

Summary of Submissions

Proposal to remove the frequency keeping in-band constrained on and off compensation

On 5 August 2013 the Electricity Authority published a consultation paper that proposed to remove the in-band frequency keeping constrained on and off compensation. Submissions closed on 17 September 2013.

List of submitters

Submissions were received from 11 parties as listed below. The shading is indicative of each submitter's approximate overall position on the proposals (green being supportive, red opposed, and orange tentative/neutral/ unconvinced).

Generator/Retailer	Distributor	Other
Contact	None	Transpower
Genesis		MEUG
Meridian		Norske Skog
Mighty River Power		Carter Holt Harvey
Trustpower		Pacific Aluminium
		NZX

Key issues

Issues raised by four of the submitters were in relation to the Authority not having done a comprehensive cost benefit analysis.

The timing of the change was critiqued as one participant thinks it conflicts with the MFK implementation in that the market hasn't had adequate time to measure the benefits (the benefits will continue to be captured though) of MFK before another change to the procurement of FK is made.

A participant thinks that the cost to the market participants to modify their systems to reflect the new methodology will not be insubstantial.

9 out of 11 submitters support the proposal.

Submitter responses to each question

Submitter	Comment	Authority Comment
Q1: Are there any interdependencies between the timing of the introduction of MFK in the North and South Islands and the date when the Code amendment proposal should be brought into effect?		
Contact Energy	<p>Yes there is. MFK provides the benefit of multiple frequency keepers and so the deviation between the dispatch value and actual value is effectively spread across parties according to the providers capabilities.</p> <p>This is quite different to SFK where a single party wears the deviation. It is important that any changes to constrained on and off payments do not prematurely occur before South Island MFK goes live, so an assessment of the MFK benefits can be made.</p>	<p>The Authority considers that any proposal that promotes our statutory objectives and realises further benefits to the FK market should be implemented as soon as possible.</p> <p>The proposal will deliver further benefits by increasing the transparency and efficiency of the FK selection process.</p>
Genesis	<p>If the code amendment is implemented, we suggest such changes to be implemented simultaneously for both the North Island and the South Island.</p>	Noted.
Meridian	<p>Meridian considers the two matters to be separate. We encourage the Authority to progress with the Code amendment immediately.</p>	Noted.
Mighty River Power	<p>None that we are aware of.</p>	Noted.
Trustpower	<p>TrustPower does not believe there are any interdependencies between MFK introduction and Code amendments. However we do note the proposals for nationwide market for FK in addition to other changes. We believe there is merit in having a coherent plan identifying 'what's going to happen when' to allow parties to plan and manage their respective positions. This plan may also encourage greater visibility and interactions, highlighting</p>	Noted.

Submitter	Comment	Authority Comment
	issues earlier rather than later.	
Transpower	No.	Noted.
MEUG	None that we are aware of.	Noted.
Norske Skog	No.	Noted.
Carter Holt Harvey	None that we are aware of.	Noted.
Pacific Aluminium	Pacific Aluminium is not aware of any interdependencies that need to be managed.	Noted.
NZX	No comment.	Noted.
Q2: Do you have any comments on the Objective of this Code change proposal?		
Contact Energy	<p>We understand that it would simplify frequency keeper selections. However as we have seen historically with change to the frequency market, we need to wait for the market to settle and adapt before changing it (not fiddle with it). Otherwise the change risks (unintentionally) taking away MFK benefits without purchasers realising the overall net benefit of a reduction in frequency costs.</p> <p>The System Operator has greater control of the frequency keepers with the MFK regulating signal, than it ever had with SFK and the associated site control of the frequency keeping. The information that we would like the Electricity Authority to present is the volume of constrained on and off amounts within the band, pre and post MFK, so that any change in benefits can be quantified.</p>	<p>The Authority considers that the change is not related to or dependent on MFK, and will not erode the benefits from MFK.</p> <p>The proposal will deliver further benefits by increasing the transparency and efficiency of the FK selection process.</p> <p>NZX have also confirmed that the in-band constrained data is not readily available hence the change cannot be quantified.</p>
Genesis	Please refer to the cover letter.	<p><u>1.Fail to facilitate market efficiency...</u> The Authority understands that the provider can assess the risk/opportunity of needing to deviate in-band from the dispatch set-point (the in-band constrained compensation). The provider can add this risk premium / opportunity cost in the availability fee.</p> <p><u>2.Impose new costs on all market participants...</u> The Authority understands that there may be a cost involved with implementing the change</p>

Submitter	Comment	Authority Comment
		at providers end. Genesis themselves have estimated the costs to be relatively moderate. Only small benefits from improved efficiency in the FK selection process would be required to justify these one-off costs.
Meridian	We support the objective. We note the proposal will also significantly improve the transparency of the frequency keeper selection process and of the resulting frequency keeping charges (which will also contribute towards the most efficient provider being selected).	Noted.
Mighty River Power	We support the objective of improving the efficiency of the current frequency keeping methodology.	Noted.
Trustpower	The proposal is fully supported by TrustPower.	Noted.
Transpower	No.	Noted.
MEUG	Agree ² . “The objective of the proposed amendment is to enhance the efficiency of the FK market by improving the likelihood the most efficient provider is selected.” ² Consultation paper, paragraph 3.2.1	Noted.
Norske Skog	No	Noted.
Carter Holt Harvey	We agree that the objective should be to improve FK market efficiency.	Noted.
Pacific Aluminium	Pacific Aluminium agrees with the objective of the proposal. Improving the efficiency with which FK selection is made should lead to a reduction in the cost of this service.	Noted.
NZX	No comment.	Noted.
Q3: Do you think there is a reduced incentive for the generators to participate in the frequency keeping market after the proposed amendment?		
Contact Energy	Yes There is a disincentive to offer a full FK service. Eliminating the in band constraint payments means it will be uneconomic for hydro stations to offer FK services without lifting	Providers may lift their availability offers to reflect the change in payment.

Submitter	Comment	Authority Comment
	prices	
Genesis	<p>Unintended consequences of this change may further dis-incentivise the generators during peak periods.</p> <p>The proposal allows market participants to build their in-band frequency constraint on and off compensation into the availability fee. As such, the market price no longer will be required to reflect two different cost components. In our view, this could potentially push the market price higher.</p> <p>Under the proposed simplified approach, it is likely that the risk premium will be higher during high cost trading periods to reflect the increased risk exposure between energy reserve and frequency markets. If these costs are not likely to be recovered in the frequency market, the generators would be less inclined to participate in that market.</p> <p>Consequently, there is a risk that the simplification may reduce the competition in the frequency keeping market.</p>	<p>The Authority considers that the proposal would not reduce competition. Total constrained costs would still be published under the proposal to provide transparency to the market.</p>
Meridian	<p>No. We consider that frequency keeping providers will reflect the costs of providing the service in their bids. This will ensure that selection is made on a transparent and fair basis.</p>	<p>Noted.</p>
Mighty River Power	<p>We do not consider the proposal will result in reduced incentives for participation in the frequency keeping market from generators. Generators reliant on in-band constraint compensation to recover costs can price this into their availability offer.</p>	<p>Noted.</p>
Trustpower	<p>If, as alleged, some generators have been exploiting the constrained on/off payments, then perhaps for these generators there may be less incentive to participate. However from an</p>	<p>Noted.</p>

Submitter	Comment	Authority Comment
	overall market view the clarity and simplicity the new charging structure will bring should benefit all consumers. Efficiency in the market using lowest overall cost must be the primary driver here.	
Transpower	No.	Noted.
MEUG	No.	Noted.
Norske Skog	No.	Noted.
Carter Holt Harvey	Improved efficiency in the FK market should not lead to lack of incentives for generators to participate. However, the potential ability to extract excessive market rents should be reduced.	Noted.
Pacific Aluminium	The proposal should reduce the generators ability to extract economic rent, but this should not be sufficient to reduce their incentives to participate. The reason is that participation should still be profitable, but there will be a reduced ability to extract arguably excessive rents. The changes to the way FK has been procured that have already been made appear to have significantly reduced costs, but we are not aware that these have reduced the incentive to participate.	Noted.
NZX	No comment.	Noted.
Q4: Do you have any comments on the assessment presented?		
Contact Energy	We are keen to understand whether this would actually reduce costs to purchasers. We need time to monitor and realise the benefits of MFK before further changes are considered. As the proposal stands it is unlikely to lower the overall cost to purchasers as the loss of revenue from the in band constraint payments is likely to be built into the half hourly fee.	The Authority considers that the change is not related to MFK, and will not erode the benefits MFK is delivering. The proposal is intended to lower the overall cost to purchasers by improving the probability that the lowest cost providers are selected in each trading period.

Submitter	Comment	Authority Comment
Genesis	As noted in our cover letter, in our view the cost and benefit assessment is too generic and not specific enough to justify the proposed changes.	A detailed quantitative cost benefit assessment would require knowledge of implementation costs for each provider and would need to make assumptions about future offer behaviour. Implementation costs are expected to be very small compared to the expected benefits from improved selection efficiency.
Meridian	Meridian considers the assessment is adequate. However, we would have liked to have seen the Authority produce a quantitative cost benefit analysis of this proposal. Meridian understands it would be possible to calculate (or estimate) the historical “within band” constrained on and off payments which have been paid to frequency keeping providers in the North and South Islands. This data would have been useful to demonstrate the magnitude of the cost which is being removed (and may allow interested parties to assess whether any subsequent increase in frequency keeping bids is reasonable).	Noted, although the proposal would not remove any costs, it would only change the method of payment for one component of the costs
Mighty River Power	We agree with the assessment.	Noted.
Trustpower	The assessment seems reasonable. FK providers would need to factor in all their costs and provide less scope for exploiting a market position. Having greater visibility of FK costs should be an overall benefit to the market and should be welcomed.	Noted.
Transpower	Nothing to add.	Noted.
MEUG	Agree with the assessment and have no further suggested benefits or costs apart from improved confidence in the FK market as discussed in response to Q7.	Noted.
Norske Skog	No.	Noted.
Carter Holt Harvey	No.	Noted.
Pacific Aluminium	No – the assessment looks sound.	Noted.

Submitter	Comment	Authority Comment
NZX	See Q5.	Noted.
Q5: Are there any additional costs or benefits that need to be considered?		
Contact Energy	We think that the Authority has helped to implement a significant step forward through MFK. The benefits of MFK such as reducing constrained on and off costs to purchasers should be assessed before any further changes are made. This could be done by monitoring the North Island MFK market for the year before MFK goes live in the SI.	It is not expected that the proposal would affect any benefits derived from MFK through increased competition. The benefits will continue to be captured – measuring them will be more difficult post this change being made,
Genesis	In our view, the Authority must conduct a more comprehensive cost benefit analysis as part of any code amendment proposal.	Refer to comments for Q4.
Meridian	No.	Noted.
Mighty River Power	No.	Noted.
Trustpower	No comment	Noted.
Transpower	No. We note that the information at footnote 9 is no longer accurate. It is likely that the system operator's costs will be lower than indicated, and NZX's higher.	Noted.
MEUG	See response to Q4.	Noted.
Norske Skog	No.	Noted.
Carter Holt Harvey	No.	Noted.
Pacific Aluminium	We are not aware of any further costs or benefits.	Noted.
NZX	The clearing manager is currently responsible for calculating constrained amounts under Part 13 of the Code, including those constrained situations arising from frequency keeping. As the proposed amendment will alter the way that frequency keeping constrained amounts are calculated changes to the clearing manager's IT system will be required. Our preliminary estimate of the changes required is \$30,000. This estimate is subject to detailed	Noted.

Submitter	Comment	Authority Comment
	design and finalisation of the Code amendment following consultation.	
Q6: Are there any other alternatives the Authority should consider apart from the status quo?		
Contact Energy	Please see page 3.	Noted, although this is not within the scope of the proposal.
Genesis	No.	Noted.
Meridian	No.	Noted.
Mighty River Power	No.	Noted.
Trustpower	The Authority should continually be challenging both the system operator and the industry to find better more efficient ways of providing services. Fixed price bands may be an option worth considering were a generator bids a fixed sum for a MW band, and the SO selects sufficient bands each trading period to cover the required amount of energy required. Providing you perform within the band you receive your payment – you may have to generate up to or down to the band but regardless you get paid you band price.	Noted although this is the current arrangement under MFK.
Transpower	No.	Noted.
MEUG	None that we aware of.	Noted.
Norske Skog	No.	Noted.
Carter Holt Harvey	None that we aware of.	Noted.
Pacific Aluminium	We are not aware of any alternatives that should be considered. The proposal is an incremental change to the way FKI is procured and has the potential to produce substantial benefits, especially during high priced periods.	Noted.
NZX	No comment	Noted.
Q7: Do you have any comments on the Authority's assessment of the proposed amendment against the requirements of section 32(1) of the Act?		
Contact Energy	We do not believe the Authority has demonstrated that this will	Refer to comments for Q4.

Submitter	Comment	Authority Comment
	reduce the costs to purchasers.	
Meridian	No.	Noted.
Mighty River Power	We agree with the assessment.	Noted.
Trustpower	The Authority's assessment seems reasonable and TrustPower agrees with the assessment	Noted.
Transpower	We agree with the assessment.	Noted.
MEUG	<p>Agree with the assessment.</p> <p>In addition MEUG believes the proposed amendment will reduce opportunities for abuse of market power in the FK market³ and therefore will positively contribute to the Electricity Authority's high level competition outcome⁴ to improve "widespread confidence among investors and consumers in the competitiveness of electricity markets."</p> <p>³The paper refers to the risk of market power in the current FK market in paragraph 3.4.3 analysis of the status quo, ie "The FK market would remain somewhat vulnerable to exploitation."</p> <p>⁴EA Statement of Intent 1 July 2013 – 30 June 2016, Table 3, p12, 20th May 2013, URL http://www.ea.govt.nz/dmsdocument/14872 found at http://www.ea.govt.nz/about-us/documents-publications/soi/</p>	Noted.
Norske Skog	No.	Noted.
Carter Holt Harvey	<p>We agree with the assessment.</p> <p>Transparency is an important part of efficient competition and we consider that this aspect of the assessment is of significance.</p>	Noted.
Pacific Aluminium	The assessment is reasonable.	Noted.
NZX	No comment.	Noted.
Q8: Do you have any comments on the Authority's assessment of the proposed amendment against the Code amendment principles?		

Submitter	Comment	Authority Comment
Contact Energy	No.	Noted.
Genesis	We do not have comments on the Principle 1. Please refer to the cover letter for the Principle 2 and 3 for more information.	Refer to comments for Q4.
Meridian	As above, we would have liked to have seen the Authority produce a quantitative cost benefit analysis of this proposal.	Refer to comments for Q4.
Mighty River Power	We agree with the assessment.	Noted.
Trustpower	Again the assessment provided by the Authority seems reasonable and is acceptable to TrustPower	Noted.
Transpower	There has been no attempt to clearly identify the efficiency gain or to quantify the costs and benefits, consistent with the Code Amendment Principles. We consider quantification would have been possible.	The Authority's consultation paper identifies the economic benefits of the proposal. The Code Amendment Principles recognise that quantitative analysis will not always be possible.
MEUG	We agree with the assessment.	Noted.
Norske Skog	No.	Noted.
Carter Holt Harvey	We agree with the assessment.	Noted.
Pacific Aluminium	The assessment is reasonable. Critically, the proposal should improve the economic efficiency with which FK providers are selected and that should lead to lower costs to consumers and thus be to their long-term benefit.	Noted.
NZX	No comment	Noted.
Q9: Do you have any comments on the Authority's proposed code amendment?		
Contact Energy	No	Noted.
Genesis	It is too early to comment until an industry consensus is reached.	Noted, although support of all but 2 of 11 submitters indicates a level of consensus.
Meridian	No.	Noted.
Mighty River Power	None other than we support the amendment.	Noted.

Submitter	Comment	Authority Comment
Trustpower	No comment	Noted.
Transpower	No.	Noted.
MEUG	No comments.	Noted.
Norske Skog	No	Noted.
Carter Holt Harvey	No comments.	Noted.
Pacific Aluminium	No comments.	Noted.
NZX	<p>The proposed code amendment may conflict with Clauses 13.194 and 13.204.</p> <p>We recommend that sub-clauses 13.194(2)(c) and 13.204(1)(b)(iii) are deleted as an alternative to the proposed Code amendment.</p>	<p>Clauses 13.194 and 13.204 provide for the calculation of constrained on and off amounts attributable to frequency keepers, not the amounts payable to frequency keepers. As such, there is no conflict.</p>