

Contact Energy's Submission on Scarcity Pricing Settings

Submitter	Contact Energy
Questions	Comments
Q1. Do you support the proposal to raise energy scarcity prices? Please explain your answer.	Yes, we support this change, these settings need to be adjusted to better align with current prices and costs.
Q2. Do you support the proposal to set energy scarcity prices at values consistent with 2018 VoLL (\$17,000/MWh, \$25,000/MWh and \$40,000/MWh)? Please explain your answer.	<p>We consider that energy scarcity prices should be sufficiently high that they do not impose a constraint on the normal operation of the market.</p> <p>We support an upward adjustment to the price to align with the current market and underlying economic costs.</p> <p>However we question the rationale for not choosing to adjust the price to the 2024 price escalated value of VoLL as identified in Table 3 of the consultation paper.</p> <p>We note that the Authority considers that this price is likely above the true cost of VoLL because it accounts for the large inflationary increases in recent years. We are unsure on what basis that the Authority has come to the view that official CPI measures of inflation are not a good measure of price escalation. This conclusion should be reconsidered.</p>
Q3. Do you support the proposal to reduce the number of reserve scarcity prices from three tranches to one tranche? Please explain your answer.	Yes
Q4. Do you support the proposal to set reserve scarcity prices at \$4,000/MWh for FIR and \$3,500/MWh for SIR? Please explain your answer.	<p>No, we consider that this will not solve the perverse outcomes we already experience in dispatching last resort generation in the reserve market. That is, the lowest energy or reserve scarcity price will cap price as SPD will always dispatch plants to generate physical energy when it really requires the most cost-effective energy reserve. Where the reserve offer is above the scarcity price (to reflect the LRMC of the plants in question with limited run time) this sees both an artificial suppression of physical spot prices or a choice to use constrained on discretionary processes to achieve the same market outcome which limits both physical and reserve prices.</p> <p>We consider that the most efficient market outcome is for generators to offer capacity at their true underlying costs into all markets they can operate in, and for the dispatch system to determine the most efficient way for this to be</p>

deployed. The current system means we have to second guess the dispatch rules rather than offering capacity at its true costs.

If it becomes inefficient to offer last resort generation into the reserve market this will have an impact on the price it is offered into the energy market. The long run marginal cost of a last resort generation is highly dependent on how often that generation is dispatched. As noted by the Authority it is currently priced at ~\$6,000 / MWh, but if is dispatched less often (eg because it is no longer efficient to offer it into the reserve market) then the offer price will need to increase to cover the fixed costs of the plant.

We therefore consider a reserve scarcity price which is at minimum higher than the cost of last resort generation is the most efficient outcome for the market. We consider that this should be set just below the energy scarcity price to ensure prices are sufficiently high to not impact on the normal operation of the market. We believe that market oversight by the regulator and HSOTC process will continue to provide a safeguard to offering processes to ensure no perverse outcomes even in a market with higher scarcity prices.

At paragraph 5.22 the Authority relies on the fact that reserve prices have not exceeded \$2,495 since RTP was implemented, but we note that this was influenced by the value of scarcity, and is not a true indicator of the underlying value of reserves. We also note that in many instances both physical and reserve prices were reduced due to the use of discretionary Constrained On mechanisms which saw plant of last resorts being dispatched but compensated away from physical and reserve market settlements.

A higher reserve price would also likely bring more reserve capacity into market, which could free up highly valuable flexible capacity for the energy market. For example the chance of a higher reserve prices will improve the currently marginal business cases for grid scale batteries. It would also bring more interruptible load to the market. Our Simply Energy brand is a leader in this part of the market, and the reserve scarcity values act as a price cap that can be too low to bring interruptible commercial and industrial operations into the reserve market. This is because there are substantial fixed costs in offering this capacity to set up the equipment, set up the processes if the reserve is called, and contingency for the impact on business operations.

The Authority considers a higher reserve scarcity price at paragraph 6.16, but dismisses it on the basis that it would require a higher energy scarcity price. We have had a look at the implementation of scarcity and see no reason for this to be the case. Scarcity pricing is equivalent to an offer in the market so the price itself need not be set to

	<p>exceed the highest offers + SIR reserve scarcity + FIR scarcity. In other words there is nothing in the system stopping final prices paid to a reserve offer exceeding energy scarcity in the very rare event that scarcity is called and reserve needs to be called. We also believe the operative driver in ultimate market scarcity is the additive combination of physical and reserve scarcity prices as in true scarce events plants that can provide both are valuing each broadly the same (with only very minor cost of additional fuel costs at play at the margin).</p> <p>We recommend that these scarcity settings are reviewed regularly (every 3 years) to ensure that they remain at an efficient price point.</p>
<p>Q5. Do you support the proposal to raise the price of controllable load to \$16,000/MWh? Please explain your answer.</p>	<p>We consider that a longer-term solution needs to be found for an efficient market signal for the dispatch of controllable load.</p> <p>In the short-term we support having the difference bids for controllable load set just below the price of energy scarcity.</p>
<p>Q6. Do you have any comments on the drafting of the proposed amendment?</p>	<p>No</p>
<p>Q7. Do you agree the proposed amendment is preferable to the other options? If you disagree, please explain your preferred option in terms consistent with the Authority's statutory main objective in section 15 of the Electricity Industry Act 2010.</p>	<p>If the price of energy scarcity, and particularly reserve scarcity is amended we support the remainder of the proposal.</p>
<p>Q8. Do you agree with the analysis presented in this Regulatory Statement? If not, why not?</p>	<p>We agree that the benefits of increasing scarcity prices will far exceed the costs of implementation. We note that the finding that there will be minimal costs on participants would hold with a higher energy and reserve scarcity price as we have recommended in this submission. We also consider that the benefits would be maximised by setting prices high enough for the market to find an equilibrium rather than being constrained by an arbitrary cap.</p>

Lastly, the proposal is timely as capacity constraints are becoming more frequent and potentially create a larger risk to security of supply over the next few winters compared with energy or dry year constraints. As such, adding a capacity risk curve to the System Operator's risk monitoring policy might be appropriate. This could be as simple as adding "Watch", "Alert" and "Emergency" trigger points to a longer-term version of the NZGB capacity forecast. Updated scarcity prices coupled with a capacity risk curve will allow participants to make better informed decisions about generation investment, hedging, outages or demand response.