



# MAJOR ELECTRICITY USERS' GROUP

4 March 2014

Dr John Rampton  
General Manager Market Design  
Electricity Authority  
By email to [submissions@ea.govt.nz](mailto:submissions@ea.govt.nz)

Dear John

## Consultation Paper – Efficient procurement of extended reserves

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Authority (EA) consultation paper<sup>1</sup> "Efficient procurement of extended reserves" dated 20<sup>th</sup> December 2013. Members of MEUG have been consulted in the preparation of this submission. This submission is not confidential.
2. MEUG appreciates the time and briefings by EA staff and advisors to assist our understanding of the paper. A summary of MEUG's view on the three key decisions to be made follow:

- a) What should be the technical standards for extended reserves in the North Island?

As the paper notes this has been determined by the System Operator with the proposed 4 block proposal. We acknowledge the need to implement as early as practicable the new technical standards.

- b) How to procure the right mix of resources to achieve those standards at least cost and to facilitate future innovative solutions?

We agree with the preferred option for AUFLS procurement to be varying AUFLS provision achieved via optimisation, with compensation plus central estimation of lines company VoLL per feeder subject to one change. The change would allow customers at dedicated feeders to opt out of their lines company obligatory arrangement with the system operator and instead they would have a direct relationship to provide and be paid for their feeder to be armed for AUFLS supply.

- c) Who should pay the cost of procurement?

We think the proposal in the consultation paper to use a beneficiaries-pay is inferior to using an exacerbators-pay approach.

Coupling exacerbators-pay and allowing individual businesses at feeders to opt in to a direct relationship with the system operator we believe will improve the proposal.

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<sup>1</sup> Document url <http://www.ea.govt.nz/dmsdocument/16319> found at <http://www.ea.govt.nz/our-work/consultations/psocg/efficient-procurement-of-extended-reserves-second-consultation/>

## 3. Detailed responses to questions in the consultation paper follow:

Question	MEUG response
1. Please provide reasons if you agree that lines companies' UoSAs do not grant them the rights to place their customers' load under AUFLS as part of a voluntary commercial agreement. Please also provide reasons if you disagree.	No reason to doubt the view in the paper that line companies do not have such rights. Even if lines companies had such rights the question is whether lines companies or end customers directly, or retailers and aggregators as agents for end customers would not be a better approach.
2. Please provide reasons if you agree that it is not practical to change the UoSAs within the timeframe required to implement the new AUFLS arrangements. Please also provide reasons if you disagree.	There is a time constraint. Over and above that though is the question about the best counterparty in the long term development of managing extended reserves as discussed in response to Qu. 1.
3. Please provide reasons if you agree that lines companies will likely face weak commercial incentives to enter into bilateral commercial arrangements to vary their level of AUFLS provision. Please also provide reasons if you disagree.	See responses to Qu. 1 and 2.
4. Please provide reasons if you agree that excluding direct connects from the obligation to provide AUFLS would be inappropriate. Please also provide reasons if you disagree.	We agree with the comments in paragraph 3.7.4 that flexible and generic regulation is preferred over inclusion of "special cases".
5. Please provide reasons if you agree that a beneficiary-pays approach to recovering the cost of any compensation payments is likely to deliver more efficient outcomes than a causer-pays approach. Please also provide reasons if you disagree.	<p>We think the proposal in the consultation paper to use a beneficiaries-pay is inferior to using an exacerbators-pay approach. The consultation paper has six arguments in support of beneficiaries-pay. Our comments on each follow:</p> <p>(1) The paper argues that the investment decision for future new HVDC investment, or any other very large transmission investment likely to be possible risks requiring extended reserves, will be no different for an exacerbators-pay approach from the status quo beneficiaries-pay approach. The status quo is the Commerce Commission approves a not to be exceeded cost and specifies the outputs of the investment using a GIT<sup>2</sup> that includes all possible costs including risk of AUFLS<sup>3</sup>.</p> <p>MEUG disagrees. In arriving at final design</p>

<sup>2</sup> GIT is used as shorthand to cover the application by the Commerce Commission of the Transpower Capex Input Methodology to requests by Transpower for approval of new investment proposals.

<sup>3</sup> Paragraphs E.1.9 to E.1.11

Question	MEUG response
	<p>and cost estimates Transpower has weaker incentives to assess AUFLS risks and mitigation strategies under a beneficiaries-pay approach. The magnitude of the incentive may not be large. Transpower may only spend a very small amount of additional project management time thinking about AUFLS exposure. Nevertheless the improved alignment of an incentive on Transpower to make sure they consider AUFLS risks and that Transpower, not the Commerce Commission or end customers, has the technical expertise to undertake that risk assessment and consider mitigation options are both benefits of using exacerbators-pay. A capital expenditure proposal submitted to the Commerce Commission to consider under the GIT will therefore be of better quality in terms of pricing the risk of AUFLS specific to that project.</p> <p>(2) The paper does not consider there would be any change in operating behaviour by possible AUFLS event causers in changing from beneficiaries-pay to exacerbators-pay<sup>4</sup>.</p> <p>MEUG disagrees. The expectation in the hierarchy adopted by the EA is that incentives and outcomes will be better with exacerbators-pay than beneficiaries-pay. In the absence of any other information we think it reasonable to assume owners of plant that may be causers or AUFLS events will at least take a moment to reassess their operating practices. Those asset owners are best placed to decide how much time they will need to re-assess their operating practices against possible AUFLS risks. The incremental resources and any change in operating may be negligible; but any change under an exacerbators-pay approach is a better outcome than beneficiaries-pay.</p> <p>(3) The paper suggests challenges in deciding allocation to potential causers is a reason not to have an exacerbators-pay approach<sup>5</sup>.</p> <p>MEUG disagrees. Simplifications and a degree of averaging are required in allocating IR. Similarly some simplifying assumptions will be needed to allocate AUFLS procurement costs to likely primary</p>

<sup>4</sup> Paragraph E.1.12

<sup>5</sup> Paragraph E.1.13

Question	MEUG response
	<p>causers'. The allocation formula may need to consider potential generator second effect or sympathetic trips to address the concern mentioned in the paper<sup>6</sup>. For example the allocator may assign some AUFLS procurement costs to all generators.</p> <p>(4) The paper suggests that because Transpower will pass any extended reserves exacerbators-pay charges onto its customers and in turn those will be passed onto consumers that this in effect is the same as applying a beneficiaries-pay approach<sup>7</sup>.</p> <p>MEUG disagrees. It is not certain that Transpower will be able to pass through such costs. The Commission may decide having Transpower exposed to these costs may improve incentives for better outcomes for the long term benefit of consumers. For example if Transpower has a stake in reducing AUFLS procurement costs then it will be able to use its considerable technical expertise and resources to facilitate innovation in the supply of AUFLS.</p> <p>(5) The paper suggests there will be no change in the quantity of AUFLS that needs to be procured by changing to an exacerbators-pay approach<sup>8</sup>.</p> <p>MEUG disagrees. In the long run causers will make some changes to avoid the risk of events occurring and hence in future resets of the AUFLS technical standards there is likely to be a downward, albeit very small, decrease in AUFLS quantities and or better specification of the block sizes and characteristics, eg earlier use of df/dt relays than the proposed initial change that will only use those for the fourth AUFLS block.</p> <p>(6) Finally the paper suggests a beneficiaries-pay approach is preferred because it incentivises stakeholders to submit realistic VoLL<sup>9</sup>.</p> <p>MEUG disagrees. Under the preferred option lines businesses don't set VoLL. The System Operator uses VoLL estimated by the EA based on information on each feeder from the lines businesses. That information should be consistent with information already</p>

<sup>6</sup> Paragraph E.1.13(a)

<sup>7</sup> Paragraph E.1.14

<sup>8</sup> Paragraph E.1.15

<sup>9</sup> Paragraph E.1.16 and paragraphs 3.10.16 to 3.10.17

Question	MEUG response
	<p>provided in PROPS. If there is a discrepancy the System Operator should investigate. We can't see what incentive a lines company would have not to provide accurate information.</p> <p>For the 5 direct connects in the North Island at first glance it is arguable they will have weaker incentives to provide true VoLL under an exacerbators-pay approach than beneficiaries-pay. Several policy design questions arise:</p> <ul style="list-style-type: none"> <li>• How much weaker is the incentive and what are the opportunities for the 5 direct connects to submit VoLL lower than their true VoLL?</li> <li>• Is adopting a beneficiaries-pay approach the only solution to any materially weaker incentive identified taking into account all of the benefits an exacerbators-pay approach will facilitate relative to beneficiaries-pay?</li> </ul> <p>MEUG notes the 5 direct connects are also subject to PROPS and therefore the System Operator has some visibility of their relative VoLL. It's important to note that for the optimisation analysis it's a reasonable estimate of forecast VoLL that's required not an estimate accurate to the n<sup>th</sup> degree. If the choice of the marginal feeder became contingent on estimated VoLL for a particular direct connect then at that stage further discussion and analysis between the System Operator and grid connected party would be warranted. MEUG believes this should be achievable on a pragmatic and reasonable basis. Most of the direct connect load will be unsuitable for AUFLS for a number of technical reasons and or load might have higher value IR and other markets. Direct connects are also conscious that they need to play their part where they can. There will be some load, such as office or non-essential warehouse load, which could be offered to be armed as AUFLS and we think the direct connect customers' will want to make that work. This has been the experience in implementing PROPS.</p> <p>Even if the EA believes there is a material residual incentive for the 5 North Island direct connects not to offer their true VoLL we think there are better ways to manage that risk.</p>

Question	MEUG response
	<p>For example the System Operator could ask the EA to commence an enquiry into a particular direct connect and use the Authority's powers to access information to validate VoLL estimates. The threat of that type of investigation in terms of both additional management time and negative publicity will be a strong deterrent to direct connects trying to game VoLL's submitted.</p> <p>Finally MEUG note that a benefit of an exacerbators-pay approach is that, along with MEUG's suggestion for end customers connected to lines businesses to opt out of their local coverage and opt in as direct AUFLS supplier to the System Operator, a more market like regime and clearer path for evolving more market mechanisms will be established. The consultation paper did not consider this benefit of an exacerbators-pay approach.</p>
<p>6. Do you have any comments about the preferred approach to determining the VoLL of lines company feeders?</p>	<p>We agree with the preferred approach subject to one addition as follow:</p> <p>Where a feeder is supplying a dedicated end customer, then that customer can opt out of being included in the local line company obligatory suite of all feeders they must supply information to the system operator on, and if selected arm, for AUFLS. Instead, an end use consumer on a dedicated feeder should have the option of having a direct relationship with the System Operator and reporting their own VoLL and if selected to be armed for AUFLS receiving payments directly.</p> <p>Receipt of payments directly and a change to an exacerbators-pay approach (see response to Qu. 5) will ensure end customers with ability to arm for AUFLS will have an incentive to make their suitability known to the System Operator. A clean line of engagement such as we propose will better facilitate this than having to work through the lines company. This will lower the costs to discover lowest cost supply of relays to arm for AUFLS. There are also benefits in managing confidential information. End customers may not necessarily wish to discuss with lines companies their VoLL and use of and plans for demand response in the energy market, IR market, participation in Dispatchable Demand from May 2014 and potentially in the future participation in the FK market.</p> <p>This modification to allow customers on dedicated feeders to opt out of obligatory</p>

Question	MEUG response
	<p>coverage by local lines company and opt in to have a direct obligation to the System Operator is consistent with progressively changing to more market type approaches such as voluntary tenders.</p> <p>The market related benefits will be best achieved by having end customers and or their retailers and aggregators as the supplier counterparties to the System Operator rather than lines companies.</p>
<p>7. Please provide reasons if you agree that issues with lines companies' incentives and contractual ability are likely to severely reduce the potential effectiveness of a voluntary AUFLS tender. Please also provide reasons if you disagree.</p>	<p>If the assumption is that lines companies will always in the future be the counterparty to the System Operator for procurement then this is true. However, we believe in the near and longer term the best counterparties or providers of AUFLS will be end customers and or their agent retailers or aggregators (see response to Qu. 1). This change will be facilitated by changes in technology.</p>
<p>8. Do you have any comments on relative ranking of the options?</p>	<p>We agree with analysis and results from the quantitative cost benefit analysis.</p> <p>Unsure if the additional step of using the NPV results in the cost benefit analysis as a sub set and also input into a broader weighting of quantified and non-quantified ranking adds much to the quality of deciding the preferred option. The fact the preferred option ranks highest on both the cost-benefit-analysis and the relative ranking approach is fortuitous and therefore we don't have to make a choice between an option that scored highest in the relative ranking approach but wasn't highest using NPV alone.</p>
<p>9. Do you have any comments on the proposed timetable?</p>	<p>MEUG were provided more details on timing when EA staff visited the MEUG monthly meeting on 26<sup>th</sup> February. This included an outline of how to manage the expiry of exemptions no later than 30<sup>th</sup> September 2015. That explanation was helpful to understand more of the implementation timeline. As the EA firm up on details of the future process we suggest the market be informed as promptly as is practicable.</p>
<p>10. Do you need any more information to help you plan your resource availability to meet the requirements set out in paragraph 4.1.9</p>	<p>Keeping parties informed of any changes to or additional details of the implementation timetable is important.</p>

Question	MEUG response
Appendix A	
11. Do you have any issues with the potential use of timers for arming AUFLS load?	No and we support further investigation of that option because there may be system security and cost saving benefits.
Appendix B	
12. Do you have comments on the indicative implementation costs used in the CBA?	No.
13. Do you have comments on the indicative on-going costs assumed in the CBA?	No.
14. Do you have comments on the indicative base level and future benefits assumed in the CBA?	No.
15. Do you have any other comments on the CBA?	No apart from congratulations to the EA and advisors to the EA for under-taking such a detailed estimate of the relative quantitative values. There is always an opportunity to debate particular assumptions and forecasting techniques however the conclusion of the analysis supporting the preferred option is reasonable and we believe can be considered robust.
Appendix C	
16. Do you have comments on the proposed compensation payment mechanism?	<p>The proposal in the paper is very high level. There will be many alternatives on how the overall approach could be implemented. We understand there will be consultation on options.</p> <p>The complexity of the compensation payment mechanism needs to be commensurate with the scale of the dollar values involved. Those are expected to be an order of magnitude less than annual turnover in the existing ancillary markets for IR or FK.</p>
17. Please provide reasons if you agree that, in an arrangement where different stakeholders are required to provide different proportions of their load as AUFLS based on their relative suitability, it is appropriate to compensate stakeholders for the costs they incur in providing AUFLS. Please also provide reasons if you disagree.	Agree parties that provide AUFLS should be compensated for their costs. An important cost is the expected cost, that is the customer specific VoLL, of being dispatched in an AUFLS event. Parties that do not provide AUFLS should not be compensated.



Question	MEUG response
Appendix F	
18. Based on your experiences of the existing AUFLS and PROPs arrangements, do you have any views on the appropriate approach to ensure consistency of the two arrangements?	We suggest a pragmatic approach consistent with the way the System Operator implements PROPS should be sufficient to ensure consistency between implementing procurement of AUFLS and modifying PROPS for the new AUFLS blocks.
19. Do you have any comments / suggestions about the historical load information requirements on stakeholders?	No.
20. Are there any other technical reasons (other than load shape, or the VoLL of customers connected to it) why a feeder may not be suitable for AUFLS?	Individual MEUG members will provide information and examples of feeders that may not be suitable for AUFLS.
21. Do you have any other comments?	No.

4. We look forward to considering the submissions of other parties on this proposal and the response of the Authority to submissions.

Yours sincerely



Ralph Matthes  
Executive Director