

WHOLESALE MARKET ADVISORY GROUP

27 January 2006

Market Design Report - Summary of Feedback

This paper summarises the WMAG's view on the Market Design Report, incorporating feedback provided via email by WMAG members in December 2005. The paper seeks the WMAG's approval of the feedback to be presented to the Board.

MARKET DESIGN REPORT

Wholesale Work Plan Task W21

Introduction

1. At its meeting on 11 November 2005, the Wholesale Market Advisory Group (WMAG) considered the Market Design Report (Report) prepared for the Electricity Commission (Commission) by the New Zealand Institute of Economic Research (NZIER).
2. This paper provides the WMAG with a summary of members' feedback on the Report and presents a proposed WMAG response to provide to the Electricity Commission Board (Board).
3. The WMAG is requested to consider and approve the WMAG response at the 27 January 2006 meeting.

Purpose

4. The purpose of this paper is to:
 - a. Provide the WMAG with members' comments on the Report;
 - b. Present a proposed WMAG response for each of the recommendations in the Report; and
 - c. Seek members' approval of the proposed WMAG responses so they can be provided to the Board at its meeting on 14/15 February 2006.

Background

5. On 11 November 2005, Brent Layton attended the WMAG meeting to present the Report to members.
6. The Senior Advisor sought advice from the WMAG on the following points:
 - a. Whether any design elements had been omitted from the Report; and
 - b. The WMAG's view of the relative priorities and suggested way forward as outlined in the Report.
7. One Commissioner (Peter Harris) also attended the meeting and outlined several specific areas of the Report in which the Commission is particularly interested in the WMAG's view. These were:
 - a. Net vs. gross pool;
 - b. Capacity tickets (market); and

- c. Demand side bidding and forecasting.
8. On 1 December 2005, a paper was sent to members which summarised discussions at the meeting, and proposed responses to the specific questions asked by Peter Harris. The WMAG was asked to provide comments on the paper and a response to each of the Report's recommendations, including priority, by 16 December 2005.¹

Draft feedback

9. The table in Appendix A shows comments received from WMAG members. These are provided to WMAG members so that a group view (or views) can be derived, and will not be attributed to individual members when feedback is given to the Board.
10. A summary of the relative priorities recommended by NZIER versus WMAG advice is shown in Appendix B.
11. The WMAG comments and suggested priorities will be finalised at the WMAG meeting on 27 January 2006 and, once complete, will be provided along with comments from the Hedge Market Development Steering Group (HMDSG), to the Board.

Recommendations

12. It is recommended that the WMAG:
- a. **Review** members' comments and the proposed WMAG responses provided in Appendix A;
 - b. **Review** the table of priorities provided in Appendix B;
 - c. **Advise** any required amendments to the proposed WMAG responses; and
 - d. **Agree**, subject to any required amendments, that the WMAG responses be provided to the Board at its meeting on 14/15 February 2006.

¹ The initial deadline was 2 December, however, following concerns raised by members that the timeframe was too tight, an extension was given to 16 December.

APPENDIX A: WMAG COMMENTS ON MARKET DESIGN REPORT RECOMMENDATIONS

Market design element	NZIER recommendation	John Scott	Kit Wilson	Steve Cross	Bruce Mason	WMAG response
Energy hedges	<p>An effort [should] be made to provide market participants and the general public with a transparent forward price curve.</p> <p><i>Highest priority.</i></p>	<p>Agree</p> <p><i>Agree (highest priority)</i></p>	<p>There is a reasonable forward curve for those who are closely involved with the market but I do not believe that it is clear that the broader public has an understanding that will temper the impact of current conditions. For example dry or wet current conditions become extrapolated well beyond the likely impact.</p> <p><i>High</i></p>	<p>I consider this issue to be more one of perception than reality. The truth is that gentailers are making prices all the time and responding to Requests for Quotation. Energy brokers are active in the market. Contact received very little interest in its latest tender round. I believe that the issues around a forward curve are grossly overstated. The core issue isn't one of being able to access forward prices, it is that customers don't like the prices they receive.</p>		<p>Some members consider the forward price curve to be more transparent than the Report suggests, particularly for those closely involved in the market.</p> <p>The WMAG believes that the perception of a lack of a transparent forward price curve arises from a reluctance by consumers to purchase hedges at current price levels.</p> <p><i>High priority.</i></p>

Market design element	NZIER recommendation	John Scott	Kit Wilson	Steve Cross	Bruce Mason	WMAG response
Transmission hedges	A thorough review of ...the form of transmission hedge [should] be undertaken to determine what would best suit New Zealand's circumstances and the Commission's objectives and obligations. <i>Highest priority.</i>	Agree, but see below <i>Third highest</i>	This discussion has taken an inordinately long time and needs to be brought to a conclusion. I agree that addressing the allocation of risk is critical. <i>High</i>	Agree		Agree. <i>High priority.</i>

Market design element	NZIER recommendation	John Scott	Kit Wilson	Steve Cross	Bruce Mason	WMAG response
Nodal pricing v. zonal pricing for energy	A thorough review of nodal and zonal pricing...[should] be undertaken to determine what would best suit New Zealand's circumstances and the Commission's objectives and obligations. <i>Highest priority.</i>	Should not be undertaken in isolation but should be part of transmission hedges. <i>Third highest.</i>	I cannot comment effectively without having access to the other papers that apparently reach an opposite conclusion. ²	Agree		The WMAG agrees with this recommendation and notes that the review should not be undertaken in isolation but should be part of the transmission hedges task. <i>Medium priority.</i>

² [As noted in the minutes of the 11 November WMAG meeting, the paper referred to here is the 2002 report to the NZEM Rules Committee (Trowbridge Deloitte) titled "Assessment of Outcomes Achieved by Full Nodal Pricing in the NZEM".]

Market design element	NZIER recommendation	John Scott	Kit Wilson	Steve Cross	Bruce Mason	WMAG response
Capacity requirements mechanisms	So unlikely to yield a net market benefit in the New Zealand context that further consideration... appears unwarranted, at least at this time. <i>Low priority.</i>	Agree, unless there are strong counter arguments tabled	Possibly worth a further look. <i>Medium</i>	Disagree. Needs further research	Disagree – we need to have mechanisms in place to ensure that future capacity requirements are met. Thus, more thorough analysis is required here.	The WMAG considers that capacity tickets were dismissed too quickly and that more analysis on this topic is needed. The WMAG is interested in reviewing the work done by the TAG, to determine whether there are wholesale issues that need to be considered. ³ <i>Medium priority.</i>

³ This was suggested at the WMAG meeting on 11 November 2005.

Market design element	NZIER recommendation	John Scott	Kit Wilson	Steve Cross	Bruce Mason	WMAG response
Gross pool v. net pool design	<p>So unlikely to yield a net market benefit in the New Zealand context that further consideration... appears unwarranted, at least at this time.</p> <p>[However,] the Commission should still investigate and seek efficient solutions to the complaints about the impact in terms of operational requirements and costs on small and specialised generators of the move to a compulsory pool.</p> <p><i>Low priority.</i></p>	<p>Agree, but the issue of compliance costs and the allocation of market costs may need to be reviewed to address complaints.</p>	<p>I have heard a lot of positive views expressed by those who used this effectively in the past. This is an area that could broaden participation among smaller players who often are ignored by the large market participants.</p> <p><i>Medium</i></p>	<p>Agree</p>		<p>While some members agree that a review of the gross pool design is low priority at this stage, further consideration of compliance costs and the allocation of market costs may need to be reviewed to address concerns raised by parties such as industrial co-generation plant.</p> <p>Other members consider that a return to a net pool design may remove barriers to entry for smaller participants.</p> <p><i>Medium priority.</i></p>

Market design element	NZIER recommendation	John Scott	Kit Wilson	Steve Cross	Bruce Mason	WMAG response
Offer and dispatch rules	<p>...Review...some elements of the offering and dispatch rules.</p> <p><i>Third highest priority.</i></p>	<p>Agree, but really should be integrated with demand side bidding and forecasting</p> <p><i>Highest – get it finished</i></p>	<i>Ongoing</i>	Agree		<p>The WMAG considers that this should be a higher priority than that recommended by NZIER. As there is some degree of overlap between this task and the demand side bidding and forecasting task, there are benefits in progressing these in parallel.</p> <p><i>Highest priority.</i></p>

Market design element	NZIER recommendation	John Scott	Kit Wilson	Steve Cross	Bruce Mason	WMAG response
Demand-side bidding and forecasting	<p>...Review...the method by which demand forecasting is done and how demand-side bidding is incorporated in the wholesale spot market.</p> <p><i>Third highest priority.</i></p>	<p>See above</p> <p><i>Highest – get it finished one way or the other</i></p>	<p>Cost and time demand is the key negative impact particularly for the smaller players.</p>	<p>Minor issue</p>		<p>The WMAG considers that accurate forecast prices are a precursor to demand response, and that this is the primary objective of the DSBF proposal. The WMAG considers that this task should continue to be progressed at high priority, in parallel with the review if the offer and dispatch rules (see above).</p> <p><i>High priority.</i></p>
Day-ahead market	<p>So unlikely to yield a net market benefit in the New Zealand context that further consideration... appears unwarranted, at least at this time.</p> <p><i>Low priority.</i></p>	<p>Agree</p>	<p><i>Low</i></p>	<p>Agree</p>		<p>Agree.</p> <p><i>Low priority.</i></p>

Market design element	NZIER recommendation	John Scott	Kit Wilson	Steve Cross	Bruce Mason	WMAG response
Demand-side participation in the management of dry-year risk	<p>[Introduce], by voluntary agreement with retailers,... contracts aimed at consumers which have them responsible for some of the management of dry-year risk in return for lower prices in other years.</p> <p><i>Second highest priority.</i></p>	<p>Agree – I am concerned at a somewhat dismissive response from some retailers. There may be some issues with the specific proposal, but we need a commitment to focus on the objective and figure out how it might best be achieved. The potential value to NZ must be very significant.</p> <p>Believe it should be high priority, but accept second highest because I think issues currently underway should be dealt with first.</p>	<p>This approach should be followed further.</p> <p><i>High</i></p>	<p>This suggestion is impractical and should not be presented for consideration. It would be very disappointing if this issue was to find its way on to any work plan as it can easily be shown to be so fraught with implementation difficulties as to be a non starter. Fundamentally, if this were viable retailers would have done this already since retailers carry huge costs from dry year risks. The reason retailers haven't done this is that there is little benefit available and implementation problems are substantial.</p>		<p>Some members consider that this initiative would cause considerable customer dissatisfaction during a high price event. Retailers do not want the publicity or costs resulting from litigating domestic customers to require contract compliance.</p> <p>Other members consider that the initiative has considerable benefits and that an attempt to resolve retailer concerns should be investigated before this initiative is dismissed outright.</p>

APPENDIX B: SUMMARY OF RECOMMENDED PRIORITIES BY NZIER VERSUS WMAG

NZIER Report	Priority	WMAG Advice
Energy hedges Transmission hedges Nodal vs. zonal pricing for energy	Highest	Offer and dispatch rules
Demand-side participation in the management of dry-year risk	High	Energy hedges Transmission hedges Demand side bidding and forecasting
Offer and dispatch rules Demand side bidding and forecasting	Medium	Nodal vs. zonal pricing for energy Capacity requirements mechanisms Gross pool vs. net pool design
Capacity requirements mechanisms Gross pool vs. net pool design Day-ahead market	Low	Day-ahead market
	Undecided	Demand-side participation in the management of dry-year risk