

Electricity Supply Security Decisions

17 June 2003

Toby Stevenson
General Manager Electricity Trading
Contact Energy Limited



“A new Electricity Commission will secure reserve generation to ensure New Zealand's electricity needs can be met even in very dry years without power savings campaigns.”

Media Statement from Hon Dr Michael Cullen, Minister of Finance and Hon Pete Hodgson, Minister of Energy 20 May 2003



“Supply side dominated self-regulation of MARIA and NZEM since 1996 has ended. The Electricity Commission gives a better chance of a more pro-competitive environment developing, but also has the usual regulatory risks. Lot of work needed to ensure the opening regulations are reasonable. The appointment of capable Commissioners is critical.”

MEUG newsletter 13 June 2003



Comments are sought on:

- the most appropriate length of the contracts and how often the Commission should let tenders.
- the quantity of ring-fenced capacity required and the balance between new and existing generation in that portfolio.
- the appropriate price(s) and conditions under which reserve generation should be offered to the system operator for dispatch.
- whether a levy on wholesale electricity prices is fair and efficient, or whether some other form of cost recovery would be better.

“The objective is to ensure that this capacity is held in reserve to meet dry year and other fuel supply risks, while ensuring that incentives remain for buyers to take out hedges and contracts against spot prices and for generators to build new base load generating plants”

“If the generation is offered at too low a price, this may reduce the commercial incentives to build new high load-factor plant or invest in demand-side management, as an effective cap would be established at a low price.”

“If the reserve is offered into the market at a price significantly above its short run marginal cost, the reserve capacity will be used less frequently (even though it may be efficient to operate it more frequently), and spot prices will be higher than necessary.”

Electricity Security of Supply: Policy Settings Cabinet Paper May 2003



To achieve these and the other stated objectives the DYR trigger should be:

- Based on price so participants in the market are clear what will happen and under what circumstances
- A response to market signals rather than the anticipation of circumstances that may or may not occur.
- Certain so that investors can build base load generation or new industrial plant with confidence
- The price all DYR is paid when run
- Possibly split so that large amounts of DYR are not brought on simultaneously

Rather than address the other questions we have our own questions on how implementation of the DYR mechanism might achieve the stated objectives:

- How does the mechanism achieve consistency over time?
- What is the fairest way by which the levy should be recovered?
- How to ensure that information is reliable?
- Where will the dry year reserves come from?

How does the mechanism achieve consistency over time?

In order to achieve consistency, what is the appropriate balance between the use of regulations and rules that can evolve while sustaining the right incentives on both buyers and sellers?



What is the fairest way by which the levy should be recovered?

How do we get the right balance between the simplicity of the recovery mechanism and the right incentives?

How does the mechanism achieve balance between rewarding those who actively manage their risk and charging those who don't?

How to ensure that information is reliable?

Should there be a link between quality of information provided and contribution to the DYR mechanism?

Where will the dry year reserves come from?

How does the mechanism achieve balance between the least cost option for DYR and maintaining a healthy investment climate for baseload?

For the answers to these questions:

Contact welcomes the government's invitation to provide feedback on such fundamental issues and are positive that the balance can be achieved on each of these within the mechanisms announced.

Contact will submit its views on the questions posed in both the government's announcement and in this presentation on June 30

Thank you

