



MAJOR ELECTRICITY USERS' GROUP

22 November 2010

Dr Carl Hansen
Chief Executive
Electricity Authority
By email to carl.hansen@ea.govt.nz

Dear Carl

Whirinaki Power Station Offer Price

1. At the MEUG meeting on 20th October that you and Dr Layton attended we discussed the Whirinaki power station offer price, and expressed our concern with the current offer of \$5,000/MWh. MEUG advised that the constrained on charges due to out of merit order dispatch of Whirinaki by the System Operator has amounted to several million dollars this year.
2. MEUG also expressed further concern about other generators offering a shade under the Whirinaki price. MEUG notes that the System Operator has also dispatched Huntly Unit 6 (which adjusted its standard offer to \$4,950.06/MWh in response to the change to Whirinaki's offer) out of merit order on a number of occasions costing consumers several more million dollars.
3. MEUG considers that constrained on compensation is designed so that generators who incur fuel costs in the interests of system security etc should be compensated for those direct costs. MEUG is not impressed that Whirinaki and Huntly unit 6 have been receiving a factor of 10 to 20 times their fuel cost as constrained on compensation.
4. Since the 20th October meeting we have reviewed the reasons the Whirinaki offer was revised earlier this year and request that the Authority change the offer price to the SRMC for all periods (except for plant testing).
5. According to advice published by the EC on the 12th February 2010 the rationale behind the change to \$5,000/MWh was to¹:
 - a) Incentivise thermal unit commitment and demand side response;

¹ Refer <http://www.ea.govt.nz/industry/security-of-supply/reserve-energy-scheme/>

- b) Improve incentives for investment in generation and demand side response;
- c) Align the offer with "LRMC"; and
- d) Provide a transitional path for commercial offering of Whirinaki once it is sold.

MEUG is not persuaded that these reasons justify a price of \$5,000/MWh.

Incentivise thermal unit commitment and demand side response

6. MEUG does not understand the logic behind claims that high offer prices at Whirinaki will somehow cause thermal units to lower their offers and thus commit units. Logic suggests that thermal plant are willing to run for months at spot prices considerably lower than their SRMC due to the prospect of picking up a few trading periods of prices set by Whirinaki at \$5,000/MWh once some minor catastrophe has occurred. MEUG considers this to be nothing more than wishful thinking, and has certainly not noticed any increase in thermal plant commitment since the offer of Whirinaki was hiked to \$5,000/MWh. Rather the reverse has occurred, with Huntly Power Station not running any units at all for extended periods. The reason that supply shortfalls have been less prevalent in 2010 compared with 2009 has nothing to do with Whirinaki's offer price and is related to other factors such as the availability of the HVDC Pole 1.

Improve incentives for investment in generation and demand side response

7. MEUG is completely unimpressed with the suggestion that prices should be artificially increased to ensure that more generation will be built. MEUG suspects that the supply side has somehow influenced the EC to believe the mantra that prices must increase ahead of time to fund their investments. MEUG members compete in competitive markets for their products and see no reason why electricity generators should not do the same. MEUG observes that electricity demand has been stagnant for 3 years and coupled with normal hydrological patterns has resulted in reasonable spot prices for a couple of years. Generators who wish to manage their price risks are welcome to discuss financial contracts with MEUG members, rather than lobby the EA for market interventions that suit their purposes.

Align the offer with "LRMC" and provide a transitional path for commercial offering of Whirinaki once it is sold

8. MEUG notes that the LRMC of Whirinaki is completely paid for by a compulsory levy on consumers and cannot be considered a typical peaking plant in any shape or form. Those who fund Whirinaki have a right to set its offers, just like those who fund commercial plant. MEUG submits that there are no benefits to consumers to offer Whirinaki at anything other than its SRMC.
9. MEUG does not believe that there is any justification to provide a transitional path for commercial offering of Whirinaki and notes that the levy charged to consumers has not followed any transitional path since the offer was changed to \$5,000/MWh on 1st March 2010.

Concluding comments

10. In conclusion we hope we have provided sufficient reasons for the Electricity Authority to immediately alter the offer price at the Whirinaki Power station to its SRMC. MEUG notes that the decision made on 12th February 2010 was reached with no consultation whatsoever. MEUG trusts that the Authority will proceed to amend the Whirinaki offer price and be totally confident that it is acting in the short and long term interests of consumers.
11. If any further information is required please contact the writer.

Yours sincerely



Ralph Matthes
Executive Director

cc Dr Brent Layton, Chair, Electricity Authority