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28 November 2016

Submissions
WAG Chair
Electricity Authority
PO Box 10041
Wellington 6143

By email: wag@ea.govt.nz

**Re: WAG Discussion Paper – Instantaneous Reserve Event Charge and Cost Allocation**

Thank you for the opportunity to provide feedback on the discussion paper on the allocation of costs of instantaneous reserves. The paper illustrates the complexities of the issue well and covers off many of the implications of alternative scenarios.

Nova Energy favours the economic rationale of the 'runway' method of cost allocation. The runway methodology is particularly appropriate in the context of a dynamic environment where users can enter and leave the market and make choices in respect of which resources they employ in doing so, e.g. trading off the economic benefits of utilising larger planes versus higher runway fees and choices of routes.

The electricity market, is less flexible in the sense that the 'exacerbators' are locked-in to their investment in power stations, and more flexible in that the 'runway' does not involve a large fixed capital investment. Market participants cannot practically redeploy their investment in power stations to alternative markets. This is most significant in respect of the investment in the remaining CCGTs. Nova therefore proposes that the 'runway' method of cost allocation be employed, but subject to a cap on the maximum marginal cost per plant. This would reasonably be at the level that would apply as if each of e3p, TCC, and Otahuhu B power stations were operating at the same level of output.

This would still provide appropriate economic signals, but would offset the punitive impact of a new cost allocative methodology on the two remaining CCGTs.

Nova's further responses to the WAG's questions are included in the attached Appendix.

Please feel free to contact me if you wish to discuss our views further.

Yours sincerely

Paul Baker

Commercial & Regulatory Advisor

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Appendix:

**Nova submission**

| Q No. | Question | Response |
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| 1. | Do you agree with our identification of the problems with current arrangements? | Yes |
| 2. | Do you agree with these basic principles for allocating IR costs? | Yes |
| 3. | Do you agree that continuing with island-based cost allocation after the introduction of the NMIR is unlikely to create perverse incentives on parties to inefficiently withhold energy or IR capacity? | Yes |
| 4. | What are your views on the merits of moving to a runway methodology (or its sub-options)? | Nova acknowledges the reservations that the WAG has on introducing the runway approach for general cost allocation; but believes that the principle is important enough such that it should be introduced. That said, the direct impact on the existing large CCGTs should be ameliorated to the extent that owners of the remaining CCGTs are not penalised excessively by a change in the rules, and the issue that NZ no longer needs all three base-load CCGTs operating.<br><br>As per our cover letter, this can be achieved by introducing the runway approach to charging, but at the same time capping the marginal rate applying to the CCGT's as if three large units where still available. By applying such a cap, there will be some unrecovered costs that should be picked up across the rest of the generators.<br><br>By applying the runway approach in this way, there are still appropriate economic signals for future long-run plant investment and divestment decisions. |
| 5. | Do you agree that a de minimis should continue and, if so, at what level? | The de-minimis should remain at 60MW as smaller generation plants do not create a significant additional market risk, i.e. unit trips at this level are largely covered by the free reserves, and never set the level of reserves required for a contingent event. The same applies under both the pro-rata or runway cost allocation method.<br><br>Under the runway cost allocation approach the size of the de-minimis is however less significant, as generators less than 60MW pick up a smaller share of the overall charge. |

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| | | Nevertheless, a de-minimis of 60MW would still be appropriate from an equity and practical perspective given the number of additional units it would need to include. |
| 6. | Are there other cost allocation options that you think should be considered? | Refer to the proposed cap on charges to the large CCGT units. |
| 7. | Which option do you think sends price signals to underlying causers of the need for, and location of, IR to be procured in a manner which best meets the cost allocation principles of section | Nova agrees that option 5, allocating costs to the HVDC then AC Island causers provides the most appropriate price signals to market participants and is the most sustainable over the long term. |
| 8. | Do you think the choice of general cost allocation approach (i.e. pro-rata versus runway) has a bearing on which option for cost allocation under the NMIR would be most appropriate? | It does appear that the HVDC then AC Island causers approach to charging is less equitable to generators in the South Island under the pro-rata approach than the runway approach. |
| 9. | To what extent do you think the choice of best option is affected by the effectiveness of how costs allocated to the HVDC are passed-on to 'underlying causers' of the level of energy transfer across the HVDC? | |
| 10. | Do you believe that some IR cost allocation options could materially impact on participants' incentives to offer energy and IR to a degree that could have material outcomes on these markets? | We are not aware of circumstances where this might apply. |
| 11. | If yes, which options are likely to give rise to such outcomes, and could you provide worked examples demonstrating such effects? | n.a. |
| 12. | Do you agree that HVDC-related IR costs should continue to be allocated to the HVDC owner and passed-on to market participants via the TPM, and do you have any observations about the interim | The key disadvantage of allocating the HVDC-related IR costs via the TPM is that there is no price signal created to incentivise a change in behaviours. The connection between the generation offers, or demand decisions are too remote from the TPM to affect market behaviours.<br>Nova believes it would be more appropriate to allocate the costs to generators in the |

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| | allocation of IR costs under the NMIR? | sending Island on a half hourly basis. In this way those generators can be expected to moderate their generation offers in response to the expected costs during very high HVDC transfers. In the longer term this would also influence generation build decisions.<br><br>Demand, is unlikely to respond to an allocation of HVDC IR costs, and therefore it is not worth the additional complexity of allocating that. |
| 13. | Do you think cost-allocation for commissioning plant should: a) continue as is; b) change to be quantity-and-price-runway-based without application of a de minimis; or c) change to be quantity-runway-based without application of a de minimis? | The cost allocation for commissioning plant should change to be quantity-runway-based, with application of a de minimis. The rationale for retaining a de minims is as per question 5. |
| 14. | Do you think a change to allocating costs to commissioning plant on a runway basis should only occur if general cost allocation were to move to a runway basis? | Yes. The commissioning charge methodology should be consistent with the basis for general cost allocation. |
| 15. | What cost-allocation approach do you think should apply for plant with under-frequency and voltage-fault-ride-through dispensations? | It is appropriate that plant with dispensations should be allocated a proportion of reserve costs. A crude-proxy approach would seem appropriate, as long as there is a reasonable expectation that the given formula is not going to penalise the dispensation holder in excess of what might have been expected on a fully allocated basis. Such a proxy should also be reasonably straightforward for the parties to understand in relationship to market prices for IR. |
| 16. | What measures do you think should be implemented to address small generation plant that are currently excluded from the need to comply with frequency-related AOPOs? | In principle, if the cost of non-compliance can be directly attributed to a generating station then the market participant should be charged for that cost. That is not to say that the default dispensation for all plant below 30MW needs to be removed. Clause 8.38 should instead need to be modified to enable the Authority to require any generating station that is clearly creating additional costs to either meet the AOPO (as clause 8.38 stands) or mitigated (i.e. pay for the impact, which may be a lower cost option).<br><br>It is expected that in most cases, those excluded generating stations with dispensations do not create readily identifiable additional costs for the rest of the market. |
| 17. | Do you think the event charge should be retained, and if so, on what basis? | Nova disagrees that the current event charge does not provide a cost reflective incentive for plant to be maintained to a reliable standard. It believes the event charge should be maintained and rebated back to the payers of IR as currently.<br><br>The discussion paper provides the example: ‘generators might withdraw their plant from |

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| | | operation for fear of incurring an event charge if they were to trip' – surely in such circumstances it is desirable to incentivise the generator to withdraw its plant if the probability of a trip times the event charge exceeds the expected revenue from generation.<br><br>The only exception to this is the HVDC, where there are regulated incentives for performance.<br><br>It may be appropriate to review the amount of the event charge, and whether it should apply to any plant that trips, over the 60 MW de minimis, rather than to just those trips that cause under frequency events. |