

Electricity Commission

Consultation Paper

Draft Procurement Plan

June 2008

A Purpose

- 1 Rule 4.1 of section IV of part C of the Electricity Governance Rules 2003 (the Rules)¹ requires the system operator to, no later than 1 June each year, submit a draft procurement plan to the Electricity Commission (Commission). The draft procurement plan must relate to the 12-month period commencing on 1 December of that year.
- 2 On 30 May 2008, Transpower (the system operator) provided the Commission with a draft procurement plan for the period 1 December 2008 to 30 November 2009. The Commission published the procurement plan in accordance with rule 5.1 on 6 June 2008.
- 3 The procurement plan forms part of the Rules, because, after it is finalised, it is included as a schedule to part C of the Rules. Accordingly, the Commission must follow the process for rule amendments under the Electricity Act 1992 (Act). Rule 5 sets specific requirements regarding the steps required to comply with the provisions in the Act relating to rule changes.
- 4 The purpose of this paper is to meet the requirements set out in the Act and the Rules for consultation on the draft procurement plan.

Submissions

- 5 The Commission invites submissions on the draft procurement plan and this statement of proposal by **4.00pm on 18 July 2008** (the submission expiry date). Please note that because of the tight timetable required by the Rules, submissions received after this date may not be considered.
- 6 Where possible, submissions should be provided in the format shown in Appendix 3. When considering what information to include in your submission (such as potentially confidential information), please be aware that all submissions provided to the Commission will be published on its website and provided to the system operator as required by rule 5.3.1.
- 7 The Commission's preference is to receive submissions in electronic format (Microsoft Word). Submissions in electronic version should be emailed with 'System Operator 2008 Draft Procurement Plan' in the subject header to: submissions@electricitycommission.govt.nz.
- 8 If submitters do not wish to send their submission by email, they should post or fax one hard copy of their submission to the address below:

¹ All references to the Rules in this consultation paper, and its appendices, are to the rules in section IV of part C of the Rules.

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- 9 The Commission will acknowledge receipt of all submissions electronically. Please contact Maree McGregor if you do not receive electronic acknowledgement of your submission within two business days.

Confidential information

- 10 Before providing information or supporting documentation in your submission that may be confidential, please be aware that the Commission is required by rule 5.3.1 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.
- 11 All information provided to the Commission is subject to the Official Information Act 1982.

Abbreviations used in this paper

- 12 The abbreviations used in this paper are explained in the table below:

<u>Abbreviation</u>	<u>Description</u>
Act	Electricity Act 1992
ASA	Ancillary Service Agents
Board	Electricity Commission's Board
Commission	Electricity Commission
FIR	Fast Instantaneous Reserve
GPS	Government Policy Statement on Electricity Governance May 2008
GXP	Grid Exit Point
IL	Interruptible Load
Minister	Minister of Energy
Regulations	Electricity Governance Regulations 2003
Rules	Electricity Governance Rules 2003
SIR	Sustained Instantaneous Reserve

B Executive summary

- 13 The proposal to which this paper relates is that the Commission recommend to the Minister of Energy (Minister) that the Rules be amended by substituting the procurement plan in schedule C5 of part C of the Rules with the procurement plan in Appendix 4 of this paper, as amended by the Commission as set out in this paper.

Draft procurement plan 2008/09

- 14 Part C of the Rules relates to common quality and sets out the arrangements concerning ancillary services. A key component of such arrangements is the system operator's procurement plan.
- 15 Rule 4.1 requires the system operator to, no later than 1 June in each year, submit a draft procurement plan to the Electricity Commission (Commission). The draft procurement plan must relate to the 12-month period commencing on 1 December of that year.
- 16 On 30 May 2008, Transpower provided the Commission with a draft procurement plan for the period 1 December 2008 to 30 November 2009. The Commission published the procurement plan in accordance with rule 5.1 on 6 June 2008. On 13 June 2008, the system operator provided a revised draft of the plan, with an updated version of clause 88.2. Clause 88.2 is discussed later in this paper.
- 17 The draft procurement plan, including the updated version of clause 88.2, is attached as Appendix 4.
- 18 Rule 4.2 sets out specific requirements for the contents of the draft procurement plan. The requirements include the principles that the system operator will apply, and the process that it will follow, in assessing the quantity of each ancillary service required to be purchased. The procurement plan also sets out the proposed approach to procuring each service and the key terms the system operator intends to include in the contracts it negotiates with potential Ancillary Service Agents (ASA).
- 19 The system operator has informed the Commission that it had undertaken its requirement under rule 4.1 to invite comments from registered participants as well as carrying out significant additional targeted consultation. The comments period commenced on 9 May 2008 and closed on 23 May 2008. In total, the system operator received feedback from seven participants, comprising a mix of distributors, generators and direct consumers. The feedback ranged from relatively minor changes to substantial matters. Where considered appropriate, the system operator adopted comments from participants in its draft.
- 20 The Commission proposes to replace the existing procurement plan in schedule C5 of part C with the draft procurement plan attached as Appendix 4.
- 21 The key changes contained in the draft procurement plan are:

- a. Provision for subcontracting of ancillary services – allows for contracted ancillary service providers to sub-contract services. The contracted ASA will remain primarily responsible for the performance of those contracted obligations (clause 71A).
- b. Changed specification of frequency keeping performance:
 - i. the requirement for an ancillary service agent to use “reasonable endeavours” to commence to respond to the system operator’s instructions has been removed, and has been replaced with a requirement for the ancillary service agent to respond to eliminate the grid frequency error (clause 88.1); and
 - ii. the requirement relating to the response rate required from a frequency keeper has been relaxed to enable a wider variety of generating plant to be used to provide frequency keeping services (clauses 88.2 and 88A).
- c. Change to selection of frequency keeping offers – allows the system operator to select more than one offer to meet the frequency keeping band (MW) requirement (clause 115).
- d. Provision for fixed price frequency keeping - provides for fixed price frequency keeping offers to be considered as an alternative to the existing ‘half-hourly’ procured service (refer in particular to clauses 26A, 39A, 103A, 105A, 105B).
- e. Change to measurement of Interruptible Load (IL) – allows an ancillary service agent to offer smaller quantities of reserve by confirming performance with equipment on site where it would otherwise be lost in the ‘noise’ at the Grid Exit Point (GXP), and to use average MW data to confirm performance of IL offered as Sustained Instantaneous Reserve (SIR), but not Fast Instantaneous Reserve (FIR), (clauses 125.3 and 130.2).
- f. Strengthened specification of situations in which the system operator might adjust ASA’s maximum reserve offer quantities – allows the system operator to reduce maximum quantity of FIR offered by ASA if the ASA are unwilling or unable to provide one-second telemetry data in support of its performance in both new and existing long term contracts (clause 142.2).

Specific comments

- 22 The change to the specification of frequency keeping performance referred to in paragraph 21(b) includes a recent change to clause 88.2, requested by the system operator. The initial draft submitted on 30 May 2008 required a frequency keeper to:

“... provide continuously a response rate of at least 10 MW per minute when the grid frequency error is greater than 0.2 Hertz (that is, when the grid frequency is outside the normal band) in the direction necessary to eliminate the grid frequency error” [emphasis added].

- 23 The revised draft that appears in Appendix 4 requires frequency keepers to:
- “... provide an average response rate of at least 10 MW per minute when the grid frequency error is greater than 0.2 Hertz (that is, when the grid frequency is outside the normal band) over all of the ancillary service agent’s frequency keeping periods” [emphasis added].
- 24 The change relaxes the requirements enough to make one more station potentially available to provide frequency keeping services with a negligible reduction in quality.
- 25 The change specified in clause 142.2 states as follows:
- “142. If:
- ...
- 142.2 the ancillary service agent is unable or unwilling to provide measuring and recording resolutions at or below one second for interruptible load FIR response, the system operator may, by written notice to the ancillary service agent, decrease the maximum quantity of interruptible load FIR specified in the ancillary service procurement contract. The system operator’s right under this paragraph 142.2 applies to existing long term contracts as well as ancillary service procurement contracts entered into between the system operator and an ancillary service agent during the term of this procurement plan.” [emphasis added].
- 26 The system operator is required by rule 6 of section IV of part C of the Rules to use reasonable endeavours to implement the procurement plan for each ancillary service by entering into contracts with the ancillary service agents in the manner specified in the procurement plan.
- 27 Clause 142.2 contains a technical requirement that the system operator is required to use reasonable endeavours to include in its contracts with instantaneous reserve ancillary service providers.
- 28 The Commission does not consider that the system operator can, through the procurement plan, override the provisions of an existing long term contract.
- 29 Therefore, before recommending a rule change to the Minister, the Commission proposes to amend clause 142.2 to omit the second sentence (which commences “The system operator’s right in this paragraph 142.2...”).

Summary of changes

- 30 The system operator has provided a summary of the changes considered and proposed. This information appears on the Commission’s website² and includes a table which describes the changes proposed, each with a brief outline of:
- a. the purpose;

² <http://www.electricitycommission.govt.nz/opdev/comqual/procurement/index.html>

- b. any alternatives considered;
- c. the benefits; and
- d. the costs.

Statement of proposal

- 31 The procurement plan forms part of the Rules, by virtue of its inclusion as schedule C5 of part C of the Rules. Accordingly, the Commission must follow the process for rule amendments under the Act.
- 32 The Commission has prepared a statement of proposal in accordance with section 172F of the Act. The statement of proposal is set out in Appendix 1 to this paper.

Consideration against section 172X objectives

- 33 The Commission has considered, in accordance with section 172X of the Act, how the proposal will give effect to its principal objectives and specific outcomes (which are set out in section 172N of the Act) and to its Government Policy Statement on Electricity Governance May 2008 (GPS) objectives in the related clause of the “System operation and wholesale and related markets” chapter.
- 34 Appendix 2 contains a table listing each specific objective and outcome in the Act and the GPS and, where relevant, how the draft procurement plan may help achieve it.

Attachments

Appendix 1: Statement of proposal

Appendix 2: Consideration against objectives and outcomes

Appendix 3: Form of submission

Appendix 4: Draft procurement plan 2008/2009 submitted by the system operator

Appendix 1: Statement of proposal

Statement of proposal

- 1 In considering a proposal to amend the procurement plan contained in schedule C5 of part C of the Rules, the Commission must follow the process for rule amendments under the Act.³ Rule 5 sets specific requirements for complying with the provisions in the Act relating to rule changes.
- 2 This paper is a statement of proposal under section 172F of the Act for the purposes of consultation under section 172E(2)(b).
- 3 This paper contains:
 - a. a statement of the proposal;
 - b. a statement of the reasons for the proposal;
 - c. an assessment of the reasonably practicable options, including the proposal; and
 - d. other information that the Commission considers relevant.

The proposal

- 4 The Commission proposes to recommend to the Minister that the Rules be amended by substituting the procurement plan in schedule C5 of part C of the Rules with the draft procurement plan provided by the system operator in Appendix 4, with the amendment to clause 142.2, as discussed further below.
- 5 Appendix 4 contains a copy of the system operator's plan to procure ancillary services for the procurement plan period (1 December 2008 to 30 November 2009).
- 6 The key changes contained in the draft procurement plan include:
 - a. Provision for subcontracting of ancillary services – allows for contracted ancillary service providers to sub-contract services. The contracted ASA will remain primarily responsible for the performance of those contracted obligations (clause 71A).
 - b. Changed specification of frequency keeping performance:
 - i. the requirement for an ancillary service agent to use “reasonable endeavours” to commence to respond to the system operator's instructions has been removed, and has been replaced with a

³ Section 172H(3) of the Act provides that if the Minister makes, or the Commission recommends, a rule for a purpose for which an electricity governance regulation may be made, the Minister and the Commission must comply with the same conditions and process that would apply under section 172D(3), section 172E, or section 172F as if they were making recommendations on that electricity governance regulation, and those sections apply (with all necessary modifications) accordingly.

requirement for the ancillary service agent to respond to eliminate the grid frequency error (clause 88.1); and

- ii. the requirement relating to the response rate required from a frequency keeper has been relaxed to enable a wider variety of generating plant to be used to provide frequency keeping services (clauses 88.2 and 88A).
 - c. Change to selection of frequency keeping offers – allows the system operator to select more than one offer to meet the frequency keeping band (MW) requirement (clause 115).
 - d. Provision for fixed price frequency keeping – provides for fixed price frequency keeping offers to be considered as an alternative to the existing ‘half-hourly’ procured service (refer in particular to clauses 26A, 39A, 103A, 105A, 105B).
 - e. Change to measurement of IL – allows an ancillary service agent to offer smaller quantities of reserve by confirming performance with equipment on site where it would otherwise be lost in the ‘noise’ at the GXP, and to use average MW data to confirm performance of IL offered as SIR (but not FIR) (clauses 125.3 and 130.2).
 - f. Strengthened specification of situations in which the system operator might adjust ASA’s maximum reserve offer quantities – allows the system operator to reduce maximum quantity of Fast Instantaneous Reserve (FIR) offered by ASA if the ASA are unwilling or unable to provide one-second telemetry data in support of its performance in both new and existing long term contracts (clause 142.2).
- 7 The change to the specification of frequency keeping performance referred to in paragraph 6(b) includes a recent change to clause 88.2, requested by the system operator. The initial draft submitted on 30 May 2008 required a frequency keeper to:
- “... provide continuously a response rate of at least 10 MW per minute when the grid frequency error is greater than 0.2 Hertz (that is, when the grid frequency is outside the normal band) in the direction necessary to eliminate the grid frequency error” [emphasis added].
- 8 The revised draft that appears in Appendix 4 requires frequency keepers to:
- “... provide an average response rate of at least 10 MW per minute when the grid frequency error is greater than 0.2 Hertz (that is, when the grid frequency is outside the normal band) over all of the ancillary service agent’s frequency keeping periods” [emphasis added].
- 9 The change relaxes the requirements enough to make one more station potentially available to provide frequency keeping services with a negligible reduction in quality.
- 10 The change specified in clause 142.2 states as follows:

“142. If:

...

142.2 the ancillary service agent is unable or unwilling to provide measuring and recording resolutions at or below one second for interruptible load FIR response, the system operator may, by written notice to the ancillary service agent, decrease the maximum quantity of interruptible load FIR specified in the ancillary service procurement contract. The system operator's right under this paragraph 142.2 applies to existing long term contracts as well as ancillary service procurement contracts entered into between the system operator and an ancillary service agent during the term of this procurement plan. [emphasis added].

- 11 The system operator is required by rule 6 of section IV of part C of the Rules to use reasonable endeavours to implement the procurement plan for each ancillary service by entering into contracts with the ancillary service agents in the manner specified in the procurement plan.
- 12 Clause 142.2 contains a technical requirement that the system operator is required to use reasonable endeavours to include in its contracts with instantaneous reserve ancillary service providers.
- 13 The Commission does not consider that the system operator can, through the procurement plan, override the provisions of an existing long term contract.
- 14 Therefore, before recommending a rule change to the Minister, the Commission proposes to amend clause 142.2 to omit the second sentence (which commences “The system operator's right in this paragraph 142.2...”).

Summary of changes

- 15 The key changes have been summarised here for ease of reference. However, submitters should carefully read the draft procurement plan contained in Appendix 4 for full details of the proposed amendments and their context.

Statement of the reasons for the proposal

- 16 The procurement plan is required to be reviewed annually. This ensures that procurement arrangements for the coming year are tailored to the expected circumstances, and enables ongoing enhancements to be incorporated.
- 17 Rule 4.1 requires the system operator to, no later than 1 June in each year, submit a draft procurement plan to the Commission. The draft procurement plan must relate to the 12-month period commencing on 1 December of that year.
- 18 On 30 May 2008, Transpower provided the Commission with a draft procurement plan for the period 1 December 2008 to 30 November 2009. The Commission published the procurement plan in accordance with rule 5.1 on 6 June 2008. On 13 June 2008, the system operator provided a revised draft of the plan, with an updated version of clause 88.2.

- 19 The Commission has decided to propose a draft plan containing the change to clause 88.2. The updated procurement plan is attached as Appendix 4.
- 20 Rule 5.4 of section IV of part C requires the Commission's Board (Board) to consider submissions received on the draft procurement plan and to make recommendations to the Minister in accordance with the Act.

Identification and assessment of reasonably practicable options

- 21 The main components of the proposed package and reasonably practicable alternatives are identified and assessed below. The Commission has considered whether it is possible to quantify the costs and benefits of the recommended rule changes and the reasonably practicable options and determined that it is not feasible to do so accurately. Therefore, the Commission has considered the costs and benefits of the recommended rule changes and the reasonably practicable alternatives in qualitative terms.
- 22 Submitters are invited to provide additional information, both qualitative and quantitative, on the costs and benefits associated with each proposed key change.

Reasonably practicable options

- 23 The Commission recognises that there are a number of potential drafting options for each provision of the procurement plan. While the Rules require the system operator to prepare a draft procurement plan, the Commission is open to submissions on the provisions of the procurement plan and how the drafting might be improved in order to give effect to the objectives of the plan.
- 24 However, for the purposes of assessing reasonably practicable options under section 172F of the Act, it is only practicable for the Commission to assess the system operator's draft procurement plan (with the amendment to clause 142.2 as proposed by the Commission) against one other option, which is retention of the existing procurement plan.
- 25 The Commission considers that it is not feasible or desirable to pursue other options unless the outcome of submissions from affected parties clearly favours a departure from the draft procurement plan.
- 26 Accordingly, the proposal is to replace the existing procurement plan with the draft procurement plan.
- 27 The submissions received will inform the Commission's views on each of the proposed amendments and the ultimate form of the procurement plan that it recommends to the Minister.

Assessment

Benefits/costs of the draft procurement plan

- 28 The Commission's preliminary view is that there are a number of benefits in replacing the existing procurement plan with the one proposed.
- 29 In particular, the Commission considers that:
- a. the relaxation of the performance required of frequency keepers and the provision for ASA to sub-contract the frequency keeping service potentially facilitates greater competition in the provision of this service, which could facilitate downward pressure on the cost of the service;
 - b. providing for fixed price tenders of frequency keeping services might facilitate greater participation in the provision of this service, which could potentially reduce frequency keeping costs (if fixed prices are lower than half hour prices) and also provides greater certainty of the costs for those who bear them;
 - c. by allowing the system operator to reduce ASA's maximum reserve offer quantities if the ASA choose not to provide one-second measurements to confirm the ASA's performance will enhance system security; and
 - d. providing for confirmation of SIR performance using average MW data and preferring measurements taken on ASA's sites reduces a barrier to entry (e.g. allows demand aggregators to offer reserve), which potentially increases competition and reduces reserve costs.
- 30 The Commission recognises that, in the delivery of some of these benefits, ASA might also incur some costs. For example:
- a. Providing for subcontracting of frequency keeping services (referred to in paragraph 29(a)) might increase compliance costs for both ASA and the system operator.
 - b. the benefit described above in paragraph 29(c) may increase the compliance costs faced by ASA, which may reduce the quantity of reserve offered and increase reserve costs; and
- 31 The Commission welcomes submissions that address material changes in costs that would result from the changes proposed in the draft procurement plan.
- 32 Similarly, the Commission welcomes submissions on:
- a. additional benefits or costs that may accrue from the proposed changes; and/or
 - b. reasonably practicable alternatives and the rationale for them.

Benefits/cost of the status quo

- 33 For the purposes of this consultation, the Commission's view is that the status quo does not offer the identified benefits in replacing the existing procurement plan with the one proposed, or any benefits additional to the procurement plan proposed.
- 34 However, the Commission recognises that service providers might incur lower costs under the existing procurement plan and thus welcomes submissions that outline any savings in costs that would follow from the existing procurement plan being retained.

Summary of costs and benefits

- 35 Although there may be some costs to service providers associated with the proposal, the Commission's view is that the draft procurement plan is likely to provide material benefits that outweigh those costs.
- 36 The Commission welcomes participants' feedback on its view of the benefits and invites comments and alternative views. The Commission requests that submitters support their views with any costs and benefits they consider relevant to the Commission's assessment.

Extent the objective is promoted or achieved

- 37 The draft procurement plan, which is proposed to replace schedule C5 of part C of the Rules, is likely to better meet the objective of the rule change proposal than the status quo. The Commission makes this statement based on its assessment that there are material net benefits associated with the key changes provided in the draft procurement plan.

Summary of the assessment

- 38 The assessment of the benefits and costs and the extent to which the objective would be promoted and achieved, supports the proposal over the status quo.

Other means to achieve the objective

- 39 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).
- 40 There is no alternative to making of a rule, because rules 4 and 5 clearly require:
- a. a draft procurement plan to be prepared annually by the system operator and submitted to the Commission;
 - b. the draft procurement plan to be published by the Commission for submissions and that the Commission consider those submissions; and

- c. the Commission to make recommendations to the Minister for the procurement plan to be included in the Rules (which also requires the removal of the existing procurement plan).

41 Accordingly, this process in rules 4 and 5 requires an amendment to the Rules.

Appendix 2: Consideration against objectives and outcomes

The Commission's principal objectives under the Act are as follows:

Section 172N	Response
<ul style="list-style-type: none"> To ensure that electricity is produced and delivered to all classes of consumers in an efficient, fair, reliable, and environmentally sustainable manner; and To promote and facilitate the efficient use of electricity. 	<p>The Commission considers that the proposed draft procurement plan would enhance efficiency, reliability and fairness by providing a more detailed specification of the technical delivery and pricing process for several ancillary services.</p>

The Commission's specific outcomes under the Act are as follows:

Section 172N	Response
a. energy and other resources are used efficiently;	<p>The Commission considers that the proposed draft procurement plan would enhance efficiency by providing a more outcome-based specification of the technical requirements for several ancillary services.</p> <p>In particular, the proposed changes to the technical requirements for frequency keeping is likely to mean that the frequency keepers available to the system operator will have generating plant fuelled by different fuel sources, which may mean that when a particular fuel is scarce (e.g., water), generation from that fuel source is able to be used for its highest value use (i.e., used efficiently).</p>
b. risks (including price risks) relating to security of supply are properly and efficiently managed;	<p>The Commission does not consider the new draft procurement plan would materially affect this outcome.</p>
c. barriers to competition in the electricity industry are minimised for the long-term benefit of end-users;	<p>The Commission considers that the proposed new draft procurement plan would positively affect this outcome by allowing fixed price tenders and subcontracting of the frequency keeping service, as well as facilitating the entry of new frequency keepers as a result of the relaxation in the technical requirements for the service.</p>
d. 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>The Commission considers that reducing performance requirements for IL providers will encourage more demand aggregators to enter the instantaneous reserve market.</p>

e. the full costs of producing and transporting each additional unit of electricity are signalled;	The Commission does not consider the new draft procurement plan would materially affect this outcome.
f. delivered electricity costs and prices are subject to sustained downward pressure; and	The Commission does not consider the new draft procurement plan would materially affect this outcome.
g. 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.	The Commission does not consider the new draft procurement plan would materially affect this outcome.

The Commission's objectives under the GPS are as follows:

<p>79. The Commission should promote and facilitate efficient and well-functioning markets and related arrangements for:</p> <ul style="list-style-type: none"> • common quality and real-time security • dispatch and pool rules • reconciliation and settlement • information disclosure to improve market efficiency, including: <ul style="list-style-type: none"> ○ aggregate hedge and contract prices and volumes ○ offers by generators • minimum prudential standards • hedge market transparency and liquidity. 	The Commission considers that the proposed draft procurement plan would promote efficient and well-functioning markets and related arrangements for common quality and minimum prudential standards.
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Appendix 3: Form of submission

Draft procurement plan clause	Submitters comment	Suggested amendment

Appendix 4: Draft procurement plan 2008/2009 submitted by the system operator