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Dear Mervyn

Dispatchable Demand Regime

Business New Zealand is pleased to have the opportunity to provide a submission to the Electricity Commission on its document entitled 'Dispatchable Demand Regime' dated 19 May 2010.¹

Introduction

Business New Zealand continues to support the Electricity Commission's work on a dispatchable demand regime.

More active participation by the demand-side in the wholesale electricity market has the potential to result in more efficient wholesale electricity market outcomes. While New Zealand has had a history of relatively low electricity prices, it is now widely acknowledged the low cost options have been fully utilised, leaving higher cost options to come on. The inclusion of dispatchable demand provides the ability for the demand-side to effectively compete with the supply-side, and in doing so, help constrain prices and provide greater system security. This in turn can be expected to have downstream benefits to all consumers.

Subject to the specific comments below, BusinessNZ is broadly comfortable with the design features outlined by the Electricity Commission. BusinessNZ's responses to the specific consultation questions are set out in Appendix Two.

¹ Background information on Business New Zealand is attached in Appendix One.

Specific Comments

BusinessNZ wishes to comment on three specific matters, these being the:

1. priority afforded this workstream, and its interrelationship with other Electricity Commission workstreams;
2. expected level of participation in the dispatchable demand regime; and
3. need for continual monitoring around the regime's success.

Each of these issues is addressed briefly below.

Priority of the Workstream

The substantive progress outlined in the Electricity Commission's consultation paper is welcome, but long overdue. BusinessNZ considers that this workstream should be afforded top priority by the Electricity Commission. It:

1. addresses a clear information market failure (from which the other 'failures' stem) whose rectification would appear to deliver a long-term benefit to end consumers;
2. appears (subject to specific comments on the design) to have widespread support from across the industry and stakeholders;
3. is a priority of the new Electricity Authority; and
4. relatively easy/quick to implement, insofar as it is less dependant on progress being made on other workstreams.

In light of these factors, BusinessNZ urges the Electricity Commission to move with haste to implement the dispatchable demand regime once the specific design parameters have been settled.

Expected Level of Participation

BusinessNZ is disappointed at the Electricity Commission's extremely low level of ambition for participation in the dispatchable demand regime. The Electricity Commission says that:

"The Commission expects that the Proposed Design would tend to be attractive to perhaps *two or three* large electricity users."² (emphasis added)

² Electricity Commission consultation paper entitled 'Consultation Paper, Dispatchable Demand Regime', dated 19 May 2010, page 23, paragraph 3.6.1

In its last submission, BusinessNZ noted that:

“Broad demand-side participation is important. To be meaningful, it is important that the scheme does not solely apply to the largest electricity users. While clearly they will be the most obvious participants, Business New Zealand considers that the ability for a wider constituency group to be involved in the market will yield tangible benefits, not least of which will be a deepening understanding of the operation of the wholesale market and (hopefully) greater confidence in its operation”³

BusinessNZ stands by this view. BusinessNZ would be extremely disappointed, having waited for so long for this initiative to come to fruition, for it to be only relevant to two or three large users. BusinessNZ would suggest that such a low level of participation may well also be outside the expectations of policy makers.

BusinessNZ appreciates the fact that there will be minimum requirements around compliance, metering etc. In any market, there are costs which must be borne by all participants – BusinessNZ is not expecting preferential treatment with respect to smaller electricity users. However, what BusinessNZ *is* expecting is the Electricity Commission to take all available opportunities to ensure that these costs are minimised. Once minimised, the design of the dispatchable demand regime should be flexible enough to accommodate the participation of a broad range of users, not just the largest. Within the framework of an open and contestable market, whether a particular user subsequently wishes to participate either directly, or via a third-party, is a cost-benefit decision that the user must take, and one over which the Electricity Commission cannot determine in advance, nor has any control.

BusinessNZ therefore seeks the Electricity Commission’s assurance that it has addressed, to the best of its ability, all of the factors that it outlines in paragraphs 3.6.1 to 3.6.5 that have the ability to limit the participation of smaller electricity users.

BusinessNZ also has some concerns relating to the proposed definition of a “*dispatchable load station*” (paragraph 3.2.1). As BusinessNZ understands the explanation set out in this paragraph, as written means a dispatchable load station is a single purchaser at a single GXP. This will prevent an aggregator from dispatching load.

This definition is likely to mean that even seemingly large consumers of electricity, like Fonterra, would be unable to participate in the dispatchable demand regime as they are a multi-site operation with relatively small opportunities by site that would require aggregation.

It is unclear to BusinessNZ what practical market operation issues would arise if this constraint (of it being a single purchaser) were relaxed, and whether the

³ BusinessNZ submission to the Electricity Commission entitled ‘Dispatchable Demand: Options’, dated 17 November 2009, page 3

risks of so doing where out-weighed by the ensuing security of supply and price benefits. Ideally, a dispatchable load station needs to be defined in such a way as to accommodate a role for third-parties who see an opportunity to act on behalf of smaller users, while acting in compliance with the requirements of the new rules.

The Need for Continual Monitoring

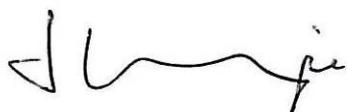
Even though the proposal may produce a net-public benefit, it is important that this not be where the matter lies. A combination of the extremely long gestation of this initiative, and the low level of ambition held by the Electricity Commission in terms of participation suggests to BusinessNZ the need for some form of ex-post implementation review to be scheduled. On-going monitoring should be used to reveal whether any further improvements to the dispatch of load are feasible. This vigilance is particularly warranted in light of the expected future electricity price path.

Summary

The inability for the demand-side to more fully participate in the wholesale electricity market has been a glaring hole in its overall design and operation of New Zealand's electricity market. The demand-side must be able to compete with the supply-side on a fair and transparent basis.

BusinessNZ considers that the consultation paper has adopted a thoughtful and methodical approach to working through the specific design issues thrown up by the dispatchable demand proposal. While some practical design details remain to be resolved, particularly around greater participation, BusinessNZ supports continued refinement of the rules in order to allow demand to be dispatched, and looks forward to working with the Electricity Commission in whatever way it can to help deliver this positive outcome.

Yours sincerely



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Business New Zealand

APPENDIX ONE: ABOUT BUSINESS NEW ZEALAND

Encompassing four regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' & Manufacturers' Association (Central), Canterbury Employers' Chamber of Commerce, and the Otago-Southland Employers' Association), Business New Zealand is New Zealand's largest business advocacy body. Together with its 52 strong Major Companies Group, and the 70-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, Business New Zealand is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

In addition to advocacy on behalf of enterprise, Business New Zealand contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.

Business New Zealand's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services). It is widely acknowledged that consistent, sustainable growth well in excess of 4% per capita per year would be required to achieve this goal in the medium term.

APPENDIX TWO: CONSULTATION QUESTIONS AND RESPONSES

<u>Review Recommendation</u>	<u>Business New Zealand Position</u>
1. Would the Proposed Design be workable?	Yes. There would appear to be no prima facie reason to consider that it would be unworkable. However, the real tests of workability relate to ensuring such issues as the interface with mandated demand reduction measures are adequately addressed, and ultimately whether it is capable of delivering a net public benefit, the key to the latter point being, in BusinessNZ's view, the extent to which it facilitates active demand-side participation and contributes, in a tangible way, to reducing security of supply risk.
2. What approach should be used to allow dispatchable electricity users to manage the risk of yo-yo dispatch during a trading period? (refer to the section beginning at paragraph 3.4.15).	Owners of dispatchable demand should be able to specify ramp rates (as outlined in paragraph 3.4.16). Providing this design flexibility would appear to cover off most of the risks associated with yo-yo dispatch.
3. What metering and communications obligations should a dispatchable load station have ? (refer to paragraphs 3.3.4 to 3.3.9).	The minimum necessary while being consistent with the obligations of other market participants.
4. Should a dispatchable load station be required to be "ring fenced" from non-dispatchable load? Why? How should this be managed? (refer to the section beginning at paragraph 3.3.10).	<p>BusinessNZ recognises that it would be undesirable for a situation to result where the value of the load reduction at a specific site is offset by an equivalent increase in load from another machine. In this case, there would not appear to be a 'mirror' generation case from which to draw insight - one is about optimising, the other is about avoiding an instruction. In this regard, the proposal set out in paragraph 3.3.11 would appear to be pragmatic.</p> <p>Having said that, BusinessNZ considers that the scenario the Electricity Commission raises is not very likely. Unless accidental, BusinessNZ could not think why a load party who has opted into price certainty via the dispatchable demand regime, would then give away that price certainty by trying to "game" the regime? This is particularly so if gate closure is reduced in future. An appropriately configured compliance regime should also minimise the risk of such an outcome deliberately occurring.</p> <p>BusinessNZ also raises the prospect that such ring-fencing has the potential to implicitly drive the design back towards that of the discarded Option 2 (dispatch load differences) as the ring fencing of machines requires a baseline to be set (at least indirectly). BusinessNZ cautions the Electricity Commission to be alive to this risk given the key reason for discarding Option 2 in the first place – its implementation costs – and the risk that any move back towards an Option 2-type approach would quickly erode any net public benefit.</p>

<u>Review Recommendation</u>	<u>Business New Zealand Position</u>
5. How accurate would dispatch compliance need to be, both for system security purposes (including matters like keeping asset loadings within limits) and for maintaining the integrity of market prices calculated using bids?	Some tolerance, as with generation, would appear to be sensible.
6. Do you agree that large binary machines should not be eligible for dispatch? (refer to the section beginning at paragraph 3.4.11). Why or why not?	All machines should be eligible subject to appropriate operation considerations. However, in the first instance, the 'owner' of the dispatchable load should be provided with the ability to find innovative market-based solutions (such as back-to-back contracts) to this problem in a way that meets the operational requirements of the System Operator.
7. What other adjustments to the Proposed Design might be helpful?	Make sure that the participation of third party aggregators is facilitated in order to encourage greater participation. See the attached letter for further comments on this issue.
8. In your best judgement, would the Proposed Design be likely to produce net benefits over reasonably practicable alternatives (including the status quo)? What priority should be attached to this work?	<p>Given the fairly clear evidence of a market failure, the benefits available from:</p> <ol style="list-style-type: none"> 1. managing potential energy capacity constraints that the Electricity Commission has indicated may arise as early as 2012; and 2. assisting the Electricity Commission in meeting the Government's objectives to maintain downward pressure on prices <p>when combined with the proposed nature of the design (which suggest that the costs associated with the intervention are modest), suggest to BusinessNZ that the proposal is likely to deliver a net public benefit over the status quo. However, obviously, this can only be determined once the analysis has been completed.</p> <p>See the attached letter for comments on the level of priority this workstream should be afforded.</p>
9. Is the net benefit analysis framework described in section 3.7 appropriate?	Yes, except to the extent that it is likely to understate the benefits (e.g. it doesn't appear to factor in security of supply benefits) and overstate the costs (e.g. it appears to factor in the private costs associated with participating in the regime). As this is an exercise in determining whether there is a net-public benefit, (as opposed to private benefit), only total market costs and benefits should be incorporated into the analysis.

<u>Review Recommendation</u>	<u>Business New Zealand Position</u>
10. If you are an electricity user, would you be likely to participate in the Proposed Design? What quantity (in MW) might you typically make available for price-responsive dispatch?	N/A
