MAJOR ELECTRICITY USERS' GROUP

1 April 2014

John Andrews
Clearing Manager
c/o NZX

By email to cmanager@nzx.com

Dear John

Submission on new Part 14A Settlement and Prudential Security methodologies under consultation required by new Part 14 schedule 14.2

1. This is a submission by the Major Electricity Users' Group (MEUG) on the NZX paper[1], as the Clearing Manager, "Settlement and Prudential Security Code Amendment 2013, Consultation on methodologies under Schedule 14.2", 3rd March 2014.
2. Relevant members of MEUG have been consulted in the preparation of this submission. This submission is not confidential.
3. Detailed responses to questions in the consultation paper follow:

Question	MEUG response
1. Do you support the proposed methodology for estimating general outstanding exposure?	Yes we agree with the proposal in section 2.3 of the paper taking into account the discussion of alternatives in sections 2.4 and 2.5.
2. Do you consider the clearing manager's current treatment of ancillary services for prudential security assessment to be fit for purpose? If not, what enhancements do you support?	Yes. Refer answer to qu. 1 above.

[1] Document URL http://www.nzxgroup.com/system/resources/W1siZiIsIjIwMTQvMDMvMDQvMDdfMjNfNTJfNjU0X0NvbnN1bHRhdGlvbl9wYXBlcl9TZXR0bGVtZW50X2FuZF9wcnVkZW50aWFsX21ldGhvZG9sb2dpZXNfTWFyY2hfMjAxNC5wZGYiXV0/Consultation%20paper%20-%20Settlement%20and%20prudential%20methodologies%20March%202014.pdf found at http://www.nzxgroup.com/who-we-are/business-overview/nzx-energy/consultations-submissions

Question	MEUG response
3. Do you support the proposed approach to estimation of future volumes?	Yes we agree with the methodology for estimating exit period volumes described in the last few paragraphs of section 2.6. This is summarised in the Executive Summary section as "For forecast volumes a three week trailing average provides differentiated values for each node and trading period across business or non-business days."
4. Do you support the proposed approach to profiling ASX prices to arrive at exit period base prices?	Yes we agree with profiling ASX prices as described in table 5 in section 2.8: "Profile by month, trading period, and node, differentiating by non-business day and business day."
5. Do you support the proposed method of calculating the adder?	MEUG supports the adder[2] being calculated on a profiled methodology. Because a profiled method uses more granular history it is likely to better reflect actual historic marginal costs or risks. If the adder price component better reflects marginal costs then over time better operational and investment decisions will be made. Non-profiling by contrast is in an averaging approach. That would benefit some parties to the disadvantage of others. MEUG suggests high load factor consumers have already been disadvantaged by the Code[3] specifying the adder be for a "... hypothetical purchaser that purchases a constant proportion of total electricity purchased ...". The paper also mentions this potential bias[4]. We do not favour further tilting the bias in favour of retailers and low load factor consumers by adopting a non-profiled basis for calculating the adder.

[2] "Adder" is not a defined term in the Code. References to "adder" are the amounts determined in new Part 14A cl. 10(5). The new Part 14A was gazetted December 2013 and comes into effect 24th March 2015.
[3] New Part 14A, cl. 10(5)(b)
[4] For example see last paragraph in section 2.12

Question	MEUG response
6. Do you support the use of three years of data to calculate the adder upon commencement, extending to ten years? Do you believe there is value in including a longer period of time up front (such as including the 2008 dry year)?	MEUG supports the initial adder being calculated for the minimum period of 3 years as provided for in new Part 14A cl 10(5)(b). Using a longer time series would, in the view of MEUG, incorporate outcomes reflecting poor risk management behaviour by generators including use of "political hedges" and exercise of market power during dry periods. Recent market structure and code changes have reduced that poor behaviour. Hence as short a historic time series as possible should be used to calculate the initial adder. We are not convinced the time series after the initial year should each year extend a year. The market structure, behaviour and risk profiles may well change again. For example more new entrant pure retailers may enter the market and other business models develop. An example of the latter would be more end consumers being directly cleared with the Clearing Manager with and without intermediary service providers. The risk profile of the industry may change and an ongoing shorter historic time series would better capture those trends. MEUG suggests from year 2 onwards the adder be calculated on the immediate past three years. If this approach proves not to be a useful estimate of the near term adder then a variation can be made using new Part 14 Schedule 14.2 cl4 to extend the historic sequence beyond the minimum 3 years provided in new Part 14A cl 10(5)(b).
7. Do you support the proposed method of calculating the settlement retention amount (SRA)?	No view.

4. We look forward to the Clearing Manager considering our submission as part of preparing a proposal to the Electricity Authority Board.

Yours sincerely

Ralph Matthes
Executive Director