



MAJOR ELECTRICITY USERS' GROUP

5 April 2006

Mr Roy Hemmingway
Electricity Commission
By email to roy.hemmingway@electricitycommission.govt.nz

Dear Roy

Concerns regarding Frequency Keeping constrained on costs

- In June last year MEUG raised concerns over rising Frequency Keeping (FK) costs. On 12 July 2005 MEUG claimed an Undesirable Trading Situation (UTS) existed because a Frequency Keeper who was constrained on could charge an extremely high price that would materially affect consumers and thereby undermine confidence in the market. The UTS claim was rejected although the underlying argument was not rebutted. Since that date the Commission has increased disclosure of information regarding FK costs. Aggregate FK costs did initially decline when the UTS claim was made but then rose again.
- The table below summarises information made public since September 2005.

Actual North Island FK Constrained On data							
Month		Sep-05	Oct-05	Nov-05	Dec-05	Jan-06	Feb-06
Trading Periods (TP) per month	Genesis	199	151	196	228	224	191
	MRP	503	347	423	559	598	417
Payments per month	Genesis	\$562,867	\$882,797	\$842,166	\$478,921	\$906,861	\$453,395
	MRP	\$39,027	\$25,600	\$31,193	\$84,899	\$108,393	\$73,275
	NI total	\$601,894	\$908,397	\$873,359	\$563,821	\$1,015,254	\$526,670
Average payment per TP	Genesis	\$2,828	\$5,846	\$4,297	\$2,101	\$4,048	\$2,374
	MRP	\$78	\$74	\$74	\$152	\$181	\$176
Maximum payment per TP	Genesis	\$39,671	\$40,773	\$39,426	\$27,961	\$39,688	\$40,504
	MRP	\$1,167	\$1,716	\$2,732	\$1,950	\$4,537	\$1,459

- There are a number of observations from the monthly data:
 - Mighty River Power (MRP) has been constrained on between 68% and 73% of the trading periods when the FK constrained on has occurred and Genesis the balance;
 - However Genesis has received between 85% and 97% of constrained on payments;
 - The average constrained on payment per trading period paid to Genesis has been between 14 and 79 times higher than that paid to MRP; and
 - The maximum constrained on payment to Genesis has exceeded \$40,000 for a single half hour trading period compared to the maximum ever paid to MRP since data has been disclosed of approximately \$4,500.

PO Box 8085, Level 8, Wakefield House, 90 The Terrace, Wellington, New Zealand
Telephone +64-4 494 0996, Facsimile +64-4 494 0997, Email info@meug.co.nz

4. The frequency keeping costs in the South Island are significantly lower and the actual costs also appear reasonably consistent between the two providers. The maximum constrained on payments for a single trading period each month in the South Island has varied with Contact Energy having the highest in September 2005, November 2005 and February 2006 and Meridian Energy having the highest for the other three months. The highest single constrained on payment for a trading period for Contact Energy was \$5,181 in November 2005 and \$5,046 for Meridian in January 2006. These maximum payments for South Island Frequency Keepers are consistent with the maximum paid to MRP, ie \$4,537
5. The maximum FK constrained on payments to Genesis ranging from \$27,961 to \$40,773 appear somewhat out of step.
6. The difference between the amounts paid for FK constrained on can also be highlighted by the maximum unit price constrained on payments have been cleared at:

Month		Sep-05	Oct-05	Nov-05	Dec-05	Jan-06	Feb-06
		\$/MWh	\$/MWh	\$/MWh	\$/MWh	\$/MWh	\$/MWh
South Island	Contact	56	34	207	163	255	189
	Meridian	42	269	192	125	527	453
North Island	Genesis	1,587	1,631	1,577	1,280	1,979	1,620
	MRP	49	265	221	183	266	105

7. The marginal cleared constrained on unit price for Genesis is consistently more than 3 times any other FK service provider.
8. The issues raised last year with the Commission by MEUG related to the opportunities available in the existing rules for FK providers to extract large constrained on charges from payees. These concerns were justified given the data set out above.
9. The constrained off charges show a similar pattern. The payments made to Genesis relative to those made to MRP warrant investigation particularly as WKA and TGO, ie hydro units, are used by Genesis for 84% of its FK activities. The costs of Huntly may be different but it is only used for FK activities for 16% of the time so the thermal vis a vis hydro units argument cannot be an issue.
10. MEUG acknowledge that longer-term solutions to improving competition and cost allocation in the provision of FK are being examined. The next phase of the FK strategic development programme of the Common Quality Advisory Group looks particularly encouraging but will require support and resources from the Commission. Most initiatives, if not all, will require rule changes and therefore will not be able to be implemented quickly.
11. MEUG strongly believe the Commission needs to find immediate solutions to improving competition and reducing the current level of costs for FK provision given:
 - a) The unconstrained opportunity for Frequency Keepers to extract large constrained on charges as set out in the paragraphs above.
 - b) The above exposure plus the risk of falling confidence by consumers that such material issues are accorded the right priority; especially given it is over 6 months since MEUG identified and alerted the Commission to this risk.
 - c) FK costs for the year ended February were \$56 million. This is a significant cost that should have been a much higher priority than appears to have been the case.

As an aside note the industry and Commission have just concluded an exhaustive consideration into HVDC pricing which has an annual cost of approximately \$70 million per annum. By comparison Commission and industry resources to improve the \$56 million per annum FK bill have been minimal.
 - d) FK costs are passed directly back to consumers on a c/kWh basis but consumers, both Time-Of-Use (TOU) and non TOU, have no means to manage that risk, eg:

- i) A TOU consumer may have diligently implemented a risk management strategy to manage energy price risk but can be blindsided by an unexpected increase in FK costs. This risk also applies to potential new entrant retailers.
 - ii) A TOU consumer may have perfectly predictable and stable demand but because other loads (eg highly weather dependent space heating) or suppliers (eg wind farms) are unpredictable; the FK procurement costs can rise. As a result the "perfectly flat load" TOU consumer ends up paying a portion of the higher FK costs caused by other unpredictable demand and supply.
12. MEUG suggest several steps are needed:
- a) Firstly, the Commission needs to undertake an immediate investigation into the extraordinarily high constrained on and constrained off charges. This should include an inquiry into the level of payments to Genesis relative to payments to other FK providers;
 - b) Secondly, the Commission should as a matter of urgency devise and implement "interim" solutions to normalise the FK market; and
 - c) Finally, ensure that frequency keeping development activities are given a high priority by the Commission and resources applied accordingly.
13. In advance of sending this letter MEUG forwarded a draft of this letter to Genesis Energy with a short window to provide any comment if they wished. Genesis did comment and a copy of the text of that email is appended to this letter
14. Consistent with the approach MEUG took last year when raising concerns regarding the FK market, copies of this letter have also been copied to the Commerce Commission because of the risk behaviour of suppliers in the FK market may breach the Commerce Act. Copies have also been forwarded to Ministers, FK service providers, the System Operator and spokesman for the generators Frequency Investigation Group for their information.

Yours sincerely



Ralph Matthes
Executive Director

cc Geoff Thorn, Commerce Commission
cc Hon Trevor Mallard, Minister of Energy and Bruce Donaldson
cc FK providers:
 Simon Coates, Contact Energy
 Dean Carroll, Murray Jackson and Malcolm Alexander, Genesis Energy
 Gillian Blythe and Chris Ewers, Meridian Energy
 Neil Williams, Mighty River Power
cc Kieran Devine, System Operator
cc Toby Stevenson, Chair CQAG
cc David Reeve, Convenor FIG

Appendix: Email comments from Genesis Energy to MEUG draft letter¹

Ralph,

Thank you for the opportunity to comment on your letter prior to it going out.

We have the following comments:

Market development

- Genesis energy has and does support frequency keeping market development initiatives and has made a number of recommendations around market clearing and keeper selection. Genesis energy has been part of the Frequency Issues Group (FIG a group set up at the bequest of the CEO's forum) that have made a number of recommendations to the CQAG and the SO around the inclusion of estimated Constrained on and off costs in keeper selection and multiple providers (Which MUEG has been made are aware of). These recommendations have not been adopted and could be easily implemented now without rule changes.

Genesis Energy

- Genesis Energy generation portfolio and business is significantly different to other frequency keeping providers. As the MEUG analysis shows Frequency Keeping is a role that Genesis energy's plant is not well suited to.
- When we are cleared for Frequency it is because, by definition, we are the least cost alternative under current process.

Clearly the trade offs made within our portfolio are complex and the detail of them is not something we offer in the public domain. We value the water in our catchments and the effect on our thermal plant in determining our position and understand that we may not be required to perform this role in the event more suitable alternatives are developed.

Regards,

Dean Carroll

¹ Corrected for spelling