

Update on UTS and Market Performance Investigations

On Saturday 26 March 2011 electricity spot market prices north of Hamilton exceeded \$19,000/MWh for several hours and reached \$8,000/MWh in the lower North Island.

The Authority's UTS Committee met on Thursday 31 March to receive an initial report on claims by several parties that an undesirable trading situation (UTS) occurred in regard to events and actions surrounding the high spot prices. The claims can be found at <http://www.ea.govt.nz/act-code-regs/uts/decisions-and-claims/>

The focus of the UTS Committee at this stage is on whether a UTS, as defined in Part 1 of the Electricity Industry Participation Code (Code), occurred on 26 March.

To assist it in making this decision, the UTS Committee has requested Authority staff obtain additional information from industry participants and report back to it next week. Hence, the Authority is today issuing information requests to participants, with responses requested by close-of-business Tuesday 5 April.

In the interim, the UTS Committee has received assurances from a number of participants that they have put in place sufficient hedge agreements to manage commercial risks regarding Saturday 2 April 2011 when grid outages near Hamilton are scheduled to occur.

Despite these assurances parties exposed to spot market prices must assess the risks for themselves, and must not rely on the above statement for managing their own circumstances.

In parallel with the UTS process, the Authority has commenced a Market Performance investigation into the events of 26 March. The scope of that investigation will encompass both the spot and hedge markets, and focus on identifying areas of the Code for possible further development.

The Authority already has a comprehensive set of reforms underway to substantially improve market performance, in both the spot and hedge markets. These reforms are mandated by section 42 of the Electricity Industry Act 2010. The Act requires the Authority to make Code amendments by 1 November 2011 or explain why it hasn't done so and what alternative measures it is taking to address the matter.

A key reform initiative relevant to recent events is the proposed introduction of a financial transmission rights (FTR) market. If an FTR market had been in place prior to last Saturday then FTR-holders could have been substantially protected from the price spikes at Otahuhu relative to Benmore, and participants would have been likely to have had a wider range of choices for hedging their risks arising from scheduled transmission outages. The Authority is on track to decide Code amendments by 1 November 2011 and have the FTR market operating in 2012.

Another hedge market development is the Government's requirement for the five largest electricity generators to offer sufficient contracts on the ASX electricity futures market to achieve a 3000 GWh target for unmatched open interest (UOI) by 1 June 2011. With the current level sitting at approximately 650 GWh, the Authority is closely monitoring the situation and is considering a draft project plan on the matter at its 6 April 2011 Board meeting.

The Authority is also well-advanced on introducing a dispatchable demand regime, which will provide the opportunity for demand-side participants to offer their load into the market for dispatch, in the same way as occurs now for generators. The Authority is particularly keen to ensure the regime encourages owners of embedded generation to participate in the spot market. This initiative could materially increase competitive pressure during tight supply situations. The project is on track for Code amendments by 1 November 2011 and to 'go live' in 2013.

The primary focus of the above initiatives is to increase competition in the electricity industry and encourage spot market purchasers to place greater reliance on commercial tools to manage their risks. The Authority is currently consulting on a proposal to introduce scarcity pricing, which is primarily targeted at achieving more efficient incentives for last resort generation plant and demand response capability to be available to the electricity market. The consultation paper discusses various incentives on spot market purchasers to adopt higher hedge levels.

The other key components of the Authority's work programme, and their main area of impact on the Authority's statutory objective, are shown in the link below.

<http://www.ea.govt.nz/act-code-regs/uts/decisions-and-claims/>.