The Electricity Authority
PO Box 10041
Wellington 6143l

03 May 2022

**Preliminary decision on claim of an undesirable trading situation on 9 August 2021 – Supplementary consultation paper**

Dear Sir/Madam,

Thank you for the opportunity to answer the supplementary question posed in the consultation:

*Do you agree that it is appropriate for scarcity pricing to apply to trading periods 39 – 42 on 9 August 2021, notwithstanding that the ISS notice may not have been issued in accordance with the Code?*

Yes, emhTrade agrees it is appropriate for scarcity pricing to apply to trading periods 39-42 on 9th August 2021, notwithstanding the issue with the island shortage situation (ISS) notice. We believe this is reasonable because, in practical terms, the criteria for a scarcity pricing situation was met:

- The system operator issued an island wide instruction that, whether intended or not intended, resulted in electrical disconnections of ~34,000 consumers across multiple distributors
- The pricing manager determined the other criteria was met (i.e. there was no binding constraint in the North Island excluding the HVDC, the HAY price was higher than the BEN price)

We recognise the Authority has released this supplementary consultation to help inform its decision on whether an undesirable trading situation (UTS) occurred on 9th August 2021. A UTS is a situation which "threatens, or may threaten, confidence in, or the integrity of, the wholesale market". Whether or not there was a UTS, with or without the application of scarcity pricing, is a decision for the Authority. However, we note that not applying scarcity pricing may undermine the wholesale market by:

- Indicating the market is not recognising the hidden cost that resulted from the forced power cuts
- Potentially discouraging the very risk management markets that scarcity pricing aims to incentivise, e.g. demand side response (DSR), financial transmission rights (FTRs), contracts for difference (CFDs), futures

In relation to futures, removing scarcity pricing is particularly problematic at this late stage (~9 months after the event) as ~1.6 GW in contracts have already been settled using interim prices. The ASX has noted these contracts will not be resettled if prices change. As such, lowering final prices by removing scarcity pricing creates gains/losses of ~$30m for futures market participants.



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The consequence of this outcome goes beyond this single event; it creates a precedent for a material basis (differential) risk between the futures market and the spot, FTR & CFD markets. Increasing basis risk will have the effect of reducing liquidity as the propensity for buyers and sellers to utilise futures will decrease with futures' effectiveness as a hedge (particularly for generation).

We note the futures market currently has ~12 TWh of open interest with a face value of ~$2.1B. Actions that could increase the basis risk for these futures need to be carefully considered and balanced as they could easily lead to a lack of confidence in the futures market with negative effects for retailer competition and investment.

We recognise that some market participants, particularly spot exposed consumers and retailers, will be negatively financially impacted by the 9th August event, which is highly unfortunate. However, many participants will be hedged with FTRs and futures, or may have limited their spot exposure by taking demand response actions (incurring costs).

Whilst the declaration of a UTS and resetting of prices to non-scarcity levels would reduce the impact for some participants, rather than protecting these participants via a UTS, we believe it is more appropriate for the Rulings Panel to determine if penalties or compensation are due from any party that is found to have breached the Code.

In this situation the Authority has to make a difficult tradeoff between the short term impact on some participants if scarcity pricing is retained, and the potential long term consequences on the wholesale market if a UTS is declared and scarcity pricing is removed.

Within the wholesale market, risk management products such as futures, CFDs, FTRs and DSR rely on alignment with spot prices to function; any misalignment will act to undermine these markets.

In our view there is a strong case for applying scarcity pricing to the 9th August event and, given the considerable time that has passed since the event, retaining these prices is, in the long term, the course of action that is most likely to maintain confidence in the market.

Yours faithfully,

Stuart Innes
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