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Carl Hansen
Chief Executive
Electricity Authority
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via e-mail: submissions@ea.govt.nz

Dear Carl

Scarcity Pricing Arrangements – Proposed Code Amendments

BusinessNZ is pleased to have the opportunity to provide a submission to the Electricity Authority on its consultation paper entitled 'Scarcity Pricing Arrangements – Proposed Code Amendments dated 26 July, 2011.[1]

Introduction

BusinessNZ raised a number of concerns in its previous submission on the issue of scarcity pricing, dated 29 April 2011. In that submission, BusinessNZ signalled that it could no longer support the proposed design, preferring instead the status quo until a less complex and intrusive alternative to addressing the problem is conceived.

However, BusinessNZ is now pleased to say that the Electricity Authority has, in its latest incarnation of scarcity pricing, moved to address many of BusinessNZ's concerns. BusinessNZ welcomes the direction of the new scarcity pricing proposals. Concerns remain regarding the information disclosure proposal.

General Comments on the Proposals

BusinessNZ has not responded to the specific consultation questions, leaving these to be addressed by those of its members who have a particular interest

[1] Background information on BusinessNZ is attached in Appendix One.

in these matters. However, BusinessNZ wishes to comment on two high-level issues, these being:

1. greater alignment between the problem and the proposed solution: in confining the application of scarcity pricing to emergency load shedding, it is now apparent that the proposed solution aligns more closely to reflect the traditional scope of scarcity pricing to that of providing the incentives to deliver sufficient capacity (this could be either thermal or hydro capacity, or demand reduction) in order to avoid those circumstances where demand exceeds supply. In being so aligned, the proposals address many of the concerns raised by BusinessNZ in its last submission on this issue, for example:

    a. scarcity pricing is now aimed at a clearly identified and material market failure;

    b. the overall set of 'moving parts' is now significantly less complex and therefore easier to assess in terms of their effectiveness and in being so, provides the Electricity Authority with future optionality around its future evolution should that be shown to be warranted at some later time;

    c. the recognition of the usefulness of the overseas comparators; and

    d. the recognition that a price cap can be seen as a default demand side bid – in the sense that buyers would rather be curtailed than consume energy at prices above the cap and it would provide protection against very high prices arising from an extreme event, and from the exercise of market power (as any bids over the scarcity price would be higher than the price at which consumers would curtail demand and would be the extraction of a monopoly rent); and

2. concerns with the 'stress-test' proposal: the information disclosure proposals from the previous consultation paper have been refined into a 'stress-testing' regime. However, having abandoned (correctly) efforts to shoe-horn scarcity pricing into a solution for energy scarcity, the stress-testing regime appears to be intended as a back-stop measure to insure against various claims being made by market participants during times of energy scarcity. But unlike scarcity pricing which is aimed at 'the missing money problem', no clear market failure for this proposal is put forward. Instead, comparisons to other stress-testing regimes in the financial sector are provided in an effort to assure market participants that this proposal is not novel. However, its application to a problem in another sector does not make it more broadly applicable. The concerns of BusinessNZ's members are more fundamental than the extent to which issues associated with the duplication of disclosure regimes (such as the NZX requirements) have been resolved in other sectors.

Therefore BusinessNZ's concerns expressed in its previous submission remain. In particular, BusinessNZ remains of the view that:

> " … in light of the implementation of a scarcity pricing mechanism, market participants face the accountability of their risk management actions through the incentives signalled via the market. Alternative proposals should be abandoned."[2]

Summary

In the absence of clear evidence that the market is incapable of providing sufficient capacity, the application of scarcity pricing to emergency load shedding is appropriate. This incremental approach allows for later evolution should future reviews demonstrate that to be desirable.

Scarcity pricing is, in BusinessNZ's view, likely to drive more efficient behaviours with respect to the management of risk and as such, is likely to be in the long-run interests of businesses and consumers. Other non-market measures targeted at testing future response capability is not.

Yours sincerely

John A Carnegie
Manager, Energy, Environment and Infrastructure
BusinessNZ

[2] BusinessNZ submission to the Electricity Authority dated 29 April 2011.

APPENDIX ONE: ABOUT BUSINESSNZ

Encompassing four regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' Chamber of Commerce Central, Canterbury Employers' Chamber of Commerce, and the Otago-Southland Employers' Association), BusinessNZ is New Zealand's largest business advocacy body. Together with its 70 strong Major Companies Group, and the 70-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, BusinessNZ is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

In addition to advocacy on behalf of enterprise, BusinessNZ contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.

BusinessNZ's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services). It is widely acknowledged that consistent, sustainable growth well in excess of 4% per capita per year would be required to achieve this goal in the medium term.