

MEUG discussion with WAG: Aligning forecast & settlement prices

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Introduction

1. Discovery of “efficient and predictable” spot prices in electricity markets is challenging.
2. We support work to improve prices currently subject to infeasibilities (local energy or IR shortfalls).
3. This discussion is focussed on problems with poor alignment of forecast spot prices and settlement prices when the market is stressed and how that misalignment deters an optimal level of demand side participation in the spot market.

The views from a demand side participant

4. It is revealing that no other wholesale electricity market internationally uses ex post settlement prices. Overseas buyer investors’ familiar with ex ante regimes may find this a barrier to investing in spot market participation. If in addition the correlation between forecast and settlement prices is poor, then fewer buyers that have an ability to react to spot will choose to do so than is optimal.
5. The performance, or lack of, price signals to be accurate predictors of settlement prices on 13th December 2011 was a highly material example of the problems that occur frequently though on a lesser scale. The legacy of the many TOU consumers that suffered during this event will have eroded the propensity of companies that could genuinely respond to spot prices from investing in processes/technologies.
6. The commercial drivers on all end consumers to find lower cost means of production are continuous. The multiple effects of the GFC, weak export or import substitution markets and a high exchange rate mean every option must be considered. The ability to choose an optimal mix of spot (assuming have an ability to respond to spot), hedges and embedded generation to manage electricity costs is more realistic than it has been in the past because of technology and more open trading platforms (ASX). Misalignment of forecast and settlement spot prices deters an optimal mix being realised. In addition market arrangements are needed to meet a range of consumer abilities to participate, ie we need the DD regime in the Code for those that can fully comply through to less compliant options for other consumers.

Other comments

7. This is a classic case of market failure due to imperfect information resulting in productive, allocative and dynamic inefficiencies. Dynamic efficiency detriments are likely to be greater than static efficiency effects.
8. With buyers that have the ability to respond to forecast spot prices deciding to forgo exposure to spot, then there will be higher demand in hedge markets and higher hedge prices than optimal.
9. A combination of frustration with poor spot price forecasts when the market is stressed and the higher prices for hedges than is necessary will continue to undermine consumer confidence in the market.
10. The preferred solution needs to be future proof to take into account ongoing technological improvements to enable demand side participation.
11. There probably is a trade off between higher implementation costs and better alignment of forecast and settlement prices. The optimal point can only be found with more analysis. We recommend the EA and WAG makes this work a high priority. We are available to support and provide information to WAG and the EA as needed.