Guidance on distributor involvement in the flexibility services market

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A changing electricity sector will see new technologies becoming increasingly available and affordable, to industry participants and consumers.

The Electricity Authority Te Mana Hiko (Authority) is committed to delivering better outcomes for consumers by facilitating access to a mix of renewable generation, storage and other technologies. This will give consumers greater control of their energy usage, foster innovation, reduce costs, and contribute to the electrification of the New Zealand economy.

Objective of this guidance

The Authority has developed guidance on distributor involvement in the flexibility services market (Guidance). This Guidance provides clarity about what we expect when distributors operate in the flexibility services market.

By developing this Guidance now, the Authority seeks to provide greater certainty to the sector at a time when the flexibility services market is still evolving. In turn, this will create better conditions for efficient and timely investment in networks, support increased flexibility by making these new technologies more viable for consumers and the sector, and encourage innovation. This should benefit consumers by providing them with more choice, and relatively lower prices, particularly for distribution services, over time.

The Authority's expectations

The Guidance has seven principles, each with examples of how we expect them to be implemented.[1] The principles cover three broad areas:

- ensuring even-handed treatment of third-party suppliers of flexibility services (Principles 1 and 2)
- protecting against the risk of distributors, intentionally or unintentionally, deterring entry or expansion by third parties in the flexibility services market (Principles 3-6)
- efficient use of flexibility by distributors (Principle 7).

The Authority expects distributors to act in alignment with the principles in this Guidance, which are consistent with supporting the development of the flexibility services market in a way that facilitates competition. This is expected to lead to a greater and more competitive range of flexibility solutions becoming available to distributors and purchasers of flexibility services.

In addition, we expect distributors will:

- put in place internal policies and processes that support implementing the Guidance; and
- ensure incentives and remuneration for staff are not inconsistent with the Guidance.

For the avoidance of doubt, this Guidance does not supersede any obligations distributors may have under other legislation, including but not limited to Parts 2 and 4 of the Commerce Act 1986.

Effective date

This guidance is effective from **[**TBC after sector workshop**]**.

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1 Examples are used in this Guidance to illustrate how the principles are intended to be used in particular scenarios. They are not comprehensive and do not limit, in any way, the principles or the Authority's expectations outlined in the Guidance.

Glossary

In this Guidance:

even-handed means treat impartially; any material difference in treatment should be objectively justifiable and not harm, and be unlikely to harm, competition.

flexibility means the ability to change generation injection and/or consumption patterns, on an individual or aggregated level, often in response to an external signal, to provide a service within the energy system.

regulated electricity distribution services means the electricity distribution service regulated under section 54E of the Commerce Act 1986

related party, in relation to a distributor, means an entity that is related to the distributor by a common shareholding or other common control (consistent with Accounting Standard NZ IAS 24)

self-supply, in relation to a distributor, means supply from within the same legal entity as the distribution business (also referred to as supply by a distributor business unit)

third party, in relation to a distributor, means an entity that is independent of the distribution business.

Principle 1

Distributors should treat all suppliers even-handedly when procuring flexibility services as inputs to regulated electricity distribution services

The Authority's expectation

Where flexibility services provide more than a de minimis input into any aspect of regulated electricity distribution services, distributors should take an even-handed approach to procuring those flexibility services. This includes, but is not limited to:

- robustly defining any potential network flexibility need
- timely, open and even-handed disclosure of the flexibility services opportunity, including the monetary value, to all flexibility traders
- following an objective procurement process, preferably an open tender, wherever practicable, regardless of whether for an individual flexibility solution, or to become part of a panel of preferred flexibility providers for a period of time
- disclosure of the distributor's rationale when procuring a flexibility service from a related party or through self-supply, including any higher reliability value ascribed to that procurement.

The Authority further expects all material terms of commercial arrangements between distributors and related parties for the supply of flexibility services will be recorded in writing.

For the avoidance of doubt, it is not contrary to the Authority's expectations for distributors to price their regulated electricity distribution services in a way that sends efficient pricing signals that encourage consumers to shift demand to off-peak periods. Those signals incentivise demand response (flexibility), so they are likely to be pro-competitive, ie, they create more opportunities to provide flexibility services.

Rationale

This principle seeks to ensure the development of a competitive flexibility services market is not held back by reducing potential revenue streams from distribution network support available to third-party flexibility traders.

Example

When considering flexibility-based solutions to an emerging network constraint as an alternative to investing in more poles and wires, distributors should not begin that process by communicating first with a related party that operates in the flexibility services market in a way that gives that party a competitive advantage.[2]

[2] See also Principle 6.

Principle 2

Distributors should be even-handed with all flexibility traders connecting to their distribution network

The Authority's expectation

Distributors should ensure the terms, processes and timeframes for putting new or expanded network connections in place are consistent for all applicants. This means:

- Distributor business units and related parties operating in the flexibility services market should not be able to secure preferential treatment for their business or their customers because they are within the distributor's group
- An end-customer should not get less preferable terms because they contract through a third party, rather than direct with the distributor.

The Authority's expectations apply across all aspects of the connection process, including (without limitation):

- contract terms, including price and reliability
- provision of information
- technical review
- operating requirements
- credit requirements
- timeframes, including queuing, prioritising and responding to requests, and change processes
- the valuation of any flexibility offered by the connecting party.

Rationale

This principle seeks to ensure the development of a competitive flexibility services market is not held back by raising the costs, or impeding the operation and business development, of third-party flexibility traders.

Example

Third-party flexibility traders seeking a distribution network connection should not be subject to more rigorous health and safety requirements and testing than a related party of the distributor.

Principle 3

Flexibility services and regulated electricity distribution services should not be jointly promoted, or bundled together in a way that advantages the distributor

The Authority's expectation

Distributor business units and related parties operating in the flexibility services market should not get an advantage over third parties by linking their flexibility service to regulated electricity distribution services.

Under this principle, the Authority expects a distributor's regulated electricity distribution service, and any flexibility service provided by one of their business units or a related party, should without limitation:

- be differently branded, so that the branding doesn't imply the two services are related
- not be advertised or promoted together, including cross-promotion
- not be sold in a way that provides an advantage to the customer (such as price or network access) for purchasing the two services together, unless that same bundle can be replicated by a third-party flexibility trader.

This principle, together with Principles 1, 5 and 6, creates an expectation that distributors should limit or prevent, if practical, having staff work across flexibility services and regulated electricity distribution services. This is to avoid distributors having a competitive advantage in the flexibility services market. It is preferable that staff involved in the provision, sales or marketing of regulated electricity distribution services are not involved in the provision, sales, or marketing of flexibility services, and vice versa.[3]

Rationale

This principle seeks to ensure the development of a competitive flexibility services market is not held back by a distributor business unit or related party that provides flexibility services being given an unfair advantage[4] through promotional or contractual links to the regulated electricity distribution service.

Example

A distributor should not allow its related solar and energy storage solutions business[5] to sell flexibility services to the distributor's customers as part of a package that includes regulated

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[3] It is not, however, contrary to this expectation for both distribution and flexibility functions within a distributor's group to have access to shared back office corporate services where they do not directly input into the provision, sales or marketing of either regulated electricity distribution services or flexibility services. This includes general administration, accounting, payroll, human resources, or information technology support services.

[4] Such an advantage may lead to a reduction in the potential revenue streams and business opportunities available to third-party flexibility traders.

[5] This principle would also capture a distributor business unit that is seeking to aggregate demand response to both on-sell externally and provide as an input to regulated electricity distribution services.

electricity distribution services, unless the distribution services component of that package is also available to third-party flexibility traders on substantially the same terms, including price.

Interaction with regulation under Part 4 of the Commerce Act 1986

Principles 3 and 4 are aligned to the Commerce Commission's cost allocation and related party transactions input methodologies for electricity distributors. This effectively prevents any financial cross-subsidy from regulated electricity distribution services to contestable flexibility services.

Principle 4

Distributors should generally not provide non-commercial (below cost) flexibility services

The Authority's expectation

The Authority appreciates that many distributors are wholly or partially community-owned businesses with a strong drive to contribute to those communities. Any such contribution should not, however, be at the cost of developing a competitive flexibility services market.

Distributors should not generally supply flexibility services to end-customers at below their incremental cost, unless they have reasonable grounds to consider these services would otherwise not be supplied, and that supplying these services is not inconsistent with the development of a competitive flexibility services market.

For the avoidance of doubt, the Authority's expectations regarding distributors providing free or non-commercial services to end-customers extend to public electric vehicle charging.

The Authority does not, however, expect distributors to apply this principle where they are supplying below incremental cost flexibility services to:

- charities or other not-for-profit organisations, provided that supply is not inconsistent with the development of a competitive flexibility services market
- in an emergency where that supply is necessary to maintain electricity distribution to end-customers.

If a distributor is meeting its obligations under the Commerce Act 1986, it is more likely to also be aligned with this principle, ie, not financially cross-subsidising flexibility services.

Rationale

This principle seeks to ensure the development of a competitive flexibility services market is not held back by reducing the potential revenue streams available to third-party flexibility traders.

Example

Distributors should not provide a package of solar panels and battery storage directly to residential consumers within their region at below the cost of those products, even if the distributor is community owned.

Interaction with regulation under Part 4 of the Commerce Act 1986

Consistent with this principle, the Part 4 Commerce Act regime set by the Commerce Commission prevents distributors from cross-subsidising any business operating in an adjacent competitive market by over-allocating common costs to their distribution business or over-valuing related party transactions, ie, through the cost allocation and related party transactions input methodologies respectively.

Principle 5

Distributors should protect confidential information supplied by third-party flexibility traders

The Authority's expectation

Distributors will hold commercially sensitive information supplied by third-party flexibility traders, eg, as part of the network connection process, or in relation to opportunities to supply flexibility services as inputs to regulated electricity distribution services (Trader Information).

Distributors should keep this Trader Information confidential. Particularly, Trader Information should not be able to be accessed or used by distributor business units or related parties that are competing with those third-party flexibility traders in the flexibility services market.

Consistent with this principle, distributors should put in place protocols relating to:

- handling and storage of hard and soft copies of this Trader Information
- any discussions that refer to this Trader Information.

Distributors should ensure all relevant staff are aware of these protocols, and any consequences for breaching them. This is particularly important where staff involved in the provision, sales or marketing of regulated electricity distribution services and staff involved in the provision, sales or marketing of flexibility services are co-located.

If distributors have any doubts about the sensitivity of information provided to them by third-party flexibility traders, they should seek clarity from those traders as soon as possible.

Rationale

This principle seeks to ensure the development of a competitive flexibility services market is not held back by allowing a distributor business unit or related party that provides flexibility services to be unfairly advantaged by knowledge of a competitor's activities, and the opportunities this may provide to access their revenue streams.

Example

Where a third-party flexibility trader discusses with a distributor its proposal for a local solar and battery storage solution, or installing a new hot water control system in a local area, the distributor should ensure any soft copies of information related to the proposal are securely stored so the Trader Information cannot be accessed by any part of the distributor's group that competes with that trader.

Principle 6

Distributors should share non-public network information even-handedly

The Authority's expectation

Distributors should provide a level playing field when sharing non-public information about regulated electricity distribution services that is relevant to flexibility traders ("Network Information"). In practice this means distributors should seek to ensure all parties with an interest in flexibility services have access to the same Network Information at the same time.[6]

Distributors should only provide Network Information to distributor business units or related parties operating in the flexibility services market if:

- third-party flexibility traders are able to access the same Network Information; and
- third-party flexibility traders could be reasonably expected to know that the Network Information has been disclosed by the distributor.[7]

Similar to Principle 5, this principle may require distributors to put in place protocols relating to handling and storing hard and soft copies of Network Information, and any discussions that refer to Network Information.

Rationale

This principle seeks to ensure the development of a competitive flexibility services market is not held back by a distributor business unit or related party that provides flexibility services being given an unfair advantage through having earlier or more knowledge of potential flexibility services opportunities on the distributor's network.

Example

Distributors should not provide distributor business units or related parties operating in the flexibility services market with access to information about actual or potential distribution network constraints in the ordinary course of business if they only provide the same Network Information to third-party flexibility traders through their annual asset management plan disclosures.

6 It would be preferable for distributors to put a standard process in place for all disclosures of Network Information to parties operating in the flexibility services market.

7 It would be inconsistent with this principle, for example, to only publish the Network Information on an obscure part of an internet portal that traders could access.

Principle 7

Distributors should ensure that the cost of regulated electricity distribution services is not inefficiently increased through self- or related-party supply of flexibility services

The Authority's expectation

This principle seeks to ensure, overall, that consumers of monopoly-regulated electricity distribution services do not bear extra costs because the distributor is engaged in providing multiple services. In effect, this means distribution services should not cross-subsidise the distributor's flexibility services functions.

If a distributor is meeting its obligations under the Commerce Act 1986, and acting consistently with Principles 1-6, it is more likely to also be aligned with this principle.

In particular, the Authority expects distributors to ensure that, where they own any flexibility assets, and part or all of those assets are within their regulatory asset base under Part 4 of the Commerce Act, those assets are used efficiently. This means the maximum value is extracted from those assets, including across potential non-regulated revenue streams, which minimises costs of regulated electricity distribution services for consumers.

Rationale

This principle seeks to ensure that distributors use flexibility services efficiently, maximising the benefits, and therefore minimising the costs that are passed on to their consumers.

Example

Where a distributor owns a battery that was primarily purchased for distribution network support, it should maximise the use of that battery. This means they should consider other possible uses such as providing flexibility services to the grid owner or ancillary services to the system operator.

Interaction with regulation under Part 4 of the Commerce Act 1986

Consistent with this principle, the Part 4 Commerce Act regime set by the Commerce Commission:

- provides efficiency incentives to non-exempt distributors by setting, and periodically resetting, price-quality paths
- through the Part 4 input methodologies, prevents distributors from raising the costs of regulated electricity distribution services through over-allocation of common costs[8] or over-valuing related party transactions through the cost allocation and related party transactions input methodologies respectively.

8 When assets in a distributor's regulatory asset base are used for non-regulated services, the Commission's regulations require the costs to be allocated between regulated and non-regulated services.