantial loss during the UTS period. This would effectively penalise TGTL for participating in the market during the UTS period. Consideration should also be given to the impact of resetting offer prices on how the hydro generators can be expected manage inflow uncertainties and hydro storage in future.
Q. 2	Do you agree that the Authority should seek to correct the UTS period by resetting the payments made/received by spot market purchasers and generators? (If not, please explain your reasoning.)	Yes, it is appropriate to seek to correct the outcomes that result from the UTS over the relevant period by resetting the payments made/received by spot market purchasers and generators. It is important that parties who were net purchasers exposed to the unnecessarily high spot prices are reimbursed for those costs, while at the same time, generators that provided generation should not be made worse off than they would be if the market was operating in a competitive manner, as anticipated by market participants and the Authority. Nova also agrees that the settlement needs to be calibrated on the volume originally dispatched.

Question		Response
		Clearly, expensive-to-operate plants such as the thermal generation that have fuel costs and must offer on a unit commitment basis, such as MPP, would have operated much less had the actual spot prices including forecasts leading up to the relevant dispatch periods been lower at the time. Given these costs of operation were incurred by the peakers during the period of the UTS, they should be recoverable. The Electricity Authority's assessment at paragraph 5.47 almost has it right when it says it is "important to compensate high price generators for supporting system security and wants to ensure that the actions to correct the UTS do not create perverse incentives to withdraw from providing those services." We say "almost" because not all high price generators offer their generation at prices above their costs, but instead must form a view as to final prices being sufficient to recover their costs of operation as well as contributing to their fixed costs. They then commit to run their plants through offering at low prices to avoid the vagaries of marginal dispatch. Peaking facilities are best operated on this basis to prolong their useful life and avoid unnecessary and costly load following activity that results in wear and tear on plant. If we understand the Authority correctly, it is proposed to let constrained on payments provide the necessary reward for thermal generation and as such, no action is necessary. For generators that offer capacity at prices reflecting marginal costs of operation and a profit margin, the constrained-on payments will be sufficient. But this is not so for thermal generators that must offer their plant on a unit commitment basis and did so acting reasonably and in good faith reliance upon: a) observed actual spot prices that were determined to be final at the time; and b) internal or external short term price forecasts such as those provided by the System Operator as a part of the dispatch process. For these plants, constrained on payments are not sufficient.
Q. 3	Do you agree that the Authority should attempt to correct settlement during the UTS period by resetting prices in the electricity market?	Whichever way the Authority chooses to adjust for the UTS, there are going to be complexities and some simplifications are required. Resetting prices using the pricing model with capped hydro offers would seem to be the most appropriate methodology.

Question		Response
		Those prices can then be used to recalculate FTR's and CfDs. It appears that ASX futures cannot be recalculated, which will advantage buyers of futures (retailers), and disadvantage sellers (generators).
Q. 4	Do you agree that injection and off-take volumes should remain unchanged in any resettlement?	Yes. Any adjustment must be cognisant of fact that generation and output cannot be changed in arrears, and the generators incurred costs associated with that. Reductions to offtake volumes would adversely impact generators which incurred costs in generating the volumes they did inject.
Q. 5	Do you agree that the Authority should attempt to correct the UTS by revising final prices in the electricity market, rather than by an 'off-market' wash-up of spot electricity payments to and from the clearing manager?	It is difficult to say as the Authority has not provided details for the "off market" washup of settlement and what this might look like. We note that the Authority has identified a number of issues associated with the proposed price reset process such as the inability to direct washups for ASX futures settlements and as such, that will create undeserved winners and losers amongst parties that purchased ASX futures and those that sold them. It may be tempting to assume that it is generators who will be sellers (losers) and retailers who will be buyers (winners) but that may not necessarily be the case as any party may have cause to buy or sell ASX futures for their own legitimate purposes. Nova notes that the changes in spot energy settlements recorded in Table 10 of the consultation paper will be significantly different to the net position of most parties after the recalculation of CfDs. For instance, Nova estimates that Meridian's $11.4m net negative position will be partly offset by $9.9m through its CfD with New Zealand Aluminium Smelters alone, and the same can be said for Nova which also held CfDs at the time which will significantly reduce the financial benefit as published. Nova will likely be put in a position where it will not have recovered its costs of thermal plant operation unless the constrained-on payments issue (which Nova has already submitted on) is addressed.
Q. 6	If offer prices and offer volumes are reset, which hydro generating stations should have offers reset? (Please answer yes/no, with any additional supporting commentary.) a. Aviemore? b. Benmore? c. Clyde?	

Question		Response
	d. Manapōuri? e. Ōhau A, B, C? f. Roxburgh? g. Tekapo A, B? h. Waitaki? i. Other stations?	
Q. 7	If offer prices and volumes are reset, do you agree that North Island offer prices and offer volumes should remain the same as originally submitted? (If not, please identify any alternative actions.)	We consider that the offer price for peakers should also be amended to reflect their role in the market. Peaker units operate on a 'unit dispatch' basis because they operate most efficiently at capacity and, importantly, they are not suited to marginal operation. The peakers are therefore offered to the market at $0.01 or thereabouts when spot prices are expected to exceed their operating costs. To reduce unnecessary start-up costs, they also continue to operate at times when the spot prices fall below that for a small number of trading periods but are expected to increase again. Given that peaker units are normally offered at around $0.01, re-running prices would mean that these units would be reimbursed at the reset market price only. Indications are that this is likely to fall to around half of the peakers' actual operating costs at the time i.e., circa $40 versus $90. Such an outcome would be a direct penalty on TGTL and an unacceptable outcome of the UTS price reset. There is no offsetting gain to the spot price reduction because the peaker units would simply not have run at lower prices and the fuel could have been sold to the market or stored for later use. We agree with the Authority's views expressed in paragraph 5.49 regarding the difficulties of attempting to apply an assessment of an eligible generators short run operating costs and that it would be simpler as well as appropriate to: a) provide for constrained on payments where offer prices for such generators are higher than the revised market clearing price; and b) provide for eligible generators that operate in a unit commitment mode to receive the same level of generation revenue that they received prior to the market price reset. This could be achieved easily by resetting such eligible generator offers to the same price as what they received form their generation for the quantity that they offered and dispatched. Quantities that were offered at much higher prices and were not dispatched would be left unchanged. Nova is open to alternatives for resolving this issue.

Question		Response
Q. 8	Do you agree that resetting offer prices and volumes by imposing a cap is the preferred action to correct the UTS? If not, please identify preferred alternatives.	The proposal appears reasonable.
Q. 9	If revisions to offer prices are to vary through time or across generating stations, how should the offer prices be determined?	Nova does not believe there is any point in varying offer prices through time or across generating stations in a situation where those stations are experiencing hydro spill. The price most relevant in those circumstances is the long term 'spill price'. The spill price is the value of water that hydro generators reflect in their offer prices when storage is full. They need to apply this value in their modelling of water values. It is an important value as it is one of the determinants of security of supply when managing hydro generation. The belief that the spill price should be 'zero' would be true if storage was not a limited resource. Because storage capacity is limited, storage has to be maintained at levels where there is always a significant risk of spillage. As a result, hydro generators still need to earn a return when spillage occurs in order to achieve their long run return on investment. If the value of generation during a period of hydro spill is set too low, then the optimal hydro storage levels for the hydro generator are commensurately lower, thereby reducing security of supply over the longer term. Conversely, a very high spill price leads to the hydro generator's optimal storage level being higher, and water spill is more likely to occur over the long run, with subsequent higher energy costs from alternative supplies, e.g., thermal generation. The appropriate settings for determining optimal water values depend on a number of parameters and need to be calculated using an appropriate hydro optimization model such as EMarket. If done well, this will include such factors as the security of supply of thermal fuels.
Q. 10	Do you consider that final prices should be reset directly? If so, how should they be calibrated?	Nova does not favour resetting final prices directly for the reasons discussed in the paper.

Question		Response
		Even if the spill price is adopted for prices on the Waitaki and Clutha hydro chains, as described above, the SPD pricing model should be run to accurately determine the appropriate prices across the entire grid.
Q. 11	Do you agree that the aggregate offer volumes of each generating station should equal the aggregate amount offered by that station during the UTS period? Please describe any preferred alternatives.	Yes. Because the market prices are being redetermined in arrears with un-capped generators constrained on, aggregating the revised offers at the capped price should not make any significant difference to the final dispatch volumes. The demand remains unchanged, and therefore power-flows and subsequent lines losses will be similar.
Q. 12	Which of these mechanisms in paragraph 5.41(a) – (e), if any, should be used to calibrate 'corrected' electricity offer prices? (Please identify any other preferred alternatives.)	The Authority should cap the hydro offer prices at the 'spill price', which should be calculated from a consideration of the wider circumstances facing the electricity market prior to the UTS period, i.e., the assumptions used to calculate water values prior to December 2019 would have taken into account the planned HVDC and Pohokura gas field outages planned for early 2020. If the Authority resets the spill price too low, then as an unintended consequence, the hydro generators will likely assume that lower spill price for future modelling, and the hydro security of supply settings will likely be lower than desirable. It is possible that the UTS claim has already had an impact on target hydro storage levels through the 2020/21 summer, resulting in a lower than desirable level of hydro reserves going through autumn. Nova's estimate is that the appropriate spill price is within the range of $13.70 [option (a)] at the lower end, and $29.59 [option (c)] at the higher end. Nova rejects option (e) i.e., SRMC, as unsustainable. If the gross profit on generation is reduced to close to zero during periods of spill, then hydro generators will be strongly incentivised to keep storage levels low to avoid all spill. This will result in a lower security of supply in the future and more volatile electricity prices.
Q. 13	Do you agree that generators, other than those with 'reset offers', that were dispatched to generate electricity at offer prices above the reset final prices	Generators that operated during the UTS period and incurred costs in doing so should at the least be compensated for those costs. They should preferably be left in a position where the revenue they earned is unchanged given they were not

Question		Response
	should be treated as constrained on? (If not, please identify preferred alternatives.)	responsible for the UTS. For thermal generators, this includes fuel and operating costs. For other hydro generators with storage, that includes water usage that could have been conserved for later use. Generators that were dispatched to generate electricity should be treated as constrained on, but their offer prices must also be reviewed to ensure they are not negatively affected by the price reset process. We have provided our views on how that can be achieved in our response to question 7. As discussed under Q.6, the gas peaker units do not offer at or near their SRMC because of the need to either commit the unit to run (with an offer of $0.01 or thereabouts) or hold back the unit at a high reserve price, e.g., over $400/MWh in order not to be dispatched for the trading period(s) in question. The TGTL peaking plants are designed to be economic to run on an intra-day basis, but they are not efficient when running partially loaded or having to follow load. They also face increased maintenance costs due to wear and tear. The McKee Peaker Plant was offered at $0.01/MWh at various times over the UTS period when prices were expected to be above SRMC. Resetting prices based on the $0.01 offer prices would mean that the actual costs incurred of running those plants would not be recovered and this would unduly penalise TGTL. If the offer prices are not amended, the losses incurred raises the risk profile for the peakers as the operator cannot always be assured that quoted prices will hold in future. Any increase in risk will lift the required rate of return on any future investment of capital in such generation as noted by the Authority in paragraphs 5.47 and 5.49.
Q. 14	Do you agree with the Authority's proposal not to revise constrained off payments, associated with frequency keeping? (If not, please explain and identify any preferred alternatives.)	
Q. 15	Should offers to the instantaneous reserves market during the UTS period be corrected? If so, how should instantaneous reserve offers be corrected?	

Question		Response
Q. 16	Do you agree with the proposed approach to treatment of derivatives for the purposes of correcting the UTS? Please explain your answer.	Nova agrees that where the terms of derivative agreements provide for resettlement of prices, then that should be undertaken at the revised prices. Ideally, ASX futures contract settlement should also be redetermined, but Nova does not have any suggestions on how that might be resolved. Nova is not in a position to determine the materiality of this or the impact on other market participants, but it appears that this will remain a potential distortionary factor in the market given the importance of the role that the ASX futures market currently plays.
Q. 17	Are there any additional, feasible and lawful actions that the Authority should or could undertake in relation to derivatives markets?	
Q. 18	How should the Authority use its powers under Part 5 in relation to LCE payments?	
Q. 19	Should the Authority use its powers under Part 5 of the Code to direct retailers to reimburse consumers that had contracts on variable price terms? What, if any, action should the Authority take in relation to variable price contracts?	No, the Authority should not specifically "direct" retailer to reimburse customers which had contracts on variable (spot) price terms. The Authority should not go as far as overriding existing contracts between retailers and their customers, especially as such contracts already provide variable-price customers with certainty of contractual terms and agreed avenues for disputing invoices (either directly with the retailer, or via UDL) and receiving account credits for over charging. The issue of reimbursement also gets complex when taking into account customer switches, plus any outstanding errors or disputes and credit issues that could be in play with customers. The Authority should encourage retailers to reimburse their variable (spot) price customers for the difference over the relevant period. However, we consider that retailers may be incentivised to do this by virtue of media attention on the UTS. If the Authority does use its powers to "direct" reimbursement, we consider that for practical purposes any reimbursement should be subject to a de-minimis sum,

Question		Response
		below which refunds should not be necessary and a clear formula for retailers to determine and apply any approximate difference in pricing over the relevant period.
Q. 20	How should any resettlement arising from the actions to correct the UTS be implemented?	It should be implemented via a separate invoice / credit note raised by the Clearing Manager.
Q. 21	If there is a resettlement, what window of time after invoicing should be allowed for traders to meet their obligations?	Parties should be given 30 days from the date of invoice to settle.
Q. 22	Please provide feedback on the operational implementation of the proposed actions to correct the UTS, including the interest rate that should be used to scale payments.	The process described in para 5.88 of the consultation paper is largely consistent with Nova's expectations. In instances where the Clearing Manager held Hedge Settlement Agreements (HSA) for the UTS period, the Clearing Manager will also need to confirm with the relevant participants that the terms of the HSA provide for the redetermination of the settlement amount. This may require a certificate signed by both parties to the HSA. The interest rate used is relatively minor in comparison to the importance of the capped offer price. The Clearing Manager should be able to apply interest in accordance with its usual processes.