



# MAJOR ELECTRICITY USERS' GROUP

20 May 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 – draft Code amendment**

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 – draft Code amendment" dated 3<sup>rd</sup> April 2014. Members of MEUG have been consulted in the preparation of this submission. This submission is not confidential.
2. The question of who should pay for extended reserves procurement costs was the key issue in MEUG submissions in the prior consultation round. MEUG and MEUG members submitted an exacerbators-pay approach was likely to better achieve the requirements of the Act. The latest consultation paper makes no change to the prior position of the Authority. The paper proposes a Code amendment to recover extended reserve costs from consumers proportional to their monthly demand.
3. MEUG was not satisfied with the consideration of our prior submissions on this issue in:
  - Section 5.9 of the consultation paper (pages 71 to 73); and
  - The discussion in the companion paper<sup>2</sup> "Efficient procurement of extended reserves – response paper to the second consultation", April 2014, refer section headed "Sub-Issue: Beneficiary or exacerbators-pays approach for cost allocation" (paragraphs 3.6.7 to 3.6.10, pages 21 and 22).
4. To provide an independent expert perspective on the question of who should pay MEUG asked the New Zealand Institute of Economic Research (NZIER) for advice.
5. Attached is advice from the NZIER titled "Extended Reserves proposal", 20<sup>th</sup> May 2014. This note from NZIER should be read as part of MEUG submissions.

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<sup>1</sup> Document url <http://www.ea.govt.nz/dmsdocument/17873> found at <http://www.ea.govt.nz/development/work-programme/wholesale/efficient-procurement-extended-reserves/consultations/#c12197>

<sup>2</sup> Document url <http://www.ea.govt.nz/dmsdocument/17872> found at same web page as above

6. The concluding summary section of the NZIER report states:

“The Authority appears to have gone about the process of developing and consulting on the revised ER arrangements in a well-structured manner and is keen to press on with the remainder of the work of technical and procurement arrangements. They propose to make changes to the Code, including confirming who will pay for ER and how they will be charged, ahead of developing the whole “package”. They plan to manage the implementation themselves if an extended reserves manager has not been appointed within their timetable. We applaud the Authority’s commitment but we urge caution with the staged approach as subsequent stages could possibly require changes to the detail in Subpart 6 – charging arrangements for IR and ER that have been drafted for inclusion in the Code.

It is not clear to us that there are compelling arguments that all ER charges should be allocated to beneficiaries (defined as distributors in Subpart 6) rather than those parties causing the compound failures, nor is it clear that a single charge based on energy consumption is appropriate and more efficient than a (perhaps) two part charge which has focus on ER “availability” and the party that caused the ER “event”. It appears that the existing IR framework and implementation arrangements are pretty well set up to do just this.”

7. Based on this independent expert advice from NZIER, MEUG submits that an exacerbators approach is feasible and preferable. Specifically:

- The cost benefit analysis in appendix C only considered options where beneficiaries pay extended reserve procurement costs. Based on the NZIER advice it is clear exacerbators-pay will have greater efficiency outcomes and therefore modifying option 2 b) to provide for exacerbators paying will have a greater NPV.
- A modified option 2 b) where exacerbators-pay would therefore better comply and be preferred in terms of the requirements of s. 32(1) of the Electricity Industry Act 2010 and the Code amendment principles.
- Therefore MEUG recommends the Authority revise option 2 b) to require exacerbators rather than beneficiaries pay for procuring extended reserves.

8. Other aspects of this submission relate to ensuring sufficient clarity on final design and transitional matters prior to finalising the over-arching framework in a Code amendment. The consultation proposes details of the selection methodology and integration with Part 4 of the Commerce Act have be left to the transition phase within an over-arching framework set out in the code amendment. Our preference is to have those details clear before the code amendment proceeds. This will mitigate the risk that implementation will be slowed down because insufficient due diligence was undertaken on likely contentious details including, but not limited to, who should pay? There will always be a risk of unintended and unforeseen issues arising; but we should at least manage those we know about.

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

Question	MEUG response
1. Do you have any comment on the Authority's overall design of the proposed extended reserves arrangements?	MEUG agrees with the overall design of the proposed extended reserves arrangements set out in the section titled "New arrangements are proposed" on pages C and D of the Executive Summary <u>except</u> with the end section of the 3 <sup>rd</sup> bullet point that states "... and for such payments to be recovered from distributors and direct consumers in proportion to their demand." If the latter text were replaced with "... and for such payments to be recovered from exacerbators" then MEUG would agree with this section.
2. What comments do you have on the indicative timeline the Authority has developed for transitioning to the proposed arrangements for extended reserves?	<p>The selection methodology will be a new process. There is a risk of inconsistent interpretation by participants leading to inconsistent inputs submitted for the selection process. Inconsistent inputs will likely result in a less than optimal procurement schedule.</p> <p>Inconsistent interpretation and implementation risks have, for example been experienced with participant rolling outage plans (PROPS) as discussed in paragraph 5.7.2 of the consultation paper.</p> <p>To overcome this risk, the Authority could undertake a trial run and or a two stage selection process.</p>
3. Do you agree with the Authority's proposed allocation of roles in relation to the technical requirements schedule, selection methodology, procurement schedule, extended reserves procurement notices, implementation plans, the extended reserves schedule and statements of extended reserves obligations? If not, what alternative would you propose, and why?	Agree.
4. Do you agree with the Authority's proposal that the Authority undertake the ERM role itself initially? If not, what alternative would you propose, and why?	This is reasonable in order to achieve as early as possible implementation.
5. Do you agree with the Authority's proposed mix of Code provisions and documents that sit outside the Code? If not, what alternative would you propose, and why?	Agree.

Question	MEUG response
<p>6. Do you agree with the Authority's proposal that publishing more details about extended reserves specification and procurement will bring a greater degree of transparency to extended reserves arrangements? If not, what changes would you propose, and why?</p>	<p>Agree.</p> <p>The consultation paper discusses transparency on technical aspects of the proposal. MEUG suggests it's important there is also transparency on the financial aspects. Therefore the Code should specify that the published extended reserves schedule include details<sup>3</sup> of payments to be paid to individual providers of extended reserves and on a monthly basis the System Operator report details of actual payments.</p>
<p>7. What comments do you have on the Authority's proposed approach to co-ordinating AUFLS with IL and other forms of demand response?</p>	<p>This is a critical issue. The paper notes this is work in progress with two parallel work streams:</p> <ul style="list-style-type: none"> <li>• “the issue of AUFLS' coherence with IL and other forms of demand response is to be addressed within the selection methodology” (paragraph 5.5.4); and</li> <li>• “this issue of ensuring consistency between AUFLS and other forms of demand response will be a key aspect of its forthcoming joint initiative with the system operator addressing the issue of the different forms of demand response in a holistic manner” (paragraph 5.5.7).</li> </ul> <p>The importance of Transpower and the Authority working jointly on demand response was highlighted in the Authority letter to the Commerce Commission, “Transpower's Demand Response Programme”, dated 14<sup>th</sup> April 2014, and published by the Commerce Commission<sup>4</sup> on 16<sup>th</sup> May 2014 as part of correspondence relevant to the Commission's paper “Setting Transpower's individual price-quality path for 2015-2010, Reasons for draft decision”.</p> <p>MEUG will participate in these work streams.</p> <p>In developing a holistic view for best use of demand response for a range of alternative uses an important aspect will be to align incentives and that will require an analysis of who receives revenues and who pays? MEUG sees no reason why extended reserves should not be considered in that holistic review of demand response.</p>

<sup>3</sup> Details of payments are to be decided in the Selection Methodology. Clause E.59 of the draft Selection Methodology in appendix E has five types of payment (1) Demand Unit Interruption Payment (2) Demand Unit Interruption Payment (3) Relay Capital Payment (4) Relay Flexibility Payment (5) Relay Fast Response Payment. Each of these payment details for each provider should be disclosed.

<sup>4</sup> The Commerce Commission draft reasons paper and Electricity Authority letter are found at <http://www.comcom.govt.nz/regulated-industries/electricity/electricity-transmission/transpower-individual-price-quality-regulation/transpowers-price-quality-path-from-2015-to-2020/>

Question	MEUG response
8. What comments to you have on the Authority's initial view on how to achieve consistency of outcomes between AUFLS and rolling outages?	Setting AUFLS requirements first and then amending PROPS as proposed seems reasonable.
9. Do you have any comments in relation to the consistency of the proposed AUFLS regime and the Commerce Commission's price control regime?	<p>For the purpose of responding to this question MEUG's objection to demand paying for procurement costs is temporarily set aside.</p> <p><u>Customer interruption payments should accrue to end customers provider that service</u></p> <p>The proposal includes payments to distributors to include (paragraph 5.8.5 (b) (i)) "compensation for expected customer interruption costs"<sup>5</sup>.</p> <p>MEUG submit there should be an equivalent payment to end customers that provide the interruptible demand. The net effect on regulated income for distributors for this payment should therefore be neutral.</p> <p>The draft Code amendment has no mechanism to ensure end customers providing interruptible load will receive payment. MEUG suggests the Authority should provide some clarity on this. For example, is it possible to have a provision in the draft Code amendment or is this an issue to be included in work reviewing distributor pricing?</p> <p><u>Integration with Part 4 IMs needs further work</u></p> <p>MEUG is unsure of the following details:</p> <ol style="list-style-type: none"> <li>1) Paragraph 5.8.2 notes equipment used for AUFLS is often required for other core functions of distributors. How will the selection methodology ensure distributors are only paid incremental costs for new extended reserve procurement capital and operating costs? Existing assets used for provision of AUFLS are presumably already part of regulated asset base and therefore should not attract any capital or operating payments. How can consumers ensure that the cost allocation process in the selection methodology fully aligns with the cost allocation and regulated asset base Input Methodologies (IM)?</li> <li>2) How can we be sure the capital recovery formula used in the selection methodology<sup>6</sup> is</li> </ol>

<sup>5</sup> In the draft Selection Methodology, cl. E.59, these are termed Demand Unit Interruption Payments.

<sup>6</sup> For example in the draft selection methodology in Appendix E, uniform series present value factors are used in clause 12 (p 196) and schedule 4, Part 4 (p203) to calculate pre-tax payments. The choice of interest rate to be used in those equations to give an equivalent outcome if the cost of capital IM, regulated asset base IM and tax IM were used is not trivial.

Question	MEUG response
	<p>consistent with, for example, the way capital recovery is calculated using the cost of capital IM, the regulated asset base IM and tax IM?</p> <p>3) If a distributor is fully compensated for the incremental capital cost of a piece of equipment selected for AUFLS in a five year period; is the capital cost treated as zero for subsequent five year major resets of the procurement schedule?</p> <p>4) Paragraph 5.8.5(c) (ii) suggests “payments for enhanced AUFLS services would be excluded from determination of price caps – i.e. it would be effectively ‘unregulated’”. MEUG is not convinced there would be sufficient competition or protection of customers that “own” demand to be offered as interruptible to warrant Relay Flexibility Payments and Relay Fast Response Payments to be treated as unregulated income to distributors.</p> <p>Further analysis is required to consider how competition to distributors in these new markets can be facilitated and as noted in 1) above, those consumers are compensated for their expected interruption costs. MEUG’s proposal, set out in our submission of 4<sup>th</sup> March 2014, that customers at dedicated feeders have the option of offering extended reserves directly to the System Operator would provide competition to distributors and should be reconsidered.</p> <p>The importance of the Authority’s proposed holistic review to ensure interruptible demand is used for its highest value use as discussed in the second bullet point in response to question 7 above is also relevant to this analysis.</p>
<p>10. What comments do you have on the Authority’s proposal to amend the Code to change the trigger setting for the second AUFLS block in the South Island from 45.5 Hz to 46.5 Hz?</p>	<p>No comment.</p>
<p>11. Are there any arrangements or agreements between parties pursuant to the AUFLS provisions currently in the Code that the Authority ought to be made aware of? If so, please give details.</p>	<p>None that we aware of.</p>

Question	MEUG response
12. Do you agree with the Authority's proposal that the equivalence regime remain applicable to extended reserves, but that extended reserves be excluded from the dispensation regime? If not, what alternative do you propose and why?	Agree.
13. Do you have any comments relating to the proposed extended reserves Code amendments? Please provide comments and suggested drafting improvements with reference to specific parts, schedules and clauses of the draft Code amendments set out in Appendix B. (refer suggested format for drafting comments in the table below)	<p>Part 8, subpart 6, clause 8.67A (p 99 of the consultation paper) needs to be revised so that extended reserve costs are allocated to exacerbators rather than distributors with consequential changes to clauses 8.68 and 8.69.</p> <p>The rationale for this revision is set out in the attached NZIER advice and discussion in paragraphs 2 to 7 of this submission.</p>
14. What comment do you have on the Authority's cost-benefit assessment summarised here and detailed in Appendix C?	<p>The analysis supporting option 2 b) seems reasonable in so far as the options considered assumed beneficiaries-pay should apply where payments are made for procuring extended reserves, ie options 2 b) and 2 c).</p> <p>Missing from the analysis is consideration of modified options 2 b) and 2 c) where exacerbators pay. Those modified options can be labelled options 2 b) <sup>exacerbators</sup> and 2 c) <sup>exacerbators</sup>. Based on the advice of NZIER comparing an exacerbators-pay with beneficiaries-pay options attached as part of this submission, MEUG submit that the NPV for options 2 b) <sup>exacerbators</sup> and 2 c) <sup>exacerbators</sup> would be higher than the NPV for options 2 b) and 2 c).</p> <p>Assuming the relativity of the amended options is unchanged then option 2 b) <sup>exacerbators</sup> will have the highest NPV and be the preferred option.</p>
15. What comment do you have on the Authority's assessment of the proposed amendment against the requirements of section 32(1) of the Act?	<p>The assessment in section 6.5 of the proposed Code amendment in appendix B did not consider the alternative proposed by MEUG in response to question 13 and the revised cost-benefit assessment taking into account options where exacerbators pay discussed in response to question 14.</p> <p>If option 2 b) <sup>exacerbators</sup> had been considered then that option would, in the view of MEUG, have better complied with and been the preferred option in terms of s 32(1) of the Act.</p>

Question	MEUG response
16. What comment do you have on the Authority's assessment of the proposed amendment against the Code amendment principles?	Same response as Q15 above except this question refers to section 6.6 and the Code amendment principles.
17. Do you have comments on the indicative implementation costs used in the CBA (Appendix C)?	See response to Q14.
18. Do you have comments on the indicative on-going costs assumed in the CBA (Appendix C)?	See response to Q14.
19. Do you have comments on the indicative base level and future benefits assumed in the CBA (Appendix C)?	See response to Q14.
20. Do you have any other comments on the CBA (Appendix C)?	See response to Q14.

10. Please contact me for any further details on this submission.

Yours sincerely



Ralph Matthes  
Executive Director

Attachment:  
NZIER note, Extended Reserves proposal, 20 May 2014