

Distributor involvement in the flexibility services market – draft guidance

24 May 2024

Context and background

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.

In this context, and as part of its *Delivering key distribution sector reform work programme*, published in October 2023, the Authority committed to producing “guidance to the industry on the threshold that, when crossed, would lead us to extend the current ‘arm’s-length’ rules to distributors operating non-network solutions”.¹

Our draft guidance on distributor involvement in the flexibility services market (the Guidance) is attached. The purpose of the Guidance is to protect the development of the flexibility services market, which will in turn promote efficient investment in, and the uptake of, distributed energy resources, ie, make these new technologies more viable for consumers and the sector. This will further support:

- reducing overall electricity system costs²
- providing consumers with more choice, and benefit from that choice, when managing their electricity use and supply.

Protecting the flexibility services market is particularly important because:

- Electricity distributors have a natural monopoly in their core distribution business. This means they do not face the same incentives, costs and risks as businesses operating in a competitive market.
- As with any monopoly business, there is a risk that distributors will leverage the advantages of that position into the adjacent flexibility services market (whether or not they intend to), or be perceived to do so, and inhibit the development of a competitive flexibility services market.
- The efficient and timely development of the flexibility services market will play a pivotal role in New Zealand doubling its supply of affordable, clean energy and becoming a lower-emissions economy.

¹ The current rules are in Part 6A of the Electricity Industry Participation Code 2010 and are discussed below.

² Through lower immediate and longer-term electricity costs (eg, less use of peaking generation; less generation investment required) and lower longer-term network costs (eg, less poles and wires investment required, as flexibility services are considered and funded on a level playing field with these more traditional approaches).

Approach

In developing the Guidance, we have moved away from the concept of setting a fixed threshold for extending the current 'arm's-length' rules to distributor involvement in the flexibility services market. In our view, the limited evidence to date, and the current state of the flexibility services market (still maturing), are more consistent with implementing broad principles-based guidance at this point. We consider this principles-based approach to be the most effective way to communicate our expectations to distributors and all other parties in relation to a developing market.

The Guidance is based on seven key principles. We expect distributors to apply the principles whenever they are involved in the flexibility services market, in any capacity. We are open to engaging with all interested parties, and providing further guidance, if any areas of uncertainty arise.

The Guidance is a market facilitation measure under section 16(1)(f) of the Electricity Industry Act 2010. However, if we find that distributors' conduct is not aligning with the Guidance, the Authority may consider amending the Electricity Industry Participation Code 2010 (Code) to impose some level of mandatory ring-fencing around their electricity distribution businesses in relation to the flexibility services market.

We will monitor distributors' alignment with the Guidance over time, including by seeking voluntary disclosures from distributors, and assurance that appropriate policies and procedures have been put in place. At this point, we expect to assess distributors' overall alignment with the Guidance in quarter 2 of 2026 with a view to then assessing whether further regulation is required.

What the Authority is seeking from stakeholders now

Before we finalise the Guidance, we will hold a workshop to seek feedback from stakeholders on a range of matters, including:

- whether the principles are comprehensive
- what constitutes flexibility for the purposes of the Guidance; there are likely to be boundary cases that are useful to work through
- the extent of the Authority's expectations, eg, regarding staff working across flexibility services and regulated electricity distribution services (as discussed under principle 3)
- whether the principles are likely to create material unintended implementation costs or problems for distributors and, if so, how we might adjust them to have a more proportionate impact
- how we propose to monitor the Guidance, and what record-keeping, disclosures and assurances we may seek from distributors.

We welcome feedback from stakeholders on any other topics the workshop should cover.

Noting other regulatory processes involving the sector, Electricity Networks Aotearoa suggested holding the Guidance workshop in the last two weeks of June. We will schedule the workshop for late June, in Wellington. We will also allow a short period after the workshop for parties to provide their views in writing. Please register your interest in attending the workshop by emailing distribution.feedback@ea.govt.nz.

Relationship between the Guidance and other regulatory rules and regimes

Existing separation rules in Part 6A of the Code

Part 6A of the Code includes corporate separation and arm's length rules applying to distributors in relation to certain generation connected to the distributor's network. These rules apply to distributor investment in generation assets.

The focus of the Guidance is different:

- The Guidance is focused on flexibility services only (that is, services that modify generation injection and/or consumption patterns), including how distributors ensure a level playing field when procuring these services, not investment in generation assets.
- The Guidance may though (appropriately) impact on how generation assets are used, if they are owned by distributors.

Interaction with regulation under Part 4 of the Commerce Act 1986

Aspects of the Guidance align with the outcomes from the economic regulation regime for distributors established under Part 4 of the Commerce Act 1986. The Authority has tested the Guidance with the Commerce Commission, and will do so again after we have taken account of stakeholder feedback at or following the Guidance workshop. The Authority is confident the Guidance and the Part 4 regime are conceptually aligned.