

TRANSPower NEW ZEALAND LIMITED

Transpower submission
to the Electricity Commission:

Interim Pricing Period

October 2009



TRANSPower

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1 INTRODUCTION

As part of Transpower's submission on the Electricity Commission's November 2008 paper *Issues and Indicative Options for Spot Market Pricing Process and UTS provisions*, we agreed that there is merit in improving the procedures for correcting pricing errors and thereby avoiding unnecessary undesirable trading situation claims. We therefore support the concept of the interim pricing period and believe that it should be investigated further.

Our submission responds to the questions in the consultation paper (as an appendix). In addition, we have highlighted the issues within the rule change proposal that we regard as of primary importance as well as other rule changes that we feel should be noted. We have also drawn attention to three further topics that are associated with the proposed pricing issues.

2 MAIN RULE CHANGE ISSUES

These are the issues that Transpower feels must be included in the interim pricing rule change to ensure an effective process:

A rule breach reference should be included with every pricing mistake claim

To avoid unnecessarily delaying final prices, each pricing mistake claimed must have a sound factual basis rather than one that is tenuous or motivated by a dislike of the pricing outcome. Certainty is an important factor in the pricing process. Pricing certainty does not exist while a pricing mistake claim is being investigated. Hence, if an investigation is to be justified, it must be supported by a minimum level of evidence. Not to specify such a requirement would be likely to lead to valuable time being spent on trivial and vexatious claims which would, in our view, be counter-productive and contrary to the intention of this rule change.

Transpower suggests that the participant making the claim should be required to refer to the rule which the pricing mistake has breached. The Pricing Manager would then be directed to the correct issue and could properly investigate the pricing input in question. In the current draft, participants do not have the onus on them to define properly the input they believe to be incorrect (rather than simply inappropriate), potentially leading to unnecessary delays to final prices and work on the Pricing Manager's (and possibly the Board's) behalf to investigate claims that may prove to be incorrect or trivial. If final pricing is to be delayed any pricing mistake claim made must be supported by a minimum level of evidence.

For example, under the proposed rules, it is possible for a participant to claim that a spring washer effect is a pricing mistake (despite having had

the relaxation factor applied). The Pricing Manager may not be able to dismiss such the claim until some investigation has taken place, resulting in a delayed final price.

There should always be a clear basis under the rules for delaying final prices and also for making corrections to those prices. Only if this is the case can the integrity of the pricing process be maintained. Transpower believes the justification cited should be a breach of the rules that relates to the pricing inputs (as the most transparent basis available to the industry and the Board). Therefore, reference to a rule breach should be a requirement of a pricing mistake claim and this should be reflected in the rule drafting and in the forms in schedule G1.

Frequency of the Board meeting

To avoid unnecessary delays in the pricing process, it is important that the Board convene to address pricing mistake claims promptly. The pricing mistakes should not be considered as items of the standard Board meetings; certainty is important, yet the wording of rule 3.26I of section V of part G contains no sense of urgency, unlike the preceding paragraphs.

Error claimants' inability to respond

Rule 3.26C.2.3 of section V of part G states that an error claimant may claim if it considers:

3.26C.2.3 that the **pricing error** was—

(a) not signalled in **dispatch prices** or **forecast prices**; or

(b) signalled in dispatch prices or forecast prices but the error claimant was unable to respond.

The term “unable to respond” in clause (b) is ambiguous. Such ‘inability’ is difficult to police and subjective for the following reasons:

- The inability to respond may be interpreted as an inability to respond through the processes laid out in the Rules, that is, the mechanism to respond might not be provided.
- The inability to respond may be a temporary or permanent physical issue with the plant, limited to that participant or the plant itself.
- It does not consider that, while the claimant may not have been able to respond, other participants were able to and did respond. It is foreseeable that more than one participant may lodge a pricing mistake claim for the same incident. This possibility is particularly important in the situation where, having seen a potential pricing mistake, one participant takes action to mitigate costs in real time while another assumes that costs will be ‘corrected’ by the Pricing Manager on resolution of the pricing mistake.

A response or lack thereof could be taken into account as part of the Pricing Manager's analysis, where this is appropriate and the response or lack of response transparent, but we suggest that rule 3.26C.2.3 of section V of part G be deleted. The factual basis for making such a claim is questionable and the rule does not consider equity between participants.

3 OTHER RULE CHANGE ISSUES

Inclusion of sub-clauses in the rule drafting

The rule drafting precisely identifies the cross references to other rules at a sub-clause level. Although this is correct, for example:

2B.1.1 Gives notice that a high spring washer price situation exists

Gives notice in accordance with rules 3.6, 3.18.4, or 3.21.1.3 that a **high spring washer price situation** exists;

it means that any changes to the Rules in future will need to identify carefully all impacts on rule renumbering throughout the Rules to a sub-clause level. In previous cases of rule renumbering this has not been fully achieved and has resulted in incorrect rule references in the updated Rules. By referring to sub-clauses, there is a danger that similar errors may be created in the future. Cross references should be made at a Rule clause level only.

“Materially affected”

Rule 3.26C.2.2 of section V of part G states that an error claimant may claim if it considers it has been materially affected by the pricing mistake. If a participant is 80 per cent hedged then it is only 20 per cent exposed to the spot market. The participant may feel that a variance in the final price materially affects its spot market exposure; however, this may not materially affect its overall position. The role of hedging in firming price and affecting materiality needs to be confirmed.

The defined purpose pricing process

Rule 2 of section V of part G states the purpose of the pricing process as:

The purpose of the pricing process is to achieve an appropriate balance between certainty and accuracy of final prices and final reserve prices for each **trading period**

As both ‘certainty’ and ‘accuracy’ are subjective measures they serve no purpose in this definition and should be removed.

4 ASSOCIATED PRICING ISSUES

Transpower time to resolve pricing mistakes

It is recognised that the Pricing Manager will incur costs when carrying out this function. What is not recognised is that a lot of the information required to investigate the claim will need to be provided by Transpower. Transpower currently incurs costs investigating undesirable trading situation (UTS) claims which are really pricing mistakes. When carrying out pricing mistake analyses, Transpower will seek to recover any additional costs that are incurred above the cost of investigating the falsely claimed UTSs.

Cost benefit analysis

Due to the qualitative and subjective nature of the cost benefit analysis, Transpower is unable to respond to any question relating to whether or not the benefits of the proposed rule changes would likely exceed the costs. The proposed changes would require software changes, none of which have been costed.

Clarification of conflict between the Rules and the Regulations

One of the issues raised in the Commission's November 2008 paper *Issues and Indicative Options for Spot Market Pricing Process and UTS provisions* was the perceived conflict between the Rules and the Regulations on the ability to change final prices. This consultation paper does not address this issue, yet it is important to understand how the interim prices affect the process and on which occasions published prices can change.

Our understanding of the relationship between the Rules and the Regulations is that the interim pricing period proposal does not alter the fact that a published final price cannot be changed, that is, once a calculated final price has been derived and published, that calculated final price stands. This is in accordance with rule 3.27 of section V of part G.

However, Regulation 56 states that the Board may direct that any trades be closed out or settled at a specified price. The distinction is that, in this case, the price being referred to is a settlement price. The calculated final price would still be retained (though it would be redundant for settlement) and the settlement of monies would occur at the price directed by the Board.

The Electricity Commission should ensure participants understand the distinction between a settlement price and a final price in the case of a UTS claim.

APPENDIX: CONSULTATION QUESTIONS

QUESTION		TRANSPOWER RESPONSE
Q1	Are there any other parties, in addition to participants and the Board, who should have the opportunity to raise concerns about possible pricing errors?	<ul style="list-style-type: none"> No.
Q2	Do you agree that the proposed timeframe for submitting a pricing error claim is appropriate? If not, please explain why not, and suggest an alternative timeframe.	<ul style="list-style-type: none"> Yes.
Q3	Do you agree with the definition of a pricing error? If not, please explain why not, and suggest an alternative definition.	<ul style="list-style-type: none"> No, the definition should require a claimed rule breach to be identified. Refer to section 2 of Transpower's letter.
Q4	Do you agree that it is not necessary to submit a rule breach claim at the same time as a pricing error claim? Please explain your answer.	<ul style="list-style-type: none"> It is important for a claimant to specify clearly what the rule breach is in order to avoid doubt and to avoid trivial and vexatious claims that cannot be substantiated. However, it may not be necessary to claim a rule breach via the compliance process until the claim is upheld. The Commission could provide guidance on the preferred process.
Q5	Do you agree that the proposed timeframe for assessing claims and resolving any pricing errors is appropriate? If not, please explain why not, and suggest an alternative timeframe.	<ul style="list-style-type: none"> Yes, on the understanding that the Board will convene to address any pricing mistake claim immediately.

QUESTION		TRANSPOWER RESPONSE
Q6	Do you have any other concerns with the proposed process for an interim pricing period? If so, please explain your concerns and suggest changes to the proposed process.	<ul style="list-style-type: none"> In addition to the points raised above concerning the need to accompany a pricing mistake with a rule breach claim, and the need for swift action by the Board, Transpower believes that the ambiguity in rule 3.26C.2.3 of section V of part G concerning an error claimant's inability to respond should be removed as a reason for making a claim.
Q7	Do you agree that the only reasonably practicable alternative to the proposal is to retain the existing pricing process? If not, please explain what alternative option do you think should be considered, and why?	<ul style="list-style-type: none"> Yes. The UTS process has as a specific purpose the investigation of manipulative and undesirable practices. This process should not be altered. A dilution of these provisions is not an acceptable alternative.
Q8	Do you agree that the benefits of the proposed rule changes would likely exceed the costs? If not, please explain why not.	<ul style="list-style-type: none"> No comment – the information needed to make this evaluation is not available.
Q9	Do you agree that the proposal meets the objectives of the rule changes better than the existing pricing process? If not, please explain why not.	<ul style="list-style-type: none"> The rule changes will need to be finalised before this can be judged. However, the degree of certainty that may be lost could be undesirable.
Q10	Do you agree that the objective cannot be achieved by anything other than a rule change? Please explain.	<ul style="list-style-type: none"> No comment.

QUESTION		TRANSPOWER RESPONSE
Q11	Do you agree with the Commission's assessment against the relevant objectives and outcomes as set out in Appendix 4? Please explain.	<ul style="list-style-type: none"> A number of the responses in the Commission's assessment rely on greater 'accuracy' of price. Being able to correct mistakes will help in many respects, but this benefit must be balanced against the perceived loss of 'certainty'.
Q12	Do you agree that the assessment of the benefits and costs of the proposal relative to the status quo supports the proposal? If not, why not?	<ul style="list-style-type: none"> No comment – insufficient information.
Q13	Do you agree that the proposal meets the objectives of the rule amendments to the greatest extent? If not, why not?	<ul style="list-style-type: none"> Refer to the answer to question 11.