



NZX Limited  
Level 1, NZX Centre  
11 Cable Street  
PO Box 2959  
Wellington 6140  
New Zealand  
Tel +64 4 472 7599

[www.nzx.com](http://www.nzx.com)

28 November 2016

Submissions  
WAG Chair  
c/- Electricity Authority  
PO Box 10041  
Wellington 6143

### **Consultation on Instantaneous Reserve Event Charge and Cost Allocation**

NZX welcomes the opportunity to provide a submission for potential changes to the instantaneous reserve (IR) event charge and cost allocation methodology.

NZX appreciates the challenges of improving the efficiency of the current approach and looks forward to working with the Authority to implement such a system.

We encourage the Authority to engage with stakeholders throughout the design and implementation phases of any change to the current methodology and to make sure the resulting design is both as simple as possible and fit for purpose.

Yours Sincerely,

Sam Knight and Steve Torrens



Submitter	NZX
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Question	Comment
Q1. Do you agree with our identification of the problems with current arrangements?	NZX agrees with the WAG's assessment of the issues with the current Instantaneous reserve cost allocation methodology.
Q2. Do you agree with these basic principles for allocating IR costs?	NZX agrees that the process of assigning IR cost on a 'exacerbators pay' principle should be applied where possible.
Q3. 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?	Creating perverse incentives from these changes is unlikely as we agree with the WAGs assessment that "it is generally the case that the loss of energy revenue will outweigh any gain in terms of reduced IR cost allocation."
Q4. What are your views on the merits of moving to a runway methodology (or its sub-options)?	<p>The runway method does appear to send clearer price signals than the current pro-rata approach.</p> <p>Although there is a large degree of uncertainty around the benefits estimate, because the costs to implement are likely to be significantly less the change appears to be worth pursuing.</p> <p>As participants already operate under a certain degree of regulatory uncertainty it is unlikely that changing the IR methodology would have a material impact on the industry's perception of regulatory certainty.</p> <p>If uneconomic retiring of units is a concern, one option may be to grandfather in larger plants such as Huntly – e3p and TCC. It appears that these units will be the ones most affected by a change and therefore a gradual change in IR costs may be preferable.</p>
Q5. Do you agree that a de minimis should continue and, if so, at what level?	If the current pro-rata system was to remain we suggest that the de minimis is reviewed by the System Operator to confirm that below the level of the threshold units will not contribute materially to the need for IR.



Question	Comment
	<p>If the IR methodology was to change to the runway method the de minimis would not appear to be needed.</p>
<p>Q6. Are there other cost allocation options that you think should be considered?</p>	<p>No</p>
<p>Q7. 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 5?</p>	<p>We have not at this stage developed high level estimates for the options presented. We agree though that none of the options would be excessively complex to implement. Options 3 – 5 will require the clearing manager’s system to access and store additional information. This may need to be either sourced from WITS or the system operator.</p> <p>Option 5 ‘Cost of HVDC then to AC island causers’ appears to offer the most transparent and comprehensive breakdown of how IR costs are allocated. This option has the potential to meet both high level principles of allocating costs to the parties causing the need for IR as well as sending a marginal pricing signal to IR setting generators.</p> <p>One benefit of this option is that it recognises that the HVDC itself does not give rise to the need to procure IR in sending-energy-island and so would not be allocated the cost of procuring IR.</p>
<p>Q8. 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?</p>	<p>In the long term the general cost allocation approach may have an effect on the inputs of the option chosen due to the fact that it may alter the long term cost structures of the larger North Island thermal generators. However altering the level of inputs is unlikely to significantly affect the decision of which cost allocation method to use. The operation of either a pro-rata or runway approach will not fundamentally affect the operation of any of the options for cost allocation under NMIR.</p>
<p>Q9. 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</p>	<p>The choice of the best option should take account of the ability to pass on HVDC costs to ‘underlying causers’. It is also important for the new regime to be as transparent and fair</p>



Question	Comment
energy transfer across the HVDC?	as possible as this would not only improve the stability of the market but minimise the potential for legal dispute.
Q10. 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?	No, as the threat of regulatory sanction is likely to be too strong and, as stated in question 3, we believe that the consequences of not generating would outweigh the gains in terms of reduced IR cost allocation.
Q11. If yes, which options are likely to give rise to such outcomes, and could you provide worked examples demonstrating such effects?	N/A
Q12. 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 allocation of IR costs under the NMIR?	No comment.
Q13. 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?	Out preferred option is c).
Q14. 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, running multiple methodologies adds to the complexity and therefore cost of any IR cost allocation scheme.
Q15. What cost-allocation approach do you think should apply for plant with under-frequency and voltage-fault-ride-through dispensations?	No comment.
Q16. 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?	The cost of gearing a system designed to encapsulate the smaller generators that are currently excluded would likely outweigh the benefits of complete compliance with frequency-related AOPOs.
Q17. Do you think the event charge should be retained, and if so, on what basis?	NZX agrees with the WAG assessment that an event charge is not an appropriate tool to incentivise reliability. Past events have demonstrated the difficulty of trying to apply an event charge in a cost effective way.



Question	Comment
	<p data-bbox="794 421 1342 589">Unique circumstances resulting in special scenarios and potential legal costs have meant that the cost of investigating and applying the event cost more than likely outweighs its benefit.</p> <p data-bbox="794 622 1390 754">The economic consequences of a plant tripping off are likely incentive enough for generators with dispatch flexibility to prioritise reliability.</p>