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Dear Carl

Genesis Energy opposes the proposed change to AOPOs

Genesis Energy Limited (Genesis) welcomes the opportunity to provide a submission to the Electricity Authority (“the Authority”) on its consultation paper “Normal Frequency Asset Owner Performance Obligations (AOPOs)” dated June 2014.

Genesis Energy supports the Authority’s initiatives to improve the efficiency and competitiveness of the frequency keeping (FK) market. However, we strongly oppose the proposed changes in this consultation paper because the cost, to the market and market participants, outweighs the possible benefits envisaged by the Authority. In particular:

- **The proposal fails to consider the costs of implementing the change to AOPOs.** In particular, it fails to take account of the unique characteristics and capabilities of existing New Zealand generation assets. Compliance costs will increase significantly for a large number of existing generators. This, in turn, leads to doubts whether there are any benefits at all – or whether the proposal is simply a wealth transfer between service providers.
- **The proposal threatens the reliability of supply.** The key purpose of the AOPOs is to ensure system security. However, compliance with the proposed changes is likely to create adverse impacts to the dispatch objective, and overall system reliability because the proposal does not take account of the technical incapability of significant generation capacity to meet the new requirements, nor the offer decisions that it is likely to incentivise.

Genesis Energy strongly recommends the Authority focus on existing initiatives, such as implementation of the multiple frequency keeping and the national FK market, that have the potential to deliver actual benefit to the market, and to consumers.

Cost of compliance is significant for most generators in New Zealand

The paper fails to account for the significant operational and technical costs to generators that will be imposed by compliance with the change.

Very few generators are currently able to comply with the proposed performance obligations without significant changes to how they operate their assets. We understand that even some of the existing hydro generation in New Zealand will face unnecessary costs to alter their existing operation to comply.

It is also harmful to the life of thermal plants, as we indicated in our submission in 2010¹. A copy of this submission is attached.

We also understand that wind and geothermal generation are unable to comply due the nature of their plant. Therefore, not only will the proposed change impose additional cost to energy production and therefore incentivise inefficient generation decisions, but it also may also be a wealth transfer exercise from one generator (those whose assets cannot meet the standard) to another (those who can).

Absence of consideration to technical inability will have impacts on reliability of supply.

Technical inability not acknowledged by proposed code changes

The proposed code change is incompatible with some important technical matters, such as governor system settings and optimising plant capabilities for different generation technology characteristics. This highlights a lack of understanding by the Authority of the diverse types of controllable dispatched generation plant and how they operate. In our earlier submission we identified the technical barriers inherent in the proposed change.

The proposed change imposes a uniform approach that can only be met by some hydro generators. Some non-hydro plants could apply settings to meet the proposed changes. But doing so will decrease plant reliability, which will in turn raise potential security of supply risks for the market.

AOPOs should prioritise system security

¹ Page 4, Genesis Energy submission to the Electricity Commission on frequency keeping cost allocation and asset owner performance obligation dated 30th July 2010.

We consider the Authority's intention to improve the market efficiency via proposed code change may violate the role of AOPOs. As per Clause 8.16 of the Electricity Industry Participation Code 2010:

"...The establishment of performance obligations and technical standards for asset owners to assist the system operator in complying with principle performance obligations...."

A hydro governor system is quite different from a thermal plant governor system, and it is this diversity that is reflected in the competition, reliability and efficiency realised in the market. The existing AOPOs provisions recognise this diversity.

Ultimately, the proposed Code change will have negative impacts to system reliability. It is not the most efficient way to pursue uncertain FK cost reduction by modifying AOPOs.

Other concerns with the proposal

There will be an adverse impact to reserve market and energy dispatch

The consultation paper fails to consider any potential impacts of the proposal on reserve and dispatch compliance. Energy, reserve and frequency dispatch are interrelated and integral to supporting the PPOs, and to achieving the dispatch objective. A change in one element should automatically trigger a review as to whether other products may be detrimentally affected. Those changes should also be considered as part of cost benefit analysis.

Benefits not quantifiable

We are also concerned that the qualitative assessment of benefits, relied upon for this proposal, is not credible. We are not convinced there is a positive trade-off between the potential savings from narrowing FK band in the longer term (as intended in theory) versus the realisation of actual costs on generation asset owners arising from compliance with the change.

The process of this consultation was not well managed

Given the cost significance and impacts of wide generations, we would expect a better industry engagement prior to this consultation. There was little mention by the Authority on this matter since 2010.

Without knowing non-compliance cost allocation methods and clear guidelines of applying equivalence such a change can induce an inefficient market outcome and introduce regulatory uncertainty. We understand the Authority's reasoning on maintaining a watching brief on dispensation outcomes. However, the lack of assurance on cost of non-compliance is an open risk to any generator business. It is not a viable option for a commercial decision to be based on an unknown cost. Further, the definition of "causers" discussed in the consultation paper is

not well defined which leads to different interpretations and confusion. The Authority should not take those concerns lightly.

Areas that merit greater attention

It is important to mention the Authority is currently conducting a number of other projects simultaneously to improve the efficiency of FK and reserve markets. Genesis Energy supports those initiatives to reduce the cost of FK and reserve market. There is no clear reason why the Authority should rush this proposal through. Our particular concern is that implementing this change concurrently with other proposed changes will mask the true costs and, more importantly, reduce the overall benefit of the improvements to FK market.

If you would like to discuss any of these matters further, please contact me on 04 495 6357 or Lawrence Cogan, Compliance Manager, on 09 951 9389.

Yours sincerely



Daisy Shen
Regulatory Advisor