



# MAJOR ELECTRICITY USERS' GROUP

27 March 2008

Dr Patrick Strange  
Chief Executive  
Transpower  
By email to [Patrick.Strange@transpower.co.nz](mailto:Patrick.Strange@transpower.co.nz)

Dear Patrick

## **Reviewing Frequency Keeping Procurement before conclusion of rule change process**

1. Frequency keeping (FK) costs for the last three months have totalled \$8.7m for December 2007, \$9.3m for January 2008 and \$13.5m in February 2008. The previous highest monthly FK costs were \$6.9m in March 2006. The last three months FK costs have been described by the Electricity Commission as "unprecedented." End consumers are highly vulnerable to FK costs spiralling out of control because unlike energy, they cannot hedge against FK costs and do not know what their liability will be until invoices are received following month end. Having to pay completely unknown FK costs creates significant pressure on end users' managing cash flow. FK costs in February represent a cost to consumers of \$5/MWh. A graph of FK costs since January 2005 is set out at the end of this letter.
2. Market participants therefore welcomed the recent Electricity Commission decision to publish a rule change consultation paper in late April proposing a change to the method used to select frequency keepers. The process for consideration and implementation of rule changes necessarily requires consultation and deliberation. Whilst this is a step in the right direction MEUG is concerned that the changes may not necessarily make any material impact on the reasons for FK costs being experienced at the moment.
3. If there are no material changes to water inflows over the next few months, the unprecedented cost of FK may continue until the rule change process is concluded. MEUG requests the System Operator consider any immediate opportunities for operational changes to minimise short term FK costs. For example relaxing the FK bands in some trading periods may allow resources to shift to other periods. There might be an opportunity to contract with other service providers in advance of a trading period thereby relieving pressure on existing providers. This is not intended to be a comprehensive list, rather an indication that FK costs are so punitive at the moment that some lateral and innovative thinking is needed. The party with the most expertise in this area is the System Operator. MEUG requests the System Operator urgently consider any near term opportunities to minimise FK costs in advance of the rule change process being concluded.
4. MEUG and individual large users have attempted to engage with the System Operator regarding more efficient means of procuring FK services. It appears to us that the System Operator seems only concerned about the risk of failing to meet its principal performance obligations (PPOs). MEUG does not understand how the System Operator can justify persisting with the current North Island Frequency "market" of two very reluctant players. MEUG has attempted to

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encourage the System Operator to consider multiple providers. Unfortunately the only significant change over the last couple of years has been for the System Operator to effectively eliminate Huntly power station from the FK market, though we understand that this may be currently under review.

5. MEUG's analysis shows that a significant portion of the FK related costs are paid to Genesis Energy in the form of constrained on charges. It is MEUG's opinion that potentially Genesis is unfairly exploiting the FK procurement methodology and is engineering payments in excess of \$2,000/MWh. It is difficult to understand how this price can possibly reflect any fair value for water as it appears to be a factor of the order of 10 times more than is required to compensate Genesis for using water at undesirable times of the day.
6. MEUG would like to think that the System Operator is doing all it can to reduce the cost to consumers of procuring frequency services as required in paragraph 80 of Schedule C5 (the Procurement Plan) of Part C of the Electricity Governance Rules, ie:
 

"The system operator will engage constructively with the Board, its Advisory Groups (principally the CQAG) and the industry to pursue cost-effective development of ancillary services methodologies."
7. Can you please advise what steps the System Operator is taking to achieve a lower cost to consumers for frequency keeping services?
8. MEUG believes it would be useful for the System Operator, the Frequency Issues Group, representatives of MEUG and Electricity Commission Common Quality Advisory staff to meet and provide input to the System Operator on quick fixes to the problem and other solutions.

Yours sincerely



Ralph Matthes  
Executive Director

cc Mr David Caygill, Chair, Electricity Commission  
cc Mr David Smol, Ministry of Economic Development  
cc Mr David Reeve, Frequency Issues Group

