

11 April 2007

Anton Murashev
Manager
Castalia Ltd
PO Box 10225
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Dear Anton

Electricity Security of Supply Policy Review

Meridian Energy ("Meridian") welcomes the opportunity to provide comment on this Electricity Security of Supply Policy Review. Meridian recognises the importance of effective rules and parameters for effective reserve energy management. Meridian's views on the consultation questions on page's 15 and 16 of the consultation document are contained in Appendix One attached.

Key Messages

Meridian reiterates the key messages contained in our earlier submission to Castalia on this topic.¹ In particular, Meridian has a strong preference for a security of supply policy that results in minimal intervention in the normal operation of the electricity market and uses cost-benefit analysis to monetise and compare the costs and benefits of intervention. We note with some concern that the current Statement of Opportunities (SOO) applies an arbitrary rules based approach to security of supply for both peak power and energy and makes no attempt to quantify the associated costs or benefits.

Meridian considers that the detailed approach adopted by this paper is useful and of high quality. However, it is highly assumption based and therefore has limited use for policy formation. That is, if assumptions are challenged many of the conclusions will change. Meridian therefore suggests that this paper is peer-reviewed by academic experts in order to test the assumptions and conclusions contained in the paper.

Notwithstanding the comments above, Meridian agrees with and supports the general direction and conclusions in this paper. In particular, Meridian agrees with Castalia's recommendation of moving to a "1 in 20" security of supply standard from the current "1 in 60" standard.

¹ Meridian's response to Castalia's Security of Supply Issues Paper. 12 January 2007.

Meridian notes that there are a number of related issues, such as Rolling Outage regulations, Security of Supply Outage Plans (SOSOP) and the use of variable pricing for Whirinaki, that are yet to be finalised by the Commission. Meridian therefore suggests that a further independent review of this policy is scheduled to follow this review within four years in order to further develop and improve the reserve energy framework.

Yours sincerely

A handwritten signature in black ink that reads "MA Mitchell". The letters are cursive and somewhat slanted to the right.

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Attachment: Appendix One: Meridian Energy's response to the discussion questions

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Question	Response
<p>1. What are your views on adopting the economic approach to choosing the level of security of supply?</p>	<p>Meridian supports an economic approach to defining an optimal level of security of supply. Overall, the reserve energy policy needs to be driven by the first-best economic benefit to the country. Meridian considers that a quantitative cost benefit analysis should be an overriding driver of the entire security of supply policy. Benefits should be monetised wherever possible in order to accurately compare benefits and costs. Meridian therefore supports the approach that Castalia has taken in its paper.</p>
<p>2. Can the predominant energy security of supply problem be quantified adequately as a winter energy deficit?</p>	<p>Meridian notes that summer security is becoming as problematic as winter security of supply. Therefore, Meridian does not consider that 'winter energy deficit' adequately quantifies the predominant energy security of supply problem.</p>
<p>3. What marginal costs should be attributed to demand restraints at various levels?</p>	<p>This is a highly theoretical question which would take substantial analysis to answer completely. Meridian suggests that further analysis is undertaken on this topic in order to determine a meaningful answer.</p>
<p>4. Do you agree with the use of a simple annual percentage energy margin as the operational standard of security of supply?</p>	<p>No. Meridian considers that this approach is too simplistic. This approach involves applying a crude factor to show how much can be produced along with a crude assessment of demand. Meridian does not consider that this provides an effective assessment. Instead, probabilistic factors should be used in order to provide a meaningful security of supply standard. Meridian considers that it is important to take into account energy availability versus capacity when assessing energy margins.</p>
<p>5. What are your views on the acceptable level of un-served energy each year relative to the 0.03 percent and 0.1 percent of total annual demand identified in this paper?</p>	<p>Meridian considers that average figures such as these have limited use.</p> <p>The numbers estimated by Castalia are extremely small and rely on the validity of a number of other assumptions, the validity of which also needs to be tested.</p>
<p>6. What are your views on how to translate the acceptable level of un-served energy into a probability of demand restraint</p>	<p>Refer to the answer to question 5 above. Meridian considers that a risk adjusted Cost Benefit Analysis trigger approach using weightings accounting for risk preferences</p>

and an energy margin?	would be useful.
7. Do you agree that there is insufficient evidence to be able to assess the likely frequency or magnitude of any electricity market failure in respect to security of supply?	<p>Yes. There is strong evidence that the market is working well. A detailed assessment of the markets involvement in new generation in response to growth in demand is contained in Meridian's 'Options Choices' document².</p> <p>However, there is an ongoing risk that interference with the market may prevent the market from functioning sufficiently to invest in sufficient generation to ensure security of supply.</p>
8. Do you agree that, given the uncertainty about market failure, the best policy going forward is to adopt a "watchdog approach"? This would mean the Commission standing by to intervene if it becomes obvious that the market will not be in a position to meet the optimal reserve energy margin within the lead time of commissioning an open cycle has turbine capacity, but being ready to switch to more comprehensive intervention options if the frequency and magnitude of market failure is greater than expected?	Government intervention in the market is already implicit in the assumptions made by the market. Meridian therefore supports a "watchdog" approach so far as it is similar to the status quo.
9. Do you agree that there is evidence of some market failure, but insufficient evidence to be able to assess the likely frequency or magnitude of market failure?	No. Meridian does not believe that there is any evidence of market failure. The Government has already intervened in the market, meaning that the market has not been allowed to fail. That is, the Government has intervened prior to the market being able to reach a solution, meaning that Government intervention in this market is already incorporated into how the market works.
10. Do you agree with the proposed separation of scope between the Regime and the Policy? Are there better alternative definitions of scope that could be adopted?	Meridian considers that it is important that the GPS clearly articulates the Government's expectation of the security of supply standard while the Commission should be allowed flexibility to apply the standard in policy documents. Further, Meridian also considers that the Commission should undertake a cost benefit analysis assessment of any

² <http://www.meridianenergy.co.nz/yourhome/frequently+asked+questions/optionschoicesdecisions1.pdf> pages 6-7.

	proposed policy or rule changes.
11. Do you agree that the current levy arrangements should remain in place?	Yes. Meridian supports the current levy arrangements. Meridian considers that the "1 in 60" security of supply standard has been adopted for the benefit of end-users and accordingly the levy should be applied to end-users.
12. Do you agree that the procurement process should be pre-announced, and that a clear trigger for procurement be established in terms of a reserve energy margin?	Yes. Meridian supports a pre-announced procurement process. Meridian considers that any procurement process should be contestable in order to ascertain the true cost of providing reserve energy. A competitive process should be run to identify reserve energy opportunities and details of the contract (or operation of true reserve energy) should be made public. We note that the Commission is yet to consult on a process for tendering reserve energy.
13. Do you agree that no further compulsory requirements should be imposed for the provision of information to the Commission?	Meridian considers that it is important to have equity of information provided by various parties, with as much information published as possible. Meridian does not support the compulsory provision of data.