

# Consultation Paper

## 2009 System Operator Draft Procurement Plan

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## Executive summary

This paper outlines the Electricity Commission's (Commission) proposal to recommend to the Minister of Energy and Resources (Minister) that the Electricity Governance Rules 2003 (Rules) be amended by substituting the procurement plan in schedule C5 of part C of the Rules with the draft procurement plan in Appendix 3 of this paper.

The procurement plan is a key component of the arrangements in part C, which deliver common quality and orderly system operation. The procurement plan contains requirements, guidelines, and contractual arrangements used by the System Operator to procure the ancillary services it needs to manage the operation of the power system and comply with its principal performance obligations.

The System Operator has advised the Commission that it has undertaken its own consultation on the changes it proposes in the 2009/10 draft of the procurement plan. Where considered appropriate, the System Operator adopted comments from participants in its draft.

The Commission published the draft procurement plan proposed by the System Operator on 5 June 2009. It now invites submissions on this draft (with minor drafting corrections) in accordance with rule 5.2 of section IV of part C of the Rules and section 172E(2)(b) of the Electricity Act 1992 (Act).



## Glossary of abbreviations and terms

<b>Commission</b>	Electricity Commission
<b>Minister</b>	Minister of Energy and Resources
<b>Act</b>	Electricity Act 1992
<b>GPS</b>	Government Policy Statement on Electricity Governance
<b>IL</b>	Interruptible Load
<b>Rules</b>	Electricity Governance Rules 2003
<b>Regulations</b>	Electricity Governance Regulations 2003



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## 1. Introduction and purpose of this paper

### 1.1 Introduction

1.1.1 The procurement plan contains requirements, guidelines, and contractual arrangements used by the System Operator to procure the ancillary services it needs to manage the operation of the power system and comply with its principal performance obligations.

1.1.2 On 29 May 2009, Transpower (the System Operator) provided the Commission with a draft procurement plan for the period 1 December 2009 to 30 November 2010. The Commission published the draft in accordance with rule 5.1 of section IV of part C of the Rules on 5 June 2009.

### 1.2 Purpose of this paper

1.2.1 The purpose of this paper is to consult with participants and persons that the Commission thinks are representative of the interests of persons likely to be substantially affected by the changes proposed in the draft procurement plan.

1.2.2 Some of the changes proposed in this paper are made in accordance with section 172F(3) of the Act because the Commission is satisfied that the effect of those changes is minor and will not adversely affect the interests of any person in a substantial way. As such, in respect of those proposed minor changes, it is not required to set out a detailed statement of the proposal, a statement of the reasons for the proposal, an assessment of the proposal and all reasonably practicable options identified by the Commission, and any other information the Commission considers relevant.

1.2.3 However, for the proposed changes that are not minor, this paper sets out a detailed statement of the proposal, a statement of the reasons for the proposal, an assessment of the proposal and all reasonably practicable options identified by the Commission, and any other information the Commission considers relevant.

1.2.4 The Commission invites submissions on the proposals in this paper, including drafting comments on the proposed changes in the draft procurement plan.

### 1.3 Submissions

The Commission's preference is to receive submissions in electronic format (Microsoft Word). It is not necessary to send hard copies of submissions to the Commission, unless it is not possible to do so

electronically. Submissions in electronic form should be emailed to [submissions@electricitycommission.govt.nz](mailto:submissions@electricitycommission.govt.nz) with Consultation Paper - 2009 System Operator Draft Procurement Plan in the subject line.

If submitters do not wish to send their submission electronically, they should post one hard copy of their submission to either of the addresses provided below.

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- 1.3.1 Submissions should be received by **4.00 pm on 23 July 2009**. Please note that, due to the tight timeframe associated with the review process, late submissions are unlikely to be considered.
- 1.3.2 The Commission will acknowledge receipt of all submissions electronically. Please contact Bronwyn Christie if you do not receive electronic acknowledgement of your submission within two business days.
- 1.3.3 If possible, submissions should be provided in the format shown in Appendix 1. Please be aware that the Commission is required by rule 5.3.1 of section IV of part C of the Rules to provide a copy of each submission to the System Operator and to publish the submissions. Copies of all submissions are provided to the System Operator at the close of business on the submission expiry date and published on the Commission's website.
- 1.3.4 All information provided to the Commission is subject to the Official Information Act 1982.

## 2. Background

### 2.1 Introduction

- 2.1.1 Part C of the Rules sets out the arrangements concerning common quality and aspects of system operation. The procurement plan is a key component of those arrangements. It sets out the requirements, guidelines, and contractual arrangements used by the System Operator to procure the ancillary services it needs to manage the operation of the power system and comply with the principal performance obligations.
- 2.1.2 The System Operator is required to complete a review of the procurement plan each year and provide a (replacement) draft procurement plan to the Commission by 1 June for the next twelve-month period starting 1 December of the same year. Between these two dates, the Commission is required to publish the draft procurement plan, consider submissions, and recommend a final procurement plan to the Minister of Energy and Resources (Minister) for inclusion in the Rules, in accordance with the Act.
- 2.1.3 On 29 May 2009, the System Operator provided the Commission with a draft procurement plan for the period 1 December 2009 to 30 November 2010. The Commission published the draft in accordance with rule 5.1 of section IV of part C on 5 June 2009.
- 2.1.4 The System Operator confirmed to the Commission that it has already undertaken consultation on the draft procurement plan, as it is required to do in accordance with rule 4.1 of section IV of part C of the Rules. The Commission understands the draft procurement plan presented in Appendix 3 incorporates changes made as a result of that consultation.



## 3. Analysis

### 3.1 The Commission's proposal

3.1.1 The proposal is to replace the existing procurement plan set out in schedule C5, in its entirety, with the draft procurement plan provided by the System Operator on 29 May 2009, but with minor additional changes proposed by the Commission in consultation with the System Operator. For the purposes of the statement of proposal, the Commission considers that the replacement of the existing procurement plan with the draft procurement plan is one rule amendment proposal consisting of an integrated package of changes.

### 3.2 Commission's objectives

3.2.1 Section 172X of the Act requires the Commission, in formulating recommendations for electricity governance rules, to outline how the proposal will give effect to its principal objectives and specific outcomes as set out in section 172N of the Act and to its GPS objectives and outcomes.

3.2.2 Appendix 2 contains a table, which lists the objectives and outcomes as specified in section 172N of the Act and the GPS and outlines how the proposal may help achieve the relevant objectives and outcomes.

3.2.3 The Commission's objective is to replace the existing schedule C5 (procurement plan) with a new procurement plan that:

- (a) includes the contents required in rule 4.2 of section IV of part C of the Rules; and
- (b) provides the most appropriate set of requirements, guidelines, and contractual arrangements for the System Operator to procure the ancillary services it needs to manage the operation of the power system and comply with the principal performance obligations in the twelve months from 1 December 2009.

## Minor changes

### 3.3 Discussion – proposed minor changes

3.3.1 The System Operator proposes to make several minor changes to schedule C5:

- (a) incrementing terms in paragraph 1 (from 'fifth' to 'sixth' and from '2008' to '2009');

- (b) deletion of redundant information from the table under paragraph 79 (comments, relevant to the recommendations of the 2008 National Winter Group, are no longer relevant); and
- (c) updating historic costs of ancillary services contained in paragraphs 118, 148, 165, 183 and 201.

3.3.2 In addition to the System Operator's proposed changes to the procurement plan, the Commission proposes further minor changes, which did not appear in the draft submitted by the System Operator including:

- (a) splitting the proposed new paragraph 53A into three sub-paragraphs to make it clearer what constitutes a material breach and that failing to meet the performance requirement of the frequency keeping service, based on the standard deviation assessment described in paragraph 88A, is also considered a material breach;
- (b) re-phrasing the proposed new paragraph 129A, which defines exclusions of offering the types of interruptible load from instantaneous reserve offers, to provide more clarity;
- (c) splitting the proposed changes in paragraph 136, which describes special testing requirements for interruptible load offered as instantaneous reserve, into several paragraphs to provide more clarity;
- (d) making drafting corrections to paragraph 151 to correctly describe the purpose, and the System Operator's objective, of procuring the over-frequency reserve ancillary service;
- (e) making drafting corrections to paragraph 164, which declares the System Operator's unawareness of any bilateral or alternative arrangements for the provision of over frequency reserve, to reflect the original intention of the paragraph; and
- (f) making minor punctuation corrections to some paragraphs throughout the procurement plan.

3.3.3 The Commission has consulted the System Operator and it endorses these additional minor changes, which are added alongside the system operator's changes in Appendix 3, and highlighted as modifications made by the Commission.

## Non-minor changes

### 3.4 Objective of non-minor proposals

3.4.1 The objective of the proposed rule change is outlined in paragraph 3.2.3.

3.4.2 Section 172F(1)(c) of the Act also requires the Commission to consider whether the objective of the proposed rule change could be satisfactorily achieved by any other reasonably practicable means, other than making a rule change, for example, by education, information, or voluntary compliance. This only needs to be considered for the non-minor amendments proposed in this paper.

3.4.3 The System Operator has proposed the following non-minor changes to the procurement plan:

- (a) Paragraph 53A - This paragraph currently provides details of what constitutes a material breach that provides grounds for immediately terminating an ancillary service schedule to the ancillary service procurement contract. Currently, the failure of a performance requirement is not considered a material breach, but this exclusion was intended only to cover one-off performance failures.

The standard deviation performance requirements for frequency keeping establish performance over a calendar month. Therefore, as the paragraph is currently worded, there is the potential for a significant period of frequency keeping non-compliance to take place before action can be taken against a provider.

The changes proposed to this paragraph address this issue by ensuring the System Operator has the right to take immediate action for non-compliance as soon as the standard deviation period is completed.

- (b) Paragraph 105B - It is proposed to clarify that this provision for constrained on and off amounts only applies to fixed price/quantity frequency keeping (not half-hourly).
- (c) Paragraph 129A - It is proposed to include, in the procurement plan, an obligation already contained in the ancillary service procurement contracts.

This paragraph is proposed in response to the concern that demand aggregators are able to contract for Interruptible Load (IL) with end-use customers while avoiding the regulatory obligations facing distributors and purchasers.

- (d) Paragraphs 136, 137, 138 and Appendix B - Definition of end-to-end test - It is proposed that any IL providers that have not successfully responded to an under-frequency event during that year will be required to carry out an end-to-end test of the functionality of the equipment used to provide the services.
- (e) Paragraph 151 - The changes proposed insert references to the different over-frequency limits in each island, which reflects the correct position and makes the paragraph consistent with the policy statement.

3.4.4 The Commission has considered whether the objective could be achieved by means other than the making of a rule. It notes that the procurement plan, although included in the Rules, is, as the name suggests, a plan for the procurement of ancillary services. It includes, amongst other things, the key contract terms and technical specifications the system operator intends seeking when negotiating contracts with ancillary service providers. Against this background, having reviewed the proposed changes, the Commission has concluded that proposing amendments to the procurement plan is the most appropriate means to achieving the objective of the changes.

### 3.5 Other reasonably practicable options

3.5.1 Section 172F of the Act provides that unless the Commission is satisfied that the effect of the recommendation is minor and will not adversely affect the interest of any person in a substantial way, before making a recommendation to the Minister on a rule, the Commission must seek to identify all reasonably practicable options, assess those options, ensure that the objective of the rule is unlikely to be satisfactorily achieved by any reasonably practicable means other than making the rule, and prepare a statement of the proposal.

#### Reasonably Practicable Options

3.5.2 For the purposes of this consultation, the Commission considers that the only reasonably practicable option to the proposal is the status quo (i.e. retain the existing procurement plan).

3.5.3 The Commission has prepared the assessment below on the basis that the draft procurement plan is one integrated package of changes.

3.5.4 Section 172F(1) of the Act requires the Commission to assess:

- (a) the costs and benefits of each reasonably practicable option, including the proposal;
- (b) the extent to which the objective would be promoted or achieved by each option; and
- (c) any other matters that the Commission considers relevant.

3.5.5 The assessment which follows is largely based on information prepared and provided by the System Operator as part of the material accompanying the draft procurement plan.

## Benefits and costs

- 3.5.6 The assessment of the benefits/costs associated with the draft procurement plan is set out relative to a counterfactual of retaining the existing procurement plan, which is also considered to be the only reasonably practicable alternative for the purposes of this statement of proposal.
- 3.5.7 The Commission has considered and decided that it is not possible to quantify the costs and benefits of the proposal and the alternative with any reasonable degree of accuracy. Therefore, the benefits and costs of its proposal and the alternative have been evaluated in qualitative terms. Submitters are invited to provide quantitative and qualitative information on the costs and benefits as part of their submission on the proposal.
- 3.5.8 The System Operator provided the Commission with its view of the benefits and costs associated with the changes proposed in the draft procurement plan. The Commission has considered this information and has summarised its view of the benefits and costs in Table 1, below.

Table 1: Costs and benefits of proposed changes to draft procurement plan

Paragraph	Description	Preliminary consideration of benefits and costs
53A	<p>This paragraph currently provides details of what constitutes a material breach that provides grounds for terminating an ancillary service provider contract. The failure of a performance requirement is not considered a material breach but this exclusion was intended only to cover one-off performance failures.</p> <p>The standard deviation performance requirements for frequency keeping establish performance over a calendar month. Therefore, as the paragraph is currently worded, there is the potential for a significant period of frequency keeping non-compliance to take place before</p>	<p>The change proposed increases the assurance that the ancillary service will meet minimum performance requirements. It does potentially increase barriers/risks for providers to enter the market. However, on balance, the Commission considers the benefit outweighs the potential cost.</p>

Paragraph	Description	Preliminary consideration of benefits and costs
	<p>action could be taken against a provider.</p> <p>The changes proposed to this paragraph address this issue by ensuring the System Operator has the right to take action for non-compliance as soon as the standard deviation period is completed.</p>	
105B	<p>It is proposed to clarify that this provision for constrained on and off amounts only applies to fixed price/quantity frequency keeping (not half-hourly).</p>	<p>The change proposed clarifies the obligations of a prospective provider, reducing a potential barrier to entry. The Commission has not identified any costs associated with the proposed change.</p>
129A	<p>It is proposed to include, in the procurement plan, an obligation already contained in the ancillary service procurement contracts.</p> <p>This paragraph is proposed in response to the concern that demand aggregators are able to contract for IL with end-use customers while avoiding the regulatory obligations facing distributors and purchasers.</p>	<p>The change proposed improves the clarity of this property right boundary. Potential providers of IL can more readily see that they cannot disconnect load that might already be included by others in their load-shedding calculations. As this existing obligation is merely being shifted from the procurement contract to the procurement plan, it does not add any new costs.</p>
136, 137, 138, Definition of end-to-end test	<p>It is proposed that any IL providers that have not successfully responded to an under-frequency event during that year will be required to carry out an end-to-end test of the functionality of the equipment used to provide the services.</p>	<p>The change proposed improves the integrity of IL service provision by gaining a greater level of certainty about the ability of IL providers to respond to under-frequency events. It does potentially increase barriers/risks for providers to enter the market because there will be additional costs incurred by IL service providers that are required to conduct a test and for the System Operator, which must witness the tests and analyse the results. However, costs may be low as the System Operator has indicated</p>

Paragraph	Description	Preliminary consideration of benefits and costs
		that, in the last year, only one provider would have had to carry out a test. The Commission's preliminary view is that the likely benefits outweigh the likely costs.
151	The changes proposed insert references to the different over-frequency limits in each island, which corrects an error in the current wording.	The proposed changes improve the clarity of the role for potential providers, reducing a potential barrier to entry. The Commission has not identified any costs associated with the changes proposed.

3.5.9 Where both benefits and costs have been identified, the Commission's preliminary view is that the benefits exceed the costs. When comparing the proposal with the status quo, the Commission considers that, taken as a package, the identified benefits of replacing the existing procurement plan with the new draft exceed the costs identified. Accordingly, the Commission considers the assessment supports the proposal. However, the Commission welcomes submissions on its view of the benefits and costs identified above.

### Assessment against the objective

3.5.10 In view of paragraph 3.2.3, the Commission's preliminary view is that the new draft:

- (a) meets the requirements of the contents of the draft procurement plan, as set out in rule 4.2 of section IV of part C of the Rules; and
- (b) provides the most appropriate set of requirements, guidelines, and contractual arrangements for the System Operator to procure the ancillary services it needs to manage the operation of the power system and comply with the principal performance obligations in the twelve months from 1 December 2009.

### 3.6 Statement of reasons for proposal

3.6.1 The reason for the proposal is to ensure that schedule C5 (the procurement plan) contains the appropriate set of requirements, guidelines, and contractual arrangements for the System Operator to procure the ancillary services it needs

to manage the operation of the power system and comply with the principal performance obligations in the twelve months from 1 December 2009.

- 3.6.2 The Commission must ensure that the objective of the rule is unlikely to be satisfactorily achieved by any reasonably practicable means other than the making of the rule (for example, by education, information, or voluntary compliance). It considers that the objective cannot be achieved by anything other than a rule change, as it is appropriate that these matters be set out in the procurement plan, which in turn requires a rule change to revoke the existing procurement plan and replace it with that now proposed.

### 3.7 Assessment of all options

- 3.7.1 The Commission's view is that the assessment of the benefits and costs of the proposal relative to the counterfactual of the status quo supports the proposal. The Commission also considers that the proposal meets the objective of the rule amendments to the greatest extent. However, the Commission welcomes submissions on this view, in particular on the costs and benefits associated with the proposal.

## 4. Conclusion

### 4.1 Conclusion to the analysis

- 4.1.1 The Commission has received and published the draft procurement plan provided by the System Operator. The System Operator has advised the Commission that it has already undertaken consultation on the draft procurement, as the Rules require. The Commission understands the draft procurement plan contained in Appendix 3 incorporates changes made by the System Operator as a result of its preliminary consultation.
- 4.1.2 The Commission has made minor drafting changes to the draft procurement plan (version provided by the System Operator on 29 May 2009) to aid clarity.
- 4.1.3 The Commission now invites submissions on the draft procurement plan in accordance with rule 5.2 of section IV of part C of the Rules, and section 172E(2)(b) of the Act. Please note that the Commission is required to provide a copy of all submissions it receives to the System Operator, and publish the submissions, which it intends doing by making them available on the Commission's website.
- 4.1.4 At the conclusion of the consultation period, the System Operator has the right to make its own submission on the draft procurement plan and on the submissions

received by the Commission in relation to it, within ten business days after the participants' submission expiry date. The Commission is then required to complete its consideration of all submissions received on the draft procurement plan and make recommendations to the Minister in accordance with the Act.

- 4.1.5 The statement of proposal, prepared in accordance with section 172F of the Act, is also included for the purpose of consultation on the rule change proposal as the replacement of the existing procurement plan set out in schedule C5 of part C of the Rules with the new draft procurement plan is a rule change under the Act.

## 5. Questions

### 5.1 Summary of questions

- 5.1.1 The Commission now seeks stakeholder feedback on the proposal. In particular, it would like to receive views on:
- (a) the nature and drafting of each of the changes proposed; and
  - (b) the costs and benefits of each of the changes proposed.
- 5.1.2 A suggested format for submissions is set out in Appendix 1 attached to this paper.



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## Appendix 1 Format for submissions

Draft procurement plan paragraph reference	Comment on proposed change	Alternative suggestion to proposed change (where applicable)

## Appendix 2 Consideration against objectives and outcomes

Objectives and Outcomes under section 172N of the Act	Response
The Commission's principal objectives are as follows:	
<p>(a) to ensure that electricity is produced and delivered to all classes of consumers in an efficient, fair, reliable, and environmentally sustainable manner; and</p> <p>(b) to promote and facilitate the efficient use of electricity.</p>	<p>(a) The Commission considers that the proposed draft procurement plan would enhance efficiency and fairness by providing more clarification on the specification for several ancillary services.</p> <p>(b) The Commission does not consider the new draft procurement plan would materially affect this objective.</p>
The specific outcomes that the Commission must seek to achieve are as follows:	
<p>(c) energy and other resources are used efficiently;</p>	<p>The Commission does not consider the new draft procurement plan would materially affect this outcome.</p>
<p>(d) risks (including price risks) relating to security of supply are properly and efficiently managed;</p>	<p>The Commission considers that the proposed draft procurement plan could improve outcomes relating to security of supply by increasing the likelihood that ancillary services will meet minimum performance standards.</p>
<p>(e) barriers to competition in the electricity industry are minimised for the long-term benefit of end-users;</p>	<p>The Commission considers that the proposed draft procurement plan could arguably increase barriers to entry for some ancillary service providers through the proposed changes to performance requirements. However, the Commission considers that the effect is likely to be minor, and that the costs are outweighed by the benefits in enhanced performance delivery.</p>
<p>(f) incentives for investment in generation, transmission, lines, energy efficiency, and demand-side management are maintained or enhanced and do not discriminate between public and private investment;</p>	<p>The Commission does not consider the new draft procurement plan would materially affect this outcome.</p>
<p>(g) the full costs of producing and transporting each additional unit of electricity are signalled;</p>	<p>The Commission does not consider the new draft procurement plan would materially affect this outcome.</p>

<p>(h) delivered electricity costs and prices are subject to sustained downward pressure; and</p>	<p>The Commission does not consider the new draft procurement plan would materially affect this outcome.</p>
<p>(i) the electricity sector contributes to achieving the Government’s climate change objectives by minimising hydro spill, efficiently managing transmission and distribution losses and constraints, promoting demand-side management and energy efficiency, and removing barriers to investment in new generation technologies, renewables, and distributed generation.</p>	<p>The Commission does not consider the new draft procurement plan would materially affect this outcome.</p>

Objectives and Outcomes under the GPS <sup>1</sup>	Response
<p>The Commission should promote and facilitate efficient and well-functioning markets and related arrangements for:</p> <ul style="list-style-type: none"> <li>• common quality and real-time security</li> <li>• dispatch and pool rules</li> <li>• reconciliation and settlement</li> <li>• information disclosure to improve market efficiency, including:                             <ul style="list-style-type: none"> <li>• aggregate hedge and contract prices and volumes</li> <li>• offers by generators</li> </ul> </li> <li>• minimum prudential standards</li> <li>• hedge market transparency and liquidity.</li> </ul>	<p>The Commission considers that the proposed draft procurement plan would promote well-functioning markets and related arrangements for common quality and real-time security by improving the ancillary service contracting arrangements.</p>

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<sup>1</sup> Paragraph 67 in the “Government Policy Statement on Electricity Governance – May 2009”.

## Appendix 3 2009 System Operator Draft Procurement Plan

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