



# MAJOR ELECTRICITY USERS' GROUP

23 August 2013

John Hancock  
Chair  
Wholesale Advisory Group

By email to [wag@ea.govt.nz](mailto:wag@ea.govt.nz)  
c/- Electricity Authority

Dear John

## Wholesale Advisory Group discussion Paper – aligning forecast and final prices

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Wholesale Advisory Group discussion paper<sup>1</sup> "Aligning forecast and final prices dated 8<sup>th</sup> July 2013. Members of MEUG have been consulted in the preparation of this submission. This submission is not confidential.
2. Responses to questions in the consultation paper follow:

Question	MEUG response
1. Do you agree that forecast prices predict final prices reasonably accurately under normal conditions, but are less accurate when the system is under stress?	Agree.
2. Can you provide any examples where you reacted to a forecast price which later turned out to be inaccurate?	For actual purchasers to respond.
3. Can you give examples where the unreliability of short-term spot price forecasts has discouraged you (or another party) from responding to them?	No. However even if examples cannot be found the rationale of forgoing options for potential innovation for direct spot participation discussed in section 3.3 of the paper is compelling.

<sup>1</sup> <http://www.ea.govt.nz/dmsdocument/15265> found at <http://www.ea.govt.nz/our-work/consultations/advisory-group/wag-aligning-forecast-and-final-prices/>

Question	MEUG response
4. Do you agree that future technological and commercial developments may allow many small to medium consumers to respond to prices – if there are efficient and reliable price signals?	Agree and New Zealand needs to take advantage of this earlier rather than later to achieve a world leading wholesale market. The latter is essential if we are to keep New Zealand businesses reliant on electricity competitive.
5. Do you agree that current arrangements make active demand-side participation difficult for participants that do not have a detailed understanding of how different spot price schedules are formed, and that altering these arrangements could attract wider participation and increase confidence in the wholesale market?	Agree.
6. Do you agree with how WAG has characterised the problem?	Agree.  MEUG believes the confidence of the public and politicians in the electricity market remains highly volatile. Misinformation and opportunism abounds as evidenced by some <sup>2</sup> of the material in the NZ Power proposal announced 18 <sup>th</sup> April 2013. In our view one of the flash points that undermine confidence for large and small TOU consumers are when the wholesale market is stressed and final prices diverge significantly from forecast prices <sup>3</sup> .
7. Do you agree that addressing the misalignment between forecast and final prices could result in a significant economic benefit?	Gross benefits yes; net benefits possibly.  Estimating costs for alternative solutions are important to assess the option that maximises expected net benefits.
8. Do you agree that there may be the potential to improve the accuracy of RTP (considered as a forecast of final prices) by improving the alignment between the ramp rate constraints and market node constraints used in RTP and those used in final pricing?	This possibility is discussed in section E.6 of appendix E. MEUG agrees there may be potential and that work on these possible improvements should be undertaken. We are mindful of the statement in paragraph E.6.6:  "If these changes were to be investigated further, it would be important to check for unintended consequences."

<sup>2</sup> Not all of the NZ Power material can be characterised as political opportunism or misinformation. For example we agree that there has been no analysis of the divergence in the historic price path of household and no-household customers to determine if there is a systemic policy issue to be addressed.

<sup>3</sup> Other flashpoints are first, when sellers try to talk up prices with reference to the need for prices to be at LRMC. Second, when consumers are advised of price increases but there are conflicting advice from retailers and distributors as to who is to blame.

Question	MEUG response
9. Do you expect the current and planned initiatives to be a <u>sufficient</u> response to the problem of misalignment between forecast and final prices?	<p>Cannot definitively say work underway as listed in paragraphs 4.1.1 to 4.1.5 will be "sufficient".</p> <p>Mandating publication of 5 minute RTP should be considered even in advance of improving RTP as discussed in appendix E.</p>
10. Do you agree that it would be preferable to provide participants with more certainty about spot prices ahead of, or in, real time?	<p>MEUG's subjective view is there may be value in considering shifting towards a design that gives more certainty rather than the current design that emphasises accuracy. This is a subjective view because we are not aware of any objective analysis to guide policy makers. That lack of analysis should be the ongoing focus of the EA.</p>
11. Do you consider that accuracy, as it is characterised in this paper, is generally more important than certainty in wholesale market design, or vice versa?	<p>See response to Q10.</p>
12. What other approaches (if any) could be used to address misalignment between forecast and final prices, and improve efficient demand-side participation?	<p>The paper covers the generic range of options that could be considered in a more detailed analysis.</p> <p>Note in response to Q9 we have suggested a further interim option to consider is mandating existing RTP be published every 5 minutes. Many MEUG members have found missing 5 minute prices to be a significant problem. Inaccurate prices when the market is stressed is bad enough; but having no prices at all for several 5 minute sequences results in operational decisions being made blindly.</p>
13. What would be the relative advantages of pursuing an incremental approach to the problem of forecast and final prices?	<p>MEUG assumes the <u>incremental approach</u> is:</p> <ul style="list-style-type: none"> <li>a) The Authority continuing with the work already underway as listed in paragraphs 4.1.1 to 4.1.5;</li> <li>b) The possibility of considering improvements to RTPs discussed in paragraph 4.1.7 to 4.2.10; and</li> <li>c) Sometime in the future once a) and b) above have been implemented for a sufficient period, a review is undertaken to see if there is a residual problem in alignment of forecast and settlement prices when the market is stressed.</li> <li>d) The Authority ceases any further work on possible real-time or ex ante pricing options until the results of the future review in c) above has been undertaken.</li> </ul>

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	<p>The alternative for the Authority is to undertake steps a) and b) of the incremental approach above and in parallel continue investigation into whether additional changes to a real-time or ex ante pricing regime should be considered. We term this the <u>firming up further options approach</u>.</p> <p>The balance of choosing between the <u>incremental approach</u> and the <u>firming up further options approach</u> depends on the expected residual alignment problem post implementation of the incremental changes and the expected cost of firming up options. The decision can be summarised as follows:</p> <table border="1" data-bbox="847 745 1409 904"> <thead> <tr> <th colspan="2" data-bbox="847 745 1062 813" rowspan="2">Which approach?</th> <th colspan="2" data-bbox="1062 745 1409 779">Value of residual problem</th> </tr> <tr> <th data-bbox="1062 779 1233 813">Lo</th> <th data-bbox="1233 779 1409 813">Hi</th> </tr> </thead> <tbody> <tr> <th data-bbox="847 813 986 904" rowspan="2">Cost to consider options</th> <th data-bbox="986 813 1062 857">Hi</th> <td data-bbox="1062 813 1233 857" style="background-color: #fce4ec;">Incremental</td> <td data-bbox="1233 813 1409 857" style="background-color: #fff9c4;">Options now</td> </tr> <tr> <th data-bbox="986 857 1062 904">Lo</th> <td data-bbox="1062 857 1233 904" style="background-color: #fff9c4;">Options now</td> <td data-bbox="1233 857 1409 904" style="background-color: #e0f2f1;">Options now</td> </tr> </tbody> </table> <p>To explain:</p> <ul style="list-style-type: none"> <li>• If the expected value of the residual problem is high and the cost of analysis to consider options now is low, then considering options now is the best approach. This is the turquoise shaded cell.</li> <li>• At the other extreme if the expected value of the residual problem is low and the cost of analysis to consider options now is high, then deferring consideration of options into the future and adopting the incremental approach is best. This is the pink shaded cell.</li> <li>• More subjectively is to decide which option is best in the remaining yellow shaded quadrants. In these scenarios there is more a risk the wrong decision will be made. MEUG suggest it more likely that the range of the value of the residual problem will be in the NPV millions of dollars range (in addition there will be a market confidence factor per Q6) whereas the cost of further firming up options now just in case they are needed should even at a high cost scenario be no more than \$100,000. Therefore for the yellow shaded scenarios the best approach is to continue work to consider options.</li> </ul>	Which approach?		Value of residual problem		Lo	Hi	Cost to consider options	Hi	Incremental	Options now	Lo	Options now	Options now
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Question	MEUG response
	On balance MEUG recommends the Authority continue investigating possible changes to either closer to real-time final pricing or ex ante final pricing. To be clear, this is only to further firm up those options. It is not MEUG's view that those options should be decided now.
14. What would be the relative advantages of the Authority considering the option of settling on ex ante or real time prices at this point?	See response to Q13 above.

3. We look forward to considering the submissions of other parties on this proposal and the response of the Wholesale Advisory Group to submissions.

Yours sincerely



Ralph Matthes  
Executive Director