MAJOR ELECTRICITY USERS' GROUP

15 October 2007

Jenny Walton
Electricity Commission

By email to info@electricitycommission.govt.nz

Dear Jenny

Submission on Reserve Energy Review Consultation Paper

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Commission (the "Commission") consultation paper, *Review of Reserve Energy Policy*, published 18th September 2007.
2. MEUG believes the proposed trigger for procuring reserve energy of 17% and 28% energy margins respectively of the New Zealand winter and South Island winter energy demand are too high. There is a high expectation that the elasticity of demand will improve in the near future. The Commission itself has a as a high priority the goal of improving demand side management. We also believe the Commission has overstated the cost of procuring contract options for large user's to provide reserve energy. These two factors we believe have not been sufficiently taken into account by the Commission and hence the proposed energy margins are overstated.
3. The Commission has failed to adopt the Castalia recommendations for dispatch of Whirinaki at SRMC arguing the existing $200/MWh regulated offer price is approximately equal to SRMC anyway. MEUG agree with the original Castalia recommendation and note that actual SRMC can, does and should vary with actual fuel oil prices. If oil prices fall then failure to run Whirinaki power station at SRMC will result in higher costs than would otherwise have been possible. This will be detrimental to New Zealand's economic welfare.
4. The consultation paper doesn't comment at all on the MEUG proposition that Whirinaki be sold and or relocated to Auckland. MEUG still believe those options should be considered.
5. Finally, MEUG disagree with both Castalia and the Commission that the current levy structure is appropriate. Large users' that self-insure are forced to pay twice.
6. We look forward to the Commission's consideration of this submission.

Yours sincerely

Ralph Matthes
Executive Director

Appendix: MEUG comments on EC Reserve Energy Review consultation paper

	Question	Comment	Response
	Security of supply standard		
Q1	Do you agree with the approach recommended by Castalia to develop an economic approach to establishing a security standard?	Agree with approach proposed by Castalia.	
Q2	Do you agree that the approach developed by trading off the cost of demand restraint against the cost of reserve energy is an appropriate means of implementing an economic approach?	The approach in the consultation paper is reasonable but is highly dependent on the assumptions and analysis. MEUG question if the assumptions used by the Commission are reasonable, eg: (1) There is a high expectation that the elasticity of demand will improve in the near future. The Commission itself has a as a high priority the goal of improving demand side management. (2) We believe the Commission may have overstated the cost of procuring contract options for large user's to provide reserve energy. (3) Figure 11 of the consultation paper illustrates the proposed energy margins against a number of scenarios. The only scenario not covered by the proposed energy margin is "worst historic inflows in the South Island," and this is an extreme event. Every other scenario is covered. Even though the report notes that it is not economic to cover every possible risk, it appears that bar one very extreme scenario, every other rare event is covered – this makes the results look questionable.	The Commission should release all the models and assumptions used and if at all possible, allow Castalia a right of reply to the recommendations in their independent report. The Commission should: (1) consider the impact of improving demand elasticity; and (2) canvas end users to determine possible options for reserve energy
Q3	Do you agree that the most appropriate expression of an economic standard as a trigger for procurement of reserve energy is a mean winter energy margin?	There is no explanation of why the Commission chose to estimate the margin over the 6 months between April and September. Why not 2 or 3 or 4 or 5 months?	Could a shorter period have been chosen to reflect an upper bound (say 2 standard deviations or equivalent) of the observed number of months that an extended dry period has occurred?
Q4	Do you support the Commissions' conclusion that the economic standard derived using the Castalia approach yields a security standard that appears unlikely to result in a lower security of supply than the existing standard?	No. Castalia were reasonably sure the current 1 in 60 year standard was too high and a 1 in 20 year standard likely to be more economically efficient.	Refer response to Q2 above.

Q5	Do you support the Commission's conclusion that the GPS should be replaced with a standard based on an economic approach and the existing reserve energy procurement trigger should be replaced by South Island and New Zealand winter energy margins?	The principles are acceptable but not the specific proposal of a trigger for procuring reserve energy being 17% and 28% energy margins respectively of the New Zealand winter and South Island winter energy demand. MEUG believe the economically efficient margins are lower than those calculated by the Commission.	Refer response to Q2 above.
Q6	Alternatively, and because the two approaches appear to yield a similar result, do you consider that the Commission should retain its current approach involving triggering reserve energy when the top of the Minzone exceeds a particular storage level such as 70%?	The current approach should continue to be used until such time as the Commission re-calculate the security of supply energy margins taking into account the comments from MEUG to the questions above.	
Q7	**Monitoring and dispatch** Do you agree that the traditional Minzone should be retained as a key short-term security of supply monitoring tool?	Yes and use of various risk levels as illustrated in figure 14 of the consultation paper would be useful.	
Q8	Do you agree that a series of risk guidelines reflecting vary risk levels could be a useful adjunct to the traditional Minzone?	Refer answer to question 7 above.	
Q9	Do you agree that the Commission should retain the current approach to dispatch of reserve energy rather than move to dispatch at SRMC?	No.	MEUG is disappointed the Commission has failed to adopt the Castalia recommendations for dispatch of Whirinaki at SRMC arguing the existing $200/MWh regulated offer price is approximately equal to SRMC anyway. MEUG agree with the original Castalia recommendation and note that actual SRMC can and does and should vary with actual fuel oil prices. If oil prices fall then failure to run Whirinaki power station at SRMC will result in higher costs than would otherwise have been possible. This will be detrimental to New Zealand's economic welfare.

	Other Castalia recommendations		
Q10	Do you agree that the GPS should be amended to introduce a requirement for the Commission to monitor whether the investment in new power stations is consistently late relative to demand growth?	No because the proposed energy margin in tandem with the Minzone for near term monitoring should suffice for security of supply. If there are wider issues about capital investment to meet overall energy demand, not just security of supply, then analysis needs to be undertaken to prove that is an issue before any change to the GPS is proposed requiring ongoing market monitoring. As part of that analysis we would also expect the Commission to assess the costs of the monitoring work and how the Commission could expect to obtain commercially confidential information. MEUG is concerned that any change to the GPS as proposed will lead to regulation requiring parties to provide information that has little to do with security of supply.	
Q11	Do you agree that if the Commission finds that the investment in new power stations is consistently late relative to demand growth it should consider possible future amendments to the GPS to require a comprehensive solution be introduced based on Energy Adequacy Hedge mechanisms?	The Commission can at anytime investigate if an Energy Adequacy Hedge mechanism would enhance economic welfare or not. It would be presumptions to simply add that option as the preferred solution into the GPS without having undertaken the analysis compared to other alternatives.	
Q12	Do you agree that the existing levy mechanism should be retained?	No. MEUG members continue to be frustrated that they pay for security and also have to pay the cost of self insurance strategies such as building cogeneration and/or have a portfolio of spot purchases and financial derivatives that are affected by the influence of the Whirinaki power plant in the market.	
Q13	Do you agree that the Commission should investigate short-term supply based alternatives (such as containerised diesel-fired plant) rather than focus on complex procurement processes and pre-consenting options?	No.	The Commission should keep an open mind on all options because circumstances can change and a preferred mix of solutions today may be an inferior solution in the future.
	Amendments to the GPS		
Q14	Do you agree that the general approach to modifying the GPS as outlined in section 8 is appropriate?	Given the just announced NZ Energy Strategy, it may be better for the Commission to assess in a more comprehensive manner any possible changes to the GPS.	