



MAJOR ELECTRICITY USERS' GROUP

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Electricity Commission
By email to submissions@electricitycommission.govt.nz

Dear Kate

Submission on AUFLS Exemptions Issues and Options

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Commission consultation paper "AUFLS Exemptions – Issues and Options", published 16th October 2009¹. MEUG held a useful conference call with Commission staff on 6th November to discuss the consultation paper. There has also been several email correspondences with Commission staff to clarify the options. There remains a lot of uncertainty on the detailed mechanics of the two options. This submission considers the overall proposal. MEUG members will also be making separate submissions focussing on how the proposals will affect how they participate in the IR market and other options.
2. The Commission identifies two key policy issues that need to be considered in managing expiry of AUFLS exemptions on 31st March 2010 as follows²:

"It is unfair to force a distributor to assign sensitive and high cost loads to AUFLS blocks by virtue of the (small) size of the distribution network to which they belong"; and

"The Commission is looking to maximise compliance with AUFLS obligations by participants without having to reduce the amount of IL available in the market."
3. MEUG agrees that the solution must address both of these issues.
4. Paragraph 5.1.1 of the consultation paper opens with the statement:

"The Commission recognises that the issues surrounding AUFLS are complex and that any changes have the potential to have a wide impact, particularly on IR availability and IR costs."
5. MEUG agrees. To manage that complexity the consultation paper focuses on the immediate issue of the expiry of current exemptions. The paper does not consider:
 - How the specification of AUFLS might change in the future and if there will be a change to how it is procured (eg any additional cost is applied to the causer of the need for AUFLS which is currently only the owner of the HVDC because of the risk of bipole failure);
 - A stock take of current North Island AUFLS net of exempted loads relative to the requirement to cover ECE over the next few years until longer term changes to the AUFLS are made.

¹ Refer <http://www.electricitycommission.govt.nz/consultation/aufls-issues-options/view>

² Consultation paper, page B

6. MEUG suggests the Commission needs to consider both of the above. For example depending on whether there is currently over or under provision of AUFLS in the North Island, and the magnitude of that quantity, then that is a material factor in considering options and implementation timelines. It is not clear that the System Operator has much incentive to ensure anything other than over-procurement of AUFLS irrespective of the cost to the IR market or individual direct grid connected consumers. MEUG is concerned that incentives are properly aligned and economic impacts minimised for both the longer-term and near term solution.
7. The consultation paper rules out evergreen exemptions as an option. In prior submissions MEUG³ has argued that grandfathering exemptions should be considered an option. There is no discussion in the consultation paper on the pros and cons of grandfathering existing exemptions; simply an assumption that that option is off the table. MEUG disagrees. There is a long history and various arrangements that led to some direct connect consumers having no AUFLS requirements prior to the commencement of the rules. Direct connect consumers invested in plant and designed their operations on the assumption there would not be any future AUFLS obligations. Proposals to introduce an AUFLS obligation on those consumers when other options exist to cover AUFLS will be seen as an unnecessary regulatory burden and undermine end user investor confidence in the regulatory environment.
8. There will need to be an extension of the current exemptions until a new regime is decided and implemented. That new regime may be an interim regime as proposed in the consultation paper or the longer term AUFLS regime. The time allowed for extending the current exemptions needs careful analysis taking into account the longer term strategy and materiality and current risk, ie the factors noted in paragraph 5 above noted considered in the consultation paper. The optimal time for extending the current exemptions is likely to be the maximum likely time because it would be costly to have to go through another consultation round for a further extension.
9. The consultation paper proposes two interim options until the longer-term AUFLS work programme is completed:
 - A waiver from the Commission for one block of AUFLS provided certain criteria are met plus an option to seek a dispensation from the System Operator for the second block along with dispensation payments (option A2/B1); or
 - A waiver for one or both blocks of AUFLS (option A2/B2).
10. For both proposals it is assumed North Island AUFLS obligations must continue to be defined in the rules on a per distributor basis. Some distributors have a high percentage of loads suitable for AUFLS. Other distributors have almost no load suitable for AUFLS. This imbalance of suitable AUFLS load between distributors leads to the consultation proposals having various regulatory mechanisms for distributors to seek waivers and dispensations.
11. MEUG suggest there is a third option that should be considered as follows. Load most suitable for AUFLS have category 1 and 2 meters or consume power equivalent to that of the household sector, eg very few individual consumers use more than 25,000 kWh per annum. Distributors in the North Island would have a percentage of feeders supplying that largely household load with blocks of AUFLS sufficient for the System Operator to manage ECE risk. Dispensations to allow IL or equivalence arrangements could be applied for. Analysis would have to be undertaken to assess what the block sizes should be and a cost-benefit-analysis relative to the consultation paper options; nevertheless MEUG suggest this is a feasible interim solution and there are some obvious benefits:
 - a) The pool of lowest cost AUFLS is defined first and distributors that wish to opt out must find a dispensation or equivalence. Society as a whole will benefit because only value adding dispensations or equivalence will be sought.

The two proposals in the consultation paper opt in distributors with high cost load and they incur a compliance cost to prove they are high cost. High cost load equal in all respects except one happens to be embedded in a distributors network and the other connected to the grid face are treated differently. The latter incurs costs to prove they

³ MEUG to EC, Submission on proposed rule change for AUFLS dispensations and exemptions, 30th September 2005, paragraphs 8 to 12, refer <http://www.electricitycommission.govt.nz/archives/Submissions/Commonqual/2005/Aufls-oct05/MEUG.pdf>

should have a waiver and dispensation and the former benefits from the low cost load connected to the distributor. The cost of high cost load having to seek a waiver or dispensation is inequitable and adds costs to the economy that could have been avoided had the regime instead opted in all lowest cost load across the North Island as a whole rather than on standard blocks per distributor.

- b) Distributors with household load may already have blocks in excess of 16% each because they tend to be risk averse. There may already be sufficient AUFLS in place from largely household load. If not, then increasing the blocks to say 20% each as proposed in 2005⁴ should be considered. A survey of existing AUFLS feeder load should be undertaken. At the extreme the North Island may already have too much reserve through AUFLS and armed but not dispatched IL that would lead to a sharper response in an ECE than the System Operator expected and hence an over-frequency problem.
 - c) There may be perverse incentives on direct connect consumers if either or both options are implemented such as withdrawing from the IL market because they are unprepared to risk uncapped AUFLS exposure. Several MEUG members are making separate submissions on this risk.
12. MEUG describe this third option as "Lowest cost North Island AUFLS pool option". Winstone Pulp International will also be proposing a similar proposal in their submission.
13. Responses and comments to the consultation paper questions follow:

Question	Response
<p>1. Are there any circumstances under which you think participants should be relieved of their AUFLS obligations, eg:</p> <ul style="list-style-type: none"> a. enforce AUFLS obligation short of requiring a distributor to assign sensitive and/or load with high interruption costs to AUFLS blocks (without cost); or b. enforce AUFLS obligations short of requiring distributor to reduce its IR offers, subject to conditions (uncleared offers not included, liable for any associated reserve costs)? 	<p>For any given trading period, where there is a lower cost source of AUFLS or where there is already sufficient AUFLS to manage ECE risk, then there should be no obligation on a participant to provide additional AUFLS.</p>
<p>2. What do you think of the proposed eligibility criteria for receiving a waiver from AUFLS (especially the threshold)?</p>	<p>Agree with proposed health and safety and RMA or other legislative requirements as relevant criteria.</p> <p>NZ Steel⁵ have previously noted a perverse outcome should the feeders to their iron plant be included in AUFLS whereby the effect of cogeneration being tripped leads to an increase in net demand from the grid. This would exacerbate an event where frequency was falling. The Commission should consider new criteria to exclude feeders being included for AUFLS where that would lead to a net increase in demand on the grid.</p> <p>Applying the \$20/kW threshold on a per</p>

⁴ EC consultation paper, Clarification of rules relating to dispensations and exemptions from AUFLS requirements, 30th August 2005, refer <http://www.electricitycommission.govt.nz/consultation/aufls>

⁵ NZ Steel to EC, Submission on Clarification of Rules Relating to Dispensations and Exemptions from AUFLS Requirements, 29th September 2005, paragraph 5, refer <http://www.electricitycommission.govt.nz/archives/Submissions/Commonqual/2005/Aufls-oct05/NZSteel.pdf>

Question	Response
	<p>distributor basis is likely to lead to some demand not being granted a waiver because it has a value just below that threshold (eg has a cost of between \$10 and \$20/kW) even though there is demand connected to other distributor networks with an interruption cost less than \$10/kW not provided for AUFLS. This is not an efficient outcome.</p> <p>The "lowest cost North Island AUFLS pool option" would more likely achieve the lowest cost supply of AUFLS.</p> <p>Norske Skog Tasman's submission in 2005⁶ noted that very small individual loads may be able to demonstrate costs in excess of a \$20/kW threshold. Norske Skog Tasman suggested a solution to this may be to have a de minimus value for the cost to any one end consumer of, for example, \$1 million. The Commission should consider this option.</p>
<p>3. What do you think of the proposal to charge generators holding dispensations from the under frequency AOPOs (and participants holding dispensations from AUFLS) only a share of the extra costs of reserve caused by their non-compliance?</p>	<p>Agree generators should only have to pay for their share of dispensation costs.</p>
<p>4. Do you think the formulas contained in the draft rules make it sufficiently clear how any extra reserve costs should be calculated and allocated?</p>	<p>No comment.</p>
<p>5. Do you think the existing provisions in the Rules are sufficient to accommodate dispensations from AUFLS technical requirements?</p>	<p>No comment. MEUG will be interested to consider the views of the System Operator on whether dispensations will work.</p>
<p>6. What do you think of the Commission's suggestions for limiting the extent to which participants can receive dispensations from AUFLS?</p>	<p>Agree this is a feasible option.</p> <p>The benefits and costs of using a dispensation mechanism for the second 16% block of AUFLS obligations after the first 16% block is granted a waiver for being high cost in option A2/B1 needs to be considered against the "lowest cost North Island AUFLS pool option".</p>
<p>7. What do you think of the option to extend the new proposed schedule (C7) for granting waivers from AUFLS to include participants that cannot provide AUFLS without removing their IR offers from the IR market?</p>	<p>Agree this is a feasible option.</p> <p>The benefits and costs of using a waiver mechanism for the second 16% block of AUFLS obligations after the first 16% block is granted a waiver for being high cost in option A2/B2 needs to be considered against the "lowest</p>

⁶ Norske Skog Tasman to EC, re Clarification of Rules Relating to Dispensations and Exemptions from AUFLS Requirements, 30th September 2005, page 5, refer <http://www.electricitycommission.govt.nz/archives/Submissions/Commonqual/2005/Aufls-oct05/Norske-skog.pdf>

Question	Response
	cost North Island AUFLS pool option".
<p>8. What specific costs and benefits can you identify might be associated with the options proposed, in particular:</p> <p>a. Replacement of rule 6.6 (exemptions) with schedule C7 (waivers)?</p> <p>b. Amendments to the cost allocation formulas for dispensations?</p> <p>c. Amendments to the general dispensation provisions and/or extension of the schedule C7 for participants that would otherwise be eligible for a dispensation</p>	<p>Both options A2/B1 and A2/B2 add compliance costs. The "lowest cost North Island AUFLS pool option" would probably have less compliance cost and would better achieve the objective of only the lowest cost load being used for AUFLS.</p> <p>There may also be perverse incentives with the consultation paper proposals compared to the "lowest cost North Island AUFLS pool option" such as direct consumers choosing to withdraw in total or partially from the IL market because they cannot manage uncapped AUFLS risk.</p>
9. What comments do you have on the preliminary rule drafting?	No comments.

14. In summary MEUG agrees with the key policy issues identified by the Commission to ensure sensitive or high cost load is not used for AUFLS and to ensure the IL market is not undermined. To find the optimal interim solution the Commission needs to have information on the current state of AUFLS relative to the ECA risk and how each option fits with the longer term strategy. Unwinding the incentives of the various parties and ensuring the interim solution has no unintended consequences is challenging.
15. For the way forward MEUG suggest:
- Clarifying with the System Operator the ECE likely to be required until the longer term AUFLS plan is implemented;
 - Considering the two options suggested in this submission, ie
 - Grandfathering existing exemptions until the longer term plan is in place; or
 - Using the wider North Island household or household equivalent load as the starting place to define AUFLS;
 - Allowing parties to make cross-submissions in response to the submissions of other parties.
 - The Commission to undertake a further consultation after considering submissions and cross-submissions.
 - Granting an extension to the current exemptions. Because the above work is unlikely to be completed in time to inform the Commission on the optimal timing to grant extensions, the Commission should act conservatively and use the longest possible timeframe in order to avoid having to make further exemptions.

Yours sincerely



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Executive Director