CONTACT

17 May 2004

The Commissioners
C/o Lisa White
Electricity Commission
Level 7, ASB Tower
2 Hunter Street
Wellington

By email: lisa.white@electricitycommission.govt.nz

Dear Commissioners

Decision 1 of the Electricity Commission

We refer to Decision 1 of the Commission dated 12 May 2004 regarding the undesirable trading situation alleged by Trustpower (the "Decision"). Terms used in this letter have the same meaning as set out in the Decision.

We have endeavoured to review and consider the Decision in as much detail as possible in the time allowed by the Commission. In the future, we would appreciate it if the Commission would allow more time for consultation under regulation 59, particularly in the early stages of the Commission's governance of the market.

Like the Commission, we are grappling with new issues and the application of new regulations. The Commission's early decisions are of particular importance, as they will set a precedent for any similar issues going forward. For these reasons, we ask that future regulation 59 consultation periods be more than just two working days. Whilst we understand the Commission has to balance consultation against the regulation 60 obligation to "restore the normal operation of the wholesale market for electricity as soon as possible", given the precedent setting nature of these decisions we think the Commission would not be accused of delay if it allowed a full working week for participants to respond. In any event it is not clear that this particular UTS has resulted in anything other than the normal operation of the market since the trading period concerned.

Contact considers the Decision to be correct given the regulatory framework in which the Commission operates. We consider that the specific regulations that the Commission has had to interpret in coming to the Decision are all open to the interpretation given to them by the Commission. Having said that, the Decision has in our view exposed some serious limitations in the Regulations with unfortunate consequences going forward.

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The Commission states at paragraph 54 of the Decision that:

> *"The fundamental aspect of trading that this event is at odds with is that trading on the wholesale electricity market is premised on market participants possessing accurate and timely information on which to base their trading decisions. In the absence of such information being available, within the bounds able, and understood to be able, to be produced by the various market mechanisms, including SPD, it would appear almost to go without saying that orderly trading is threatened."*

Given the Commission's analysis in paragraph 53 of the Decision, our interpretation is that any circumstance that comes within the paragraph 54 statement will be capable of being claimed as a UTS under either of regulation 55(1)(a) or 55(2)(e).

Regulation 55(1)(a) is limited by the Commission having to form the view under regulation 55(1)(b) that the issue can not satisfactorily be resolved by any other mechanism available under the rules. The specific circumstances under regulation 55(2) do not suffer from this limitation and may therefore become the basis for most UTS claims going forward. However, due to the operation of regulations 112 and 116, it is our view that in most cases the Commission can (and should) form the view that the issue can not satisfactorily be resolved by any other mechanism available under the rules and accordingly the broader regulation 55(1)(a) is available to participants to claim UTS largely unlimited by regulation 55(1)(b). We think it unlikely that this was the intention of the regulation drafters, but it is the result nonetheless. The reason there is no other satisfactory means to resolve the issue is the operation of regulation 116 and, to a lesser extent, 112.

If you start from the point that no participant should suffer financial loss from an error by a service provider to the market, the sensible outcome is for the service provider who made the error to be required to compensate the participants who have suffered losses from the error. In this case, this would ensure that parties working on improper information as a result of the Transpower error were put back in the position they would have been had the error not been made and that Transpower would be incentivised to limit such errors in the future. It would also avoid the need for any delay in, or recalculation of, final prices. However, due to the operation of regulation 116 that result is not available to the Commission in these circumstances (and will not be available in similar future circumstances). Further, even if regulation 116 were repealed, regulation 112 would operate to ensure that, in most circumstances, full compensation would not be payable. Accordingly, we consider the Commission had little choice but to call a UTS and delay final prices. In this way, Trustpower, and other affected parties have been kept whole.

The result of calling a UTS and keeping Trustpower whole is that Transpower receives no penalty for its error. The only way Transpower will be penalised, and therefore incentivised to avoid future errors, is if it has breached a rule and is exposed to a fine. We are currently considering whether a rule has been breached by Transpower.

Our consideration of a possible breach by Transpower has exposed a further quirk of the Regulations. If there was an obvious breach by a participant, then all other participants would have to allege a rule breach for fear of breaching regulation 62. We ask that the Commission advise participants of how strictly it intends to enforce regulation 62; i.e. whether, once a rule breach is

alleged, all participants who have a reasonable belief that the allegation is correct are required to allege the same breach.

A further point of interest to us is that, should the Commission impose a fine on Transpower (or any party for that matter), the Regulations provide no guidance as to what happens to the money once paid by the offending participant.

The consequence of the Decision is that we will now seek to put in place systems to ensure we claim a UTS prior to publication of final prices where we believe there has been an error leading to us having incorrect information. We imagine other participants will do the same. There is little to be gained from alleging a breach (except avoiding a breach of regulation 62) where regulation 116 will mean compensation is not available. The only way a participant can be kept whole is to claim a UTS and delay publication of final prices. A further perverse outcome of this Decision is that claims for UTS must necessarily be made without the full information at hand, due to the time constraint imposed by normal final price publication.

Given the importance that the UTS process is going to have going forward, we ask that the Commission:

1. provide further guidance as to what constitutes a UTS (we provide some examples of past errors below);
2. advise participants of the process for claiming a UTS and, in particular, how much information must be provided and what, if anything, a participant can do if sufficient confirmed information is not available prior to publication of final prices;
3. confirm that greater consultation time will be allowed in the future;
4. confirm that, in accordance with principles of natural justice, the Commission will issue (at least to the participant concerned) reasons for any refusal to call a UTS claimed by a participant; and
5. advise participants of how strictly it intends to enforce regulation 62 where a UTS is called.

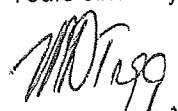
In our view, based on the Decision, the following circumstances may have enabled a participant to claim UTS:

- On 23 April 2004 at 08:35 the System Operator revised the permanent constraint on the two FHL_RDF circuits from 53MW to 49MW. The market was not notified of this change until 09:26. This revision caused significant price separation between the East Coast and the rest of the market. Had participants been aware of these revisions when the System Operator made them the detrimental price effects could have been mitigated.

- On 25 March 2004 at 16:56 the System Operator notified the market that the outage on the BRY_ISL circuit that was scheduled to finish at 18:00 was being extended until 21:30. This outage had been extended in SPD at 13:23. As a result price separation occurred in the upper South Island. As with the above case, had participants been aware of these revisions when the System Operator made them the detrimental price effects could have been mitigated.

Finally, we endorse the Committee's call for an advisory group to be established. However, we consider that the issues raised above relating to the Regulations should also be referred to an appropriate group for review.

Yours sincerely



Mark Trigg
Manager, Strategy and Revenue

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17 May 2004

Lisa White

Electricity commission
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New Zealand

Dear Lisa

Consultation under regulation 59(b) Undesirable Trading Situation, trading period 36 on 24 April 2004 and the Electricity Commission decision dated 12 May 2004

On reviewing the Electricity Commission decision dated 12 May 2004 Genesis would like to raise the following points.

Genesis whilst also a net purchaser of electricity at TGA0331 does not agree with the findings of the commission in relation to the second point of the Electricity Commission consideration "40(b)" for the following;

Genesis believes this event is a price calculation issue, not something that affected orderly trading. Provisional and final prices are the results of trading as represented by the market model. Trading occurs in effect prior to real time given gate closure rules. Market Participants are locked into a trading position at that time through security constrained economic dispatch. The price signals from the market up to and during period 36 are just that, price signals. Inside trading period 36 there were market signals that may have driven a demand response owing to incorrectly applied constraint in this instance and this should be followed up with a complaint alleging a rule breach[1].

Genesis therefore considers provisional and final prices to be the result of trading and being ex-post can not and did not jeopardise orderly trading. Genesis considers that this issue would be best dealt with via a breach of market rules and the seeking of penalties or claiming material financial disadvantage.

Again Genesis is concerned about the lack of time given for consultation on this matter and requests that the Electricity commission allow more time for this with any future matters

[1] Genesis is presently reviewing the rules and regulations with a view to allege a breach.

Yours sincerely

Peter Kimber
Wholesale Market Manager

MAJOR ELECTRICITY USERS' GROUP

17 May 2004

Electricity Commission
C/- Ms Lisa White

By email to lisa.white@electricitycommission.govt.nz

Dear Lisa

Alleged Undesirable Trading Situation 24 April 2004

1. MEUG welcome the opportunity to comment on the decision dated 12 May circulated to Market Participants and other interested parties by email on 13 May. MEUG agree with the decision to calculate final prices after removing the Tauranga Constraint and to urgently establish an advisory group to consider related SPD matters. Detailed comments on each of these follow.

The UTS process, decision and remedy

2. MEUG congratulate the Commission on acting so promptly to delay publishing final prices until an investigation into the cause and materiality of event were known.

3. Some changes to the style and content of the decision would assist a much wider range of Market Participants and others downstream understand the issues and with greater knowledge will come greater participation and better decision making by the demand and supply side. In particular MEUG suggest copies of all correspondence with third parties and service providers (The Pricing Manager and System Operator), with any commercially confidential information excluded, be appended to the decision. This disclosure will serve two purposes. First, the market will understand better how future UTS are likely to be managed. Second, the robustness of the Commission decision can be better monitored. As an example in paragraph 30 and 31 the decision refers to Trustpower suggesting local supply issues could be dealt with by some alternative approach such as operating out of merit order. It would be useful to have public the details of the Trustpower proposal.

4. The decision could also be improved by more detailed explanations of technical terms. For example "spring-washer" and "deficit branch group constraints" need to be explained in some detail in the context of this event. This will help a broader group of potential demand and supply participants understand how SPD works and with greater understanding will come greater confidence and pragmatic solutions to improve the market.

5. Another example of where only those with a detailed knowledge of SPD will be able to understand the decision is why the magnitude of the effect of the constraint in paragraph 24 was tested using a 1MW increment whereas the decision is to remove the constraint equation entirely.

6. There may be value in a review of the management of this the first UTS. For example there may have been affected parties downstream of retailers that were not aware of the UTS or

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the potential financial impact. Even at the wholesale market level reliance on email notifications for requesting feedback at short notice may not have captured all affected parties. That may be an issue for those affected companies to consider; or it may be more efficient for the Commission to use other channels to inform.

7. MEUG believe Transpower should have self notified a breach once its error was known (paragraph 66 of the decision).

Industry working group

8. MEUG understand several other parties other than Trustpower raised matters that could be usefully investigated, eg Norske Skog. Note that had the decision appended all correspondence as suggested in paragraph 3 above, then MEUG and other parties would have been able to validate if the issues raised by Trustpower were inclusive of the issues raised by other parties and hence if the Commission decision only to address Trustpower concerns was robust.

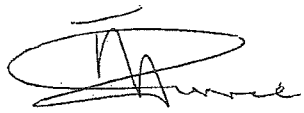
9. The terms of reference and composition of the group should comprise a mix of modelling experts and others with a broader understanding of how SPD fits with the development of more participation by demand and supply in the market. Perhaps the easiest way forward would be to establish a sub-group of the existing Wholesale Market Advisory Group.

10. Though not a Market Participant, MEUG wishes to record its interest in being kept informed of progress and any consultation in establishing an industry working group.

Concluding comments

11. MEUG appreciate the opportunity to make these comments and look forward to be consulting in the future.

Yours sincerely



Terrence Currie
Chairman

energy clearing house

Roy Hemmingway
Chair
Electricity Commission Board
PO Box 10041
Wellington

Re: ALLEGED UNDESIRABLE TRADING SITUATION – 24 April 2004, Trading Period 36

I am writing regarding the update regarding the "Undesirable Trading Situation" released by the Commission on 13 May 2004.

The Clearing Manager issued invoices for April 2004 on 13 May 2004 in accordance with rules 7 and 8 of Part H of the EGR's. The electricity settlement for trading period 36 on 24 April was excluded completely because there were no final prices for that trading period.

The Clearing Manager seeks a direction from the Board as to how the Clearing Manager should deal with the settlement of the affected trading period =once the final prices for trading period 36 are published.

The Clearing Manager will next issue invoices in June for the month of May. Assuming that final prices are published by then, the options are to include the amounts payable for trading period 36 on April 24 as:

- An extra energy payment; or
- A wash-up amount

The reason we ask for a direction from the Board is that the rules do not appear to allow the Clearing Manager to do either of these things.
Rules 7 and 8 of part H deal with the content of invoices. All references to energy transactions are couched in terms of 'the prior billing period'. A 'billing period' in defined as meaning one calendar month. For invoices to be issued in June, this means the month of May. It does not appear to allow the Clearing Manager to include in the May invoice any amount for a trading period in April.

Generally, where energy amounts need to be corrected this is done using the wash-up process that is described in rule 11. Rule 11.1 allows the Clearing Manager to invoice a washup amount only in certain circumstances, where it has received corrected information

- That relates to energy consumption, and that comes from the reconciliation manager, or
- On the resolution of a dispute, or
- That relates to the provision of ancillary services

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None of these extend to the revision of information in order to resolve an undesirable trading situation.

We note, however, that among the powers that the Board is given by regulation 56 to correct an undesirable trading situation there is the ability to '[give] directions to any participant to act in a manner (not inconsistent with these regulations, the rules, or any other law) that will, in the Board's opinion, correct or assist in overcoming the undesirable trading situation.

Further, it is an offence under regulation 57 not to comply with any such direction. Clearly any direction that the Board might give in exercise of this power would overcome any of the apparent difficulties with rules 7, 8 or 11.

Of the two options for invoicing the invoicing trading period 36 of April 24, the clearing manager recommends that the washup process be used, for two reasons. First, this approach would be far simpler to put into effect. To invoice trading period 36 as an energy cost out of calendar sequence is beyond the scope of what our system is designed to do.

Second, the washup process is designed to correct errors and using it to resolve an undesirable trading situation is consistent with that purpose. A washup will take place next month in the ordinary way, and the system will automatically calculate interest at an appropriate rate for both payers and payees. Attempting to do this manually as part of an energy cost would be a far more complex process. We could not guarantee that the result would be free of error.

For these reasons the Clearing Manager requests that the Board issuing a direction to the Clearing Manager that trading period 36 for April 24 be invoiced as a washup in the June invoices.

If you have any questions regarding any of the points raised above please do not hesitate to call me on 498-0054.

Yours Sincerely

Shelley Nixon
For EGR's Clearing Manager

Meridian Energy

17 May 2004

Roy Hemmingway
Chair
Electricity Commission
P O Box 10 041
WELLINGTON

Dear Roy

Alleged Undesirable Trading Situation

Meridian welcomes the opportunity to make submissions on the Electricity Commission's decision regarding an alleged undesirable trading situation.

Meridian supports the Electricity Commission's proposed urgent investigation of the issues raised by TrustPower with respect to modelling and frequency of constraints within SPD. As discussed in our letter of 6 May 2004 (Request for Information – Undesirable Trading Situation) Meridian believes all participants would benefit from an increased understanding of the policies and procedures Transpower has in place when the price is heading towards $100,000/MWh and that there should be consultation to improve current practice. A related issue, which may be another workstream, is the treatment of rentals created by spring washer effects.

If you have any queries please contact me.

Yours sincerely

Mary Ann Mitchell
Regulatory Analyst

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17 May 2004

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via e-mail: lisa.white@electricitycommission.govt.nz

Dear Lisa

Re: Undesirable Trading Situation (UTS) – 24 April 2004

Mighty River Power is supportive of the proposed resolution of the above UTS by the Electricity Commission on this occasion given the specific facts of the event.

Mighty River Power has no further comment to make on the above event over and above that made to Electricity Commission by email on 7 May 2004.

Yours sincerely

James Moulder
GENERAL MANAGER TRADING

Norske Skog
Tasman

Lisa White
Electricity Commission
Level 7 ASB Tower
PO Box 10041
Wellington

17th May 2004

Re: Alleged Undesirable Trading Situation in trading period 36, 24th April 2004

Dear Lisa

Thank you for the opportunity to provide comments on the decision dated 12 May concerning the alleged UTS on 24 April 2004. Norske Skog supports the decision to re-calculate final prices for reasons we submitted earlier. Norske Skog also welcomes the proposition to urgently convene a working group to investigate wider areas of concern related to spring washers and the SPD model in general. We would like to have the opportunity to be able to suggest areas of study for this working group. However in our opinion the existing Wholesale Market Advisory Group is well placed to define terms of reference for a consultant to undertake, and we feel that this is likely to be the most efficient and expedient approach.

We have studied the spring washer phenomenon carefully over the last three weeks and have concluded that the SPD model displays some interesting results as demand is increased in the existence of a binding loop constraint. In fact it appears that there is a very small range of demand of the order of 2 MW through which the nodal prices can increase from normal levels, to prices around $10,000/MWh and on to infeasibility. It seems from information we have seen that this was also the case in the Tauranga situation on April 24th. However for these effects to occur requires a remarkable combination of reactance values. We have seen no evidence that such a combination existed on April 24th.

We observe that as spring washers are wound up by increasing demand the level of accuracy in metered demand, reactance values and branch capacities has a crucial bearing on whether a price settles at say around $50/MWh, or many orders of magnitude more. Whether this is a desired outcome of nodal pricing should be debated.

We feel that the process of resolving infeasibilities needs to be addressed as there is a potential to arrive at a feasible, yet degenerate solution if the process is not carefully designed. There does not appear to be any rule in the EGRs that defines this process.

We also feel that the system operator's practice of incorporating a branch group deficit variable is questionable, and should be reviewed as it appears to be unnecessary given that there are already bus deficit variables, and more importantly because it leads to confusing nodal price outcomes.

Finally we wish to make the observation that there are a number of assertions made in the report from the Board of May 12th that have not been substantiated by any supporting

Norske Skog
Tasman

evidence. It would be helpful if the Board could release the analysis that was used to reach many of the conclusions in the report. For instance it appears to be accepted by the Board that the high provisional prices at Tauranga resulted from the spring washer mechanism. We would be extremely interested to see analysis that explains this outcome.

Kind Regards

Graeme Everett
Norske Skog Tasman

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17 May 2004

Mr Roy Hemmingway
Chairperson
Electricity Commission

By e-mail to: lisa.white@electricitycommission.govt.nz

Dear Sir

Alleged UTS 24 April

This submission from Transpower New Zealand Limited, as System Operator, is made in response to the Commission's decision posted on 13 May 2004, and as provided for in Regulation 59(b).

In relation to the Commission's findings and determination the System Operator submits the following:

- the System Operator has no issue with the Commission's finding the UTS was a result of incorrect inputs to the SPD model;
- clause 23(b) of the Decision could be ambiguous. For example, one possible interpretation is "in provisional pricing SPD matched demand, generation and transmission capability as defined by the constraint and determined a feasible provisional price at the node". The System Operator is unsure if that interpretation is intended. The clause could be reworded to clarify the reference to SPD as being to either the SPD RTP solution or SPD Provisional Pricing outcomes. The purpose in using the words "demand and load were matched" is not clear;
- a material factor behind the events leading to the UTS is the under bidding of the forecast demand at Tauranga by retailers. Had demand bids at this node been an accurate assessment of likely demand, the constraint (in respect of which the Commission's decision refers) could have been detected in the pre-dispatch schedule and then would have been removed for the notified trading period;
- the System Operator is reviewing its role in this UTS to determine if any breaches occurred and, if so, by which participants. It has self-reported alleged breaches for events subsequent to trading period 36 (when Kaimai generation tripped).

With regard to the Clause 67 proposal for an advisory group review of SPD, the System Operator:

- supports consideration of relevant matters by an advisory group (AG);
- suggests that rather than establishing a separate AG, the issues be considered by the existing Wholesale Market AG, Common Quality AG, or a team drawn from both Ags;
- asks the Commission to note the incorporation of infeasibilities to solve specific schedules in SPD prior to final pricing is a long-standing feature of the SPD model. Over the last (approximately) eighteen months publication of the Schedule of Prices and Dispatch Quantities (SPDQ) and Real Time Prices (RTP), SPD outcomes when infeasibilities occur are now more visible to participants. This has led to heightened concerns about outcomes from the SPD model and, therefore, concerns about the model itself;
- can provide additional flagging information in the RTP results published in COMIT for all types of infeasibility situations;
- asks the Commission to note that the System Operator is planning to hold educational workshops on SPD other issues. These are scheduled for late July. If these workshops are not timely enough for the intended AG review the System Operator would welcome any earlier opportunity to present educative materials to the proposed AG, to Commissioners and to their Advisers.

Yours sincerely

John Clarke
System Operations Investigations & Planning Manager