



**MERIDIAN'S SUBMISSIONS IN RESPONSE TO
THE PRELIMINARY REPORT TO THE
MINISTERIAL REVIEW OF ELECTRICITY
MARKET PERFORMANCE**

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MERIDIAN'S SUBMISSIONS IN RESPONSE TO THE PRELIMINARY REPORT TO THE MINISTERIAL REVIEW OF ELECTRICITY MARKET PERFORMANCE

Executive Summary

1 Meridian welcomes the opportunity to comment on the Preliminary Report by the Electricity Technical Advisory Group and the Ministry of Economic Development (the **Preliminary Report**). It is clear that a lot of work and thought has gone into the Preliminary Report, the report recommends some significant changes, and we are committed to addressing the issues identified.

Changes to industry governance and rules

2 Meridian supports the recommended changes to industry governance and the rules relating to security of supply, costs of new supply, transmission and distribution, and wholesale and retail prices.

3 A number of the recommendations identify the need for improvements in some key areas (such as when to trigger a security of supply event and the Grid Investment Test). Other recommendations highlight where insufficient progress has been made on known issues (such as transmission hedges and use of system agreements). As a general comment, Meridian expects there to be a consensus that the Preliminary Report has identified at a high level the areas where improvement should be made.

4 A theme that emerges from the Preliminary Report is that these issues will become the tasks set for the new Electricity Market Authority (**EMA**). The EMA is being established to address the same hard questions that the Electricity Commission struggled to address, with the objective that the EMA will produce better rules and outcomes than the Electricity Commission did. While it is easy to agree with that aspiration, it will be important to examine the incentives and restrictions that contributed to the problems with the Electricity Commission model, and to learn the lessons of the last five years. The more focused role of the EMA will help in this regard.

5 In this submission Meridian comments on each recommended governance and rule change, and where possible identifies ways to successfully implement the recommendation. As highlighted above, however, the Preliminary Report and this submission are necessarily at a high level. A lot of work remains for the Ministry of Economic Development (**MED**) and other government departments to reform the legislative framework and establish the EMA, and then for the EMA to resolve the issues identified in the Preliminary Report. Meridian submits that it will be important to engage the market participants on this implementation, and we look forward to contributing.

Recommendation 17

6 Recommendation 17 proposed an asset swap between Meridian and Genesis Energy as a way of improving the performance of the market. The Preliminary Report notes that only an initial assessment of the asset swap has been completed, and that further analysis is necessary.

7 The objectives of the asset swap outlined in the Preliminary Report are improving competition in the retail sector, and dry year risk management. Meridian has considered the proposed asset swap and while it may achieve those objectives, we are concerned that the costs to New Zealand, once fully assessed, may outweigh the benefits that can be achieved.

- 8 Acknowledging that the costs of the proposed asset swap may outweigh the benefits, we raise for consideration a proposal for a liquid wholesale hedge market. Meridian submits that if implemented, this hedge market will improve competition in the residential retail sector.
- 9 In such a regime generators would be required to place a certain proportion of their generation through an approved electricity futures trading exchange, ensuring liquidity. This will then give prospective retailers (and generators) access to energy and a reliable mechanism to manage their price risks. We would be interested to discuss the merits of this proposal with officials, the Advisory Group and industry participants.

Transitional issues

- 10 The Preliminary Report proposes a major overhaul of the governance and regulation of the sector. Given the scale of the changes Meridian submits it will be important for officials to engage the industry early on likely transitional issues. These could include:
 - 9.1 ensuring the changes do not hold up transmission investment that is already approved or in an advanced stage of planning;
 - 9.2 getting the new security of supply rules in place in a way that gives the market time to adjust its risk positions in an orderly manner;
 - 9.3 identifying early whether the existing regulations and rules can be adopted by the EMA under the new legal framework (including the narrower purpose statement);
 - 9.4 deciding whether an EMA establishment group is needed and if so what it should do prior to the establishment of the EMA;
 - 9.5 deciding what the Electricity Commission can continue to do given the proposed changes, particularly to the regulator's objectives; and
 - 9.6 the practical importance of the first appointments to the board of the EMA and the Security and Reliability Council (**SRC**), both in terms of process, independence and capability.

Next Steps

- 11 Meridian looks forward to engaging further with Ministers, officials, the Electricity Technical Advisory Group and ultimately the new Electricity Market Authority to ensure the efficiency of the electricity market, including reliability, for the long term benefit of consumers.

Responses to the Recommendations

Dry Year Management

1. Require retailers to make payments to consumers in the event of a public conservation campaign or enforced power cuts, with a graduated scale reflecting the level of nationwide savings (as determined by the System Operator), and with a minimum payment of, say, \$10 per week.

Meridian's response

- 1 Meridian supports the introduction of these payments.
- 2 The Preliminary Report has identified a need for more balanced incentives around the calling of public conservation campaigns or enforced power cuts. We agree that the recommendation to require market participants to compensate consumers in the event of a public conservation campaign or enforced power cuts would achieve this balance.
- 3 There is a question around whether the obligation should be imposed on retailers or generators. The mechanism seems more at influencing the incentives of generators, and imposing this obligation on retailers increases the risks on retailers contrary to the objectives of increasing retail competition.

Implementation issues

- 4 This recommendation is one of a number of recommendations that addresses aspects of security supply. Meridian is supportive of the changes to the security of supply framework proposed in the Preliminary Report.
- 5 It will be important that these changes are viewed as a whole, and that they are implemented in a way that gives market participants increased certainty as to the rules that will apply in security of supply situations. In particular, real gains will be made if the reforms result in very clear rules on:
 - 5.1 when a public savings campaign will be triggered;
 - 5.2 the payments to consumers that will be made in the event of a public savings campaign (including who would be eligible for this payment, the basis for calculating how much a consumer receives, and how retailers share the collective costs, as discussed below);
 - 5.3 the scarcity pricing that will apply during a public savings campaign (discussed in Recommendation 2);
 - 5.4 preventing generators from getting the benefit of a public savings campaign (discussed in Recommendation 2);
 - 5.5 when and by whom a rolling outage/enforced power cut would be triggered;
 - 5.6 the payments to consumers that will be made in the event of an enforced power cut; and
 - 5.7 the scarcity pricing that will apply in an enforced power cut (when physical demand and supply do not reconcile; discussed in Recommendation 2).
- 6 Meridian notes there will be transitional issues that will arise in the change from one security of supply framework to another. While there is clearly an interest in improving the security of supply framework as quickly as possible, transitional arrangements should allow market participants some time to adjust their risk positions in an orderly manner.

Next steps

- 7 Meridian submits that this recommendation could be taken forward in the following way:
 - 7.1 Ministry of Economic Development (**MED**) prepare legislation that gives the EMA the power to set rules that require these payments in the event of a public conservation campaign or enforced power cuts.
 - 7.2 EMA to consult on appropriate rules, including:

- (a) clear rule for when to trigger a public conservation campaign;
- (b) clear rule for when to enforce power cuts;
- (c) clear rules establishing what consumers receive, including whether payments depend on quantum consumed, quantum saved, size of customer, etc; and
- (d) clear rules for the basis upon which generators or retailers will meet these charges – equally, or if not equally then on what basis.

2. Put a floor on spot prices during any public conservation campaign or during any enforced power cuts in a dry year of, say:
 - 2.1. \$500/MWh (50c/kWh) when a public conservation campaign is activated.
 - 2.2. \$1,000 - \$5,000/MWh (\$1 - \$5/kWh) if and when forced power cuts are activated.

Meridian's response

- 8 Meridian supports the proposition that prices should reflect scarcity. When a resource becomes scarce, the price for that resource should rise.
- 9 There are a wide range of scarcity pricing mechanisms in use in other markets. The scarcity pricing proposed by the Preliminary Report, however, is unique and untested. For this reason particular care will need to be taken to avoid unintended outcomes.

Implementation issues

- 10 There are three interrelated issues in the Preliminary Report discussion:
 - 10.1 prices should reflect scarcity;
 - 10.2 what should happen to prices when the Minister triggers a public conservation campaign in response to a shortage concern. The Preliminary Report has recommended that generators not receive the benefit of any conservation campaign, and indeed face incentives to avoid a campaign; and
 - 10.3 we need a mechanism for determining a price when physical supply does not meet demand, such as a rolling outage situation. Current market arrangements are silent on how a price would be arrived at, and this is a gap in the market rules.
- 11 On each of these issues, Meridian agrees that improved clarity and certainty will improve the efficient functioning of the market.
- 12 The Preliminary Report proposes a scarcity pricing mechanism, and recommends a particular form of scarcity pricing – a price floor.
- 13 As noted above, “scarcity pricing” encompasses a range of mechanisms. In electricity markets this can also refer to price caps, price increments, and value of lost load (**VOLL**) pricing. The objectives of these mechanisms also differ from market to market – the scarcity pricing mechanisms can be directed at restraining market power, providing additional revenue to generators to incentivise new generation, setting a default price when supply does not match demand, and signalling to consumers the need to constrain consumption.
- 14 Even in this context, the proposal in Recommendation 2 is unique. In no other market does a mechanism set a price floor every half hour over potentially an extended period, regardless of demand and supply conditions (and therefore relative scarcity). Other markets do not limit scarcity pricing to public conservation campaigns. While the Preliminary Report suggests that the Australian mechanism is analogous, on closer inspection it is quite different.
- 15 The Preliminary Report does not analyse in any detail the impact of Recommendation 2 in practice. This means that implementation of Recommendation 2 should allow for time to consider all possible consequences, and sufficient flexibility to address unintended outcomes.
- 16 For example, while the aim of the mechanism is to target the way generator/retailers manage scarcity risk, there is the potential to:
 - 16.1 harm industrial customers trying to fill an export order during the period of a public conservation campaign;
 - 16.2 deter generator/retailers from offering hedges, or increase the price of hedges; and
 - 16.3 alter the behaviour of generators.
- 17 It is also not clear how a price floor will meet the need for a price setting/discovery mechanism

where physical supply and demand do not match.

Next steps

- 18 Meridian submits that this recommendation could be taken forward in the following way:
 - 18.1 MED prepare legislation that gives the EMA the power to establish scarcity pricing. This should be on terms that give the EMA a broad flexibility to develop a proposal after more detailed consideration and consultation.
 - 18.2 EMA to consult on a scarcity pricing mechanism, including amongst the options the Recommendation 2 proposal.

3. Clarify roles and responsibilities for security of supply (as set out in Table 2 on page 21).

Meridian's response

- 19 Meridian welcomes this recommendation's focus on clarifying roles and responsibilities for security of supply. Meridian agrees that it is important for all stakeholders to have confidence in the industry governance and that good decisions will be made when the market comes under pressure.
- 20 When security of supply is threatened and there is pressure to make informed decisions quickly, good governance in the sector requires that the division of roles is clear and that they are assigned to the persons or bodies most expert to deal with security of supply issues.
- 21 For example, in the case of who should be responsible for triggering public conservation campaigns, we support the Preliminary Report's acknowledgement that ultimately this should be decided by the Minister, recognising that such a decision has both political and economic implications. It would not be right to give a decision with such implications to the regulator.

Implementation issues

- 22 Clarity of roles and responsibilities is crucial to ensure that the accountabilities of decision-makers do not become blurred. Meridian notes that, on the basis of Table 2, the SRC seems to have a role in advising a number of key decision-makers: the System Operator, the EMA, and the Minister. To avoid any blurring of accountabilities, the regime will need to be clear that the SRC's role is purely an advisory one. The parties that have been allocated decision-making responsibilities must be accountable for their decisions, even when taking advice from the SRC.
- 23 Effective decision-making around security of supply cannot rely solely on the delineation of roles and responsibilities however. Clear *rules* are equally important if the experience of previous years is anything to go by.
- 24 The Preliminary Report does not, for example, explore how an appropriate trigger point for calling a public conservation campaign would be determined, or the substance of an appropriate rule for triggering a campaign.
- 25 We appreciate that it is difficult to fully engage on the issue within this preliminary review process. But when the new regime is put in place, the threshold for calling a public conservation campaign must be crystal clear. This has not worked well in the past. Most recently, the Electricity Commission has struggled to articulate the boundaries around this issue. The current draft security of supply policy from the Electricity Commission focuses on one fuel source (water) rather than the availability and storage of all fuel sources (water, gas, coal, etc). It also attempts to influence simultaneously both quantity and price in the market, yet the mechanism is only equipped to deal with quantity.
- 26 Meridian notes that following the construction of Contact Energy's gas storage facility, Ahuroa, there will be greater thermal storage capability in New Zealand than hydro storage. Modifications to the security of supply arrangements moving forward should acknowledge this.
- 27 We recognise that the task of establishing the clear rule for triggering a public conservation campaign will be the responsibility of the EMA. We note here that the EMA will not be able to simply pick up the Electricity Commission's security of supply policy. Improvement in this area will be heavily dependent on a robust process to develop a clear rule that appropriately identifies when a public conservation campaign should be triggered.

Next steps

- 28 Meridian submits that this recommendation could be taken forward in the following way:
- 28.1 MED to prepare legislation that establishes clear roles and accountabilities as per Table 2, including clear boundaries between the advisory role of the SRC and the accountability of decision-makers.
- 28.2 EMA to consult on and then promulgate a rule that clearly defines the appropriate

circumstances when a Minister can call a public conservation campaign.

28.3 System Operator to develop and publish security of supply forecasting and information.

28.4 MED to prepare and publish longer term supply and demand forecasts.

4. Phase out the reserve energy mechanism, and reassign the Whirinaki power station to an SOE or sell it.

Meridian's response

- 29 Meridian supports this recommendation.
- 30 Meridian agrees that the presence of Whirinaki power station in the current framework creates distortions that distract from rather than enhance security of supply outcomes. That is because the reserve energy mechanism:
 - 30.1 reduces incentives for demand-side price responses;
 - 30.2 reduces incentives for private and more efficient investment in peaking plant; and
 - 30.3 is in a location that is sub-optimal for assisting dry periods.

Implementation issues

- 31 If the reserve energy mechanism is phased out, as recommended, then the future role of the Whirinaki power station should be made clear so that there is no uncertainty in the market. In particular, if the Whirinaki power station is reassigned or sold, it should be clear whether the new owner will operate the Whirinaki power station on a purely commercial basis or whether the new owner will be required to use the Whirinaki power station to pursue other public policy objectives. If the reserve energy mechanism is phased out, Meridian submits that the new owner of the Whirinaki power station should be free to, and expected to, operate the power station on a commercial basis. This could potentially involve transitional arrangements.
- 32 Information currently provided to the Electricity Commission and used in the annual reserve energy needs analysis provides a useful signal to the market of the energy and capacity adequacy of the New Zealand system. This information sharing forms a valuable part of how security of supply will be realised, and should not be lost in the phasing out of the reserve energy mechanism.

Next steps

- 33 Meridian submits that this recommendation could be taken forward in the following way:
 - 33.1 MED to propose amendments to the Electricity Act to phase out the reserve energy mechanism.
 - 33.2 The Crown to sell the Whirinaki power station on the open market.
 - 33.3 MED to provide for information gathering powers for the EMA moving forward.

5. Alternatively, if the Government wants to retain the reserve energy mechanism as a backstop, then it should:
 - 5.1. Reassign Whirinaki to an SOE or sell it.
 - 5.2 Ensure that a mechanism is developed (such as a surcharge on spot prices) through which parties that benefit from any reserve energy when it is called on (that is, parties that are exposed to spot prices) contribute to the standing costs of that reserve energy.

Meridian's response

- 34 As discussed in our response to Recommendation 4, Meridian supports the recommendation to phase out the reserve energy scheme in order to remove current market distortions that serve to undermine rather than bolster security of supply.
- 35 If the reserve energy mechanism is retained, however, then it will be very important to improve on the current security of supply policy. In this sense, the future owner of the Whirinaki power station (EMA; SOE; third party investor) is less important than clear, appropriate rules that give the market certainty that the reserve energy mechanism will only be implemented in predictable, appropriate circumstances.
- 36 Meridian supports the objective of ensuring that the parties that benefit from reserve energy when it is called upon contribute to the standing costs of that reserve energy.

Implementation issues

- 37 As noted above, if this recommendation is pursued then a key implementation issue will be establishing a clear security of supply framework that gives market participants confidence that the reserve energy mechanism will only be activated in predictable, appropriate circumstances.
- 38 The Electricity Commission has found it difficult to establish such a framework. The issues are complex. A clear rule is required that accounts for the availability and storage of all fuel supplies (water, gas, coal, etc).
- 39 A key issue is whether the framework will also attempt to make the reserve energy mechanism cost-neutral. This has proved to introduce a near-impossible level of complexity into the current policy framework, and draws the operator of the Whirinaki power station into solving or influencing both price and quantity in the market.
- 40 Another key implementation issue will be working through how a surcharge on spot prices (to capture parties that benefit from reserve energy) will be implemented in practice, including how beneficiaries will be identified.

Next steps

- 41 As Meridian supports Recommendation 4, Meridian supports proceeding in the following way:
 - 41.1 MED to propose amendments to the Electricity Act to phase out the reserve energy mechanism.
 - 41.2 The Crown to sell the Whirinaki power station on the open market.

6. Require SOEs to disclose their risk positions and other relevant information in the same way as private sector companies listed on the Stock Exchange, to improve the quality of information available on risk and sharpen risk management incentives.

Meridian's response

- 42 Meridian supports the disclosure objectives addressed in Recommendation 6.
- 43 Meridian is focused on being as transparent as our listed competitors and will be providing the equivalent information on the same basis as these companies.

Implementation issue

- 44 An important issue will be to ensure that any disclosure requirement for SOEs is implemented without putting SOEs at a commercial disadvantage to their listed counterparts.
- 45 Meridian currently provides information in its financial statements on the value of electricity derivatives, as required by accounting standards (see Note 23 of our 2008 Annual Report). Meridian's 2009 Annual Report will also detail the volume of electricity subject to derivative contracts.
- 46 Going forward, Meridian intends to disclose this information as part of a commitment to a general continuous disclosure obligation as robust as those imposed on listed companies. The continuous disclosure commitment should be in place in the fourth quarter of 2009.

Next steps

- 47 No formal mechanism should be required for SOEs to move to this level of disclosure. A short transition will be needed to establish internal systems and protocols with Shareholding Ministers.

7. Investigate developing terms and conditions for accessing 'reserve water' in lakes in dry year emergencies which cap benefits to generators and provide for compensation to affected communities and mitigate or avoid environmental effects.

Meridian's response

- 48 Meridian agrees that developing terms and conditions for accessing reserve water in lakes in dry year emergencies will help to assist security of supply. Clear criteria established in advance for this access will be essential if the "reserve water" is to be of benefit in an emergency situation.
- 49 The Advisory Group and MED were careful to note that there had not been time for a full review of this issue. However, the objective is to think ahead and address this issue in a way that allows for careful consideration and public scrutiny rather than a hasty legislative amendment in an emergency. Meridian agrees with this approach.
- 50 The Resource Management Act (**RMA**) has processes in place for ensuring that the environmental effects of accessing reserve water are mitigated, and Meridian supports progressing this recommendation within the RMA framework rather than outside it. That said, however, it is timely to review whether the RMA processes are sufficiently flexible to the degree needed by the industry when responding to dry year situations (including facilitating the amendment of conditions in tight time frames).

Implementation issues

- 51 Meridian agrees that the environmental effects that may result from accessing reserve water and that the ability to access emergency storage will always need to be accompanied by conditions that ensure any adverse environmental effects will be mitigated.
- 52 The RMA has processes in place to ensure that this happens.
- 53 However, existing consents under the RMA have given rise to considerable uncertainty and inconsistencies.
- 54 Meridian has experienced similar hurdles in the use of its lakes as those identified in the Preliminary Report's case study of the consent conditions for the use of Lake Hawea.¹ There are significant challenges around accessing local water for the national interest.
- 55 Meridian has work underway which aims to clarify consent conditions at Lake Pukaki. Currently we have lake level consent conditions that vary depending on the time of the year. Meridian is likely to seek a consent amendment to allow the use of the highest maximum level throughout the year thereby capturing more of the spring/summer inflows as storage. Meridian may also seek permission to use a lower minimum lake level so that during very dry low inflow periods more storage is available for generation but recognises that this will take time to work through with interested parties.
- 56 To achieve these consent changes, Meridian will work with stakeholders as well as local authorities.
- 57 Another implementation issue to work through will be determining the mechanisms for capping the benefits generators achieve through accessing reserve water in dry year emergencies, and how conditions around this will interact with the proposed price floors during energy shortages.

Next steps

- 58 We are mindful of the signal in the Preliminary Report that a full review of this issue is needed. In that context Meridian submits for consideration the following approach:
 - 58.1 Ministry for the Environment (**MfE**) and MED and the EMA to co-ordinate on the clear criteria for when an emergency situation exists.
 - 58.2 MfE and MED to review RMA processes to establish criteria for consents that permit access

¹ Improving Electricity Market Performance – Volume 2. Appendix 7: Access to reserve water.

- to reserve water in emergencies, and enhanced storage outside of emergency situations.
- 58.3 EMA to establish rules for capping benefits to generators and providing compensation to affected communities when reserve water is accessed (note the legislative framework prepared by MED will have to give the EMA this power).
- 58.4 The RMA review by MfE to require regional councils to review existing water consents for consistency with the new framework.
- 59 Meridian will continue to use the existing consent amendment process to seek amendments to the consent conditions at Lake Pukaki.

To help restrain the costs of generation

8. Ensure, when making decisions on climate change policy, that full weight is given to the importance of providing certainty for investors including, to the extent possible, providing for stability and predictability on the future cost of carbon and other emissions.

Meridian's response

- 60 Meridian agrees that it is important to have predictability on the future cost of carbon and other emissions.
- 61 However, it is uncontroversial that the price of carbon will vary in the future. Variation in price is not in itself an issue for business. Market participants are familiar with managing variations in input prices and costs. What matters most is that there is stability and predictability about the market rules used to support price discovery. If the rules are stable and predictable, businesses can manage price variation.

Next steps

- 62 Meridian submits that this Recommendation could be taken forward by MfE implementing an Emissions Trading Scheme mechanism.

9. Ensure that the current reviews of the Resource Management Act and water allocation consider:
- 9.1. Whether and how the 'call-in' process could be used to better effect for generation projects (new and existing).

Meridian's response

- 63 We agree that the issues noted for consideration in Recommendation 9 should be reviewed.
- 64 In relation to the issue identified in 9.1, Meridian notes that the "call-in" process is a useful tool. It was used in respect of the Te Mihi geothermal project (Contact Energy), Te Waka stage 2 windfarm (Unison), the Hauauru ma raki project (Contact Energy), the Turitea windfarm (Mighty River Power), and also the Waikato transmission upgrade (by Transpower).
- 65 The "call-in" process was also requested by Meridian in 2006 in respect of Project Hayes, but the request was made with insufficient time prior to the scheduled commencement of the council hearing to be effective. Since then, "call-in" processes and participant understanding of them has improved and Meridian expects that call-in use is likely to continue for future generation proposals.

Implementation issues

- 66 The call-in process will be appropriate in some but not necessarily all cases. For instance, it may not be appropriate for the call-in process to be used where:
- 66.1 appeals would be unlikely if an application is processed through a council process; or
- 66.2 other statutory approval processes (for example, the Conservation Act concession processes) may ultimately determine approval timeframes (i.e. there is little point proceeding quickly through resource consent call-in only to be slowed through concession processes).
- 67 To ensure that the process works efficiently, it will be important for all participants involved in the process to develop confidence in it. We expect that this will develop over time.
- 68 Consideration should also be given to whether call-in for re-consenting may be desirable.
- 69 Another option worthy of consideration includes developing a more realistic consenting category (i.e. controlled activity status under the RMA) for re-consenting and potential complementary planning measures to support this. This is discussed further under 9.4.

- 9.2 Other fast-track mechanisms for consenting (or re-consenting) nationally significant generation projects.

Meridian's response

- 70 Meridian supports the initiative of investigating whether a single set of criteria and process could be developed for nationally significant generation projects that otherwise require multiple statutory approvals, including potential consideration of the use of public conservation land.

Implementation issues

- 71 We note that a single decision maker process that simply combines a Resource Management Act and Conservation Act process without coordinating the criteria for consideration is likely to lead to more, not less, uncertainty and cost. Development of appropriate criteria will be critical to making progress in this area.

9.3 Providing for water and geothermal rights to match the life of the assets.

Meridian's response

- 72 Meridian supports this recommendation. Electricity generation facilities are a very long lived form of investment, providing significant intergenerational benefits, and generally providing lower cost electricity than building additional new replacement facilities to replace "lost" generation. Incentives to invest in generation will be supported if rights match asset lives.
- 73 Clear articulation of the "electricity perspective" at the government level to provide guidance regarding the relevance of this issue for Resource Management Act and water allocation reform processes would be welcomed.

9.4 Whether certain types/sizes of generation could be deemed to be a permitted activity in predefined circumstances and areas.

Meridian's response

- 74 We support in principle the development of a National Environmental Standard under the Resource Management Act making some forms of small scale generation permitted or controlled activities.

9.5 The terms for consents, particularly the lapse provisions, to better recognise the nature of large-scale generation investment projects.

Meridian's response

- 75 Meridian supports this recommendation. Investment in generation capacity that has been approved via statutory processes can require longer lapsing periods for determining if the investment is to proceed to the build stage. The decision to commit to build involves an assessment by the investor(s) of a range of dynamic macro-economic, social and other factors that change over time. Ensuring that investors have flexibility about when options to build are exercised is expected to ensure a greater pool of options will be available.

9.6 Whether powers such as compulsory acquisition of land, with appropriate compensation provisions, should be available to nationally significant generation projects.

Meridian's response

- 76 Meridian supports the review of this issue and stresses it is not just a new generation build issue. We believe that there are circumstances where the ability to exercise certain network utility/requiring authority powers is appropriate for existing electricity generation activities – for instance, in order to undertake emergency remedial activities as anticipated under section 330 of the Resource Management Act for existing generation facilities, and to seek recognition and protection for important existing "works" or generation-related plant where they are located on private land.

10. Ensure that the current petroleum resources review takes full account of the importance of gas to electricity generation using existing or new assets.

Meridian's response

77 Meridian agrees with Recommendation 10.

Next steps

78 Meridian submits this Recommendation could be taken forward by MED.

11. Improve the quality of published information on gas reserves.

Meridian's response

- 79 Meridian agrees with Recommendation 11.
- 80 Meridian submits that these improvements to published information on gas energy reserves should be seen as part of the broader security of supply policy. As discussed in relation to Recommendations 3 and 5, the improved security of supply policy and rules need to address New Zealand's energy reserves and risk curves, not just hydro storage and hydro risk curves.
- 81 This means that the EMA and the market needs the same quality of information on coal, gas and geothermal reserves, gas storage and contract positions as is currently made available in relation to hydro inflows, reserves and spill.

Next steps

- 82 Meridian submits that MED should implement Recommendation 11, broadened in the ways discussed above.

12. Identify barriers to the development of geothermal energy which can and should be addressed by the Government.

Meridian's response

83 Meridian agrees with Recommendation 12 that regulatory barriers to the development of geothermal energy should be identified.

Next steps

84 Meridian submits that this Recommendation could be taken forward by MED.

13. Consolidate responsibility for the promotion of energy efficiency in EECA, and remove it as a responsibility of the electricity regulator, while:
 - 13.1 Carrying out a strategic review of EECA to ensure it is well-focused and performing effectively.
 - 13.2 Transferring best practice approaches developed by the Electricity Commission where possible.
 - 13.3 Reviewing funding for EECA, with a general principle that funding should be through levies where the beneficiaries can be clearly identified and administrative (collection) costs are low.

Meridian's response

- 85 Meridian agrees with the recommendation to consolidate promotion of energy efficiency with EECA.
- 86 It has been inefficient to have both the Electricity Commission and EECA pursuing energy efficiency in the use of electricity. We agree that EECA is the correct body to be allocated this consolidated responsibility.
- 87 Given the additional responsibilities to be allocated to EECA, we agree that a strategic review of EECA's performance would be prudent.

Implementation issues

- 88 Whether it is appropriate for EECA to be funded through levies where the beneficiaries can be clearly identified will need to be carefully considered.
- 89 The recommendation to consolidate responsibility in EECA highlights that, with the benefit of hindsight, the Electricity Commission should never have been given electricity efficiency objectives and electricity efficiency functions should always have been centralised in EECA. This means the fact that the electricity efficiency functions performed by the Electricity Commission are currently levy-funded is simply a historical anomaly and the result of a policy mistake. In light of the decision to revert back to a central government agency for the performance of these functions, it is not obvious that the best decision in terms of how EECA should be funded is to carry over levy-funding.
- 90 The starting point should be the range of activities undertaken by EECA. Where they relate to electricity efficiency, the difficulties in "clearly" identifying beneficiaries will only compound the issue of levy-funding. In all likelihood, the real beneficiaries of electricity efficiency initiatives will be New Zealand consumers rather than generators or retailers. In such a situation, funding EECA's activities from general taxation is appropriate. This is more efficient than the current arrangements where retailers are levied, this is passed on by retailers, and the electricity price signal is distorted.
- 91 In other areas of EECA's activities levying electricity market participants, or even beneficiaries more generally, would seem even more inappropriate. An example is the Warm Homes initiative supported by \$323.3m of tax payer funding. There is no rationale for levying electricity retailers, and levying home owners would undermine the policy.

Next steps

- 92 Meridian submits that this Recommendation could be taken forward by:
 - 92.1 MED to propose amendments to the Electricity Act to consolidate energy efficiency functions with EECA.
 - 92.2 MED to procure a strategic review of EECA.
 - 92.3 Treasury to advise MED and EECA on the application of best practice funding policy in the particular context in which EECA operates.
 - 92.4 A Memorandum of Understanding (**MOU**) currently exists between the Electricity Commission and EECA. The need for an MOU in the new environment will need to be reviewed by the EMA and EECA.

14. Review whether there are likely to be net benefits, compared to alternatives, in developing a National Environmental Standard for small-scale distributed generation, such as solar photovoltaics, micro-wind turbines and solar water heating panels.

Meridian's response

- 93 Meridian agrees that this review should be undertaken.

Implementation issues

- 94 In conducting this net benefit assessment it will be important to consult stakeholders on how the net benefit assessment will be performed. Questions like what alternatives to use, and what counts as a cost and as a benefit, will profit from industry input.

Next steps

- 95 Meridian submits that this recommendation could be taken forward by MED and MfE conducting the review identified in Recommendation 14.

To improve procedures for upgrading transmission services

15. Amend the Grid Investment Test to make it clearer, simpler and less prescriptive, and to take into account wider competition benefits.

Meridian's response

- 96 Meridian supports this recommendation.
- 97 Amending the Grid Investment Test should reduce delays to approving grid upgrades. Transmission investment is by its very nature complicated. In order to make the investment process more straightforward, the process needs to provide more certainty and predictability and be undertaken in a more timely manner.
- 98 Meridian also supports the inclusion of wider competition benefits in the Grid Investment Test. The competitiveness and efficiency of a retail electricity market relies in part on investment that will remove transmission constraints. The Grid Investment Test should therefore be developed in such a way as to reflect these benefits so that the national grid develops in a way that promotes the best outcomes for New Zealand, the New Zealand electricity market, and consumers.
- 99 Meridian agrees that the EMA is the most appropriate agency to develop an appropriately clear, simple, and less prescriptive Grid Investment Test.

Implementation issues

- 100 An important implementation issue is establishing a framework that allows the EMA to avoid the pitfalls of the current transmission investment framework. These include:
- 100.1 the multiplicity of ways in which the grid is redefined for different regulatory purposes, including core and non-core, connection and interconnection, the definition of the grid for operational purposes and for pricing transmission losses and constraints;
 - 100.2 the artificial separation of reliability and economic considerations;
 - 100.3 an assessment that competition benefits are too hard to factor in;
 - 100.4 an early focus on micro managing transmission investment to quite small differences in benefits, costs and timing (since overcome with the robust materiality threshold introduced into the recently revised GPS); and
 - 100.5 an inability to consider related transmission proposals as a package.
- 101 Meridian also suggests that other, less tangible, benefits should also be considered in the GIT. Examples include operational flexibility benefits, ancillary service and instantaneous reserve benefits. These can be significant and are currently neglected in transmission investment considerations.
- 102 The hard question is how did the current process become so complicated and unwieldy? A key implementation issue will be to identify the incentives that motivated the Electricity Commission to produce such a detailed regime, and ensure the EMA is not put in the same position.
- 103 This highlights the fact that it will not be sufficient to simply give the EMA responsibility for the existing regulations and rules. The EMA must be permitted to develop its own framework, in a setting where it is encouraged and empowered to focus on the big picture and not sweat the detail of transmission investment.
- 104 It will also be important that Transpower progress its work on a transmission strategy. This could provide the platform for the development of a Grid Vision, which has been a significant policy tool in the UK.²

² UK Grid Vision 2009. Our Transmission Network: A Vision for 2020.

Next steps

- 105 Meridian submits that this recommendation could be taken forward in the following way:
 - 105.1 MED to propose amendments to the Electricity Act that empower and incentivise the EMA to develop a GIT that is clearer, simpler, less prescriptive and takes account of wider competition benefits. To avoid a repeat of the experience with the Electricity Commission this is likely to require legislative guidance on the importance of a strong transmission grid and the appropriate level of materiality for regulatory supervision (along the lines of the Government Policy Statement (GPS) on infrastructure investment provided to the Commerce Commission but with greater legal force).
 - 105.2 EMA to prepare and consult on a revised GIT.
- 106 There are also some existing workstreams that could be progressed in the short term:
 - 106.1 Electricity Commission to fast track the rule change that will give effect to the recently revised GPS empowering Transpower to apply the GIT to investments under \$20m without requiring Electricity Commission approval.
 - 106.2 Transpower to finalise its transmission code containing pre-agreed technical standards for assessing grid investment proposals (for example, the types of transformers Transpower will use).
 - 106.3 Transpower to progress development of a transmission strategy with stakeholder input that sets out at a high level, agreement for the strategic direction for New Zealand's transmission system as a whole and by region.

16. Transfer approval of major grid upgrades to the Commerce Commission to ensure integrated consideration of transmission expenditure, performance and prices, subject to rules on service and reliability standards, pricing methodologies and the grid investment test set by the electricity regulator.

Meridian's response

- 107 Meridian supports the proposed separation of roles between the EMA as "rule-maker" and the Commerce Commission as "rule-applier".
- 108 The experience of the Electricity Commission indicates that the EMA will benefit from a more focused role in developing high quality rules.
- 109 This recommendation also recognises that the Commerce Commission has the necessary expertise to perform the role of applying the Grid Investment Test established by the EMA.

Next steps

- 110 Meridian submits that this recommendation could be taken forward by MED proposing amendments to the Electricity Act.

To improve wholesale and retail competition and help restrain prices

17. Subject to further analysis following submissions, restructure SOE assets, by either:
- 17.1 Option One: Create a new SOE generator-retailer comprising the Huntly and Manapouri power stations, and, additionally, transfer Takapo A and B to Genesis and Whirinaki to Meridian.
 - 17.2 Option Two: Transfer the Huntly power station to Solid Energy, the Manapouri station to Genesis and the Whirinaki station to Meridian.
 - 17.3 Option Three: Transfer the e3p and P40 power stations from Genesis to Meridian and the Manapouri power station from Meridian to Genesis.

Meridian's response

- 111 The Minister of Energy at the time of the Preliminary Report's release stated that Ministers had decided that Option One and Two were too costly and risky. As a consequence, Meridian has focused on Option Three.
- 112 The objectives of the asset swap are improved competition in the residential retail sector, and dry year risk management. While the proposed asset swap may achieve those objectives, we are concerned that the costs to New Zealand, once fully assessed, will outweigh the benefits that can be achieved.
- 113 Option Three will likely result in a number of risks that will need to be addressed, for example:
- 113.1 Logistical:
 - (a) Need for Meridian to refinance existing debt (and incur prepayment penalties);
 - (b) Negotiation of RTANZ support contract between Meridian and Genesis;
 - (c) Negotiation of, if required, a gas support contract between Meridian and Genesis;
 - (d) Negotiation of Agreement for Sale and Purchase between Meridian and Genesis;
 - (e) Provision of indemnities to directors of Meridian and Genesis with respect to any potential Companies Act and SOE Act breach; and
 - (f) Need to consider any competition law issues that may arise.
 - 113.2 Cost: cost estimates for achieving the asset swap are more significant than suggested in Table 3 of the Preliminary Report, Volume Two.
 - 113.3 Timing: the practical timetable for completing Option Three would likely be mid 2011. This reflects assumptions regarding the time that will be required to complete due diligence, negotiate terms sheets, and then full agreements, achieve Cabinet approval and satisfy conditions precedent.
- 114 In conclusion, Meridian recognises that the Crown may still choose to pursue an asset swap. So long as an indemnity is provided to directors, Meridian will work to ensure a smooth transition to the new arrangements.
- 115 Meridian is aware that a number of parties have suggested that an alternative asset swap may be more appropriate: swapping Tekapo A and B power stations rather than the Manapouri power station and White Hill wind farm.
- 116 Meridian has not considered this suggestion in detail, but would note that there are a number of hydrological features that would either need to be addressed, or the costs incurred (through a less efficient use of water on the Waitaki Chain) included in any restructuring assessment:
- 116.1 A common scenario involves the temporary over supply of run of river inflow. This Ohau

and/or Ahuriri water is used for generation or spilt, the ability to temporarily reduce Tekapo generation to use this run of river water reduces spill and increases stored water.

116.2 During periods of low demand (particularly over the Christmas break), Tekapo generation is normally shut down. This is unavoidable, as all the available load is generated from Ohau water, Ahuriri water and some Pukaki water to maintain the minimum flow in the Lower Waitaki River.

116.3 Inflow into Lake Pukaki (129 cumecs) is on average higher than Lake Tekapo (81 cumecs). In other words, Lake Tekapo inflows are 63% of Lake Pukaki inflows. However, the available storage in Lake Tekapo is only 30% of Lake Pukaki, so the inflow to storage relationship is quite different. Similarly, there are differences in the maximum canal flows – Tekapo canal maximum is 130 cumecs, whilst Pukaki canal maximum flow is 560 cumecs. This means management of Lake Tekapo levels requires long term planning and certainty. Different operators for Tekapo A and B, relative to the rest of the Waitaki Chain, could lead to a more inefficient operation, increased spill and potentially resource consent breaches.

117 Further details could be provided if this variation is considered further.

Alternative Proposal

118 Meridian has considered whether an alternative to the asset swap proposed here could achieve the Crown's objectives.

119 Meridian agrees that the Preliminary Report makes a number of recommendations that will assist in improving retail competition – transmission hedging, streamlined investment in the transmission grid, standardisation of use of system agreements and tariffs. However, Meridian submits these will not in themselves give a good level of comfort that retail competition will be improved.

120 New Zealand does not have a liquid contracts market. There are a number of instruments that are currently used by participants – over the counter hedges, the Energy Hedge platform, and from July 2009 ASX New Zealand Electricity Futures. With time these instruments and platforms will facilitate New Zealand achieving a liquid contracts market.

121 Meridian supports the development of a compulsory trading requirement on an approved New Zealand electricity futures trading exchange for generators over a certain size. The form or degree of compulsion could vary depending on whether sufficient trades were being made. For example,

121.1 the lowest level of compulsion could be to mandate that each generator, with collective installed capacity of greater than 500MW is required to adhere to a market maker agreement (place 1 MW contract buy and sell in each and every quarter for the open quarters) as negotiated between the trading platform and the generator;

121.2 if this was not sufficient, in addition to 118.1 above, the generator could be required to place a minimum of 5-10MW of contracts, each day, in each and every quarter for the open quarters;

121.3 if this was not sufficient the generator could be required to place a minimum of 2-5% of installed capacity (megawatts) in contracts (net), every day, in each and every quarter for the open quarters.

122 Achieving a liquid contracts market will allow all retailers, new and existing, to acquire hedges to cover their retail risk. New entrant merchant generators will be able to use the platform for trading rather than incur the costs of setting up a retail business.

123 Further, a liquid contracts market can be implemented without material costs and within a short period of time. There are no material negotiations that would need to be concluded in order to implement such a proposal.

- 124 Meridian considers that the combination of a liquid contracts market, alongside financial transmission rights and the other measures proposed in the Preliminary Report will improve retail competition, and particularly facilitate greater competition at the residential level as new entrant retailers and existing retailers have the mechanisms to cover their existing sales positions by fixing their forward costs via the exchange platform.

Next steps

- 125 MED and Treasury to consider further the costs and benefits of the proposed asset swap. Meridian is happy to engage further with officials in this analysis.
- 126 Meridian submits the EMA should consider developing a rule to require generators over a certain size to sign a market maker agreement with an approved New Zealand electricity futures trading exchange.

Retail Competition

18. Introduce, as a priority, a transmission hedging mechanism to assist retailers manage risks created by transmission congestion.

Meridian's response

- 127 Meridian supports the introduction of a transmission hedging mechanism and agrees with the Preliminary Report's findings that such a mechanism is overdue in New Zealand.
- 128 In this context it is appropriate to recall, however, that an appropriate transmission hedging mechanism should be developed recognising that the most effective way of mitigating transmission risk is to ensure appropriate transmission investment. For this reason, the improvements to the GIT process discussed above are a priority.

Implementation issues

- 129 Decisions need to be made around what kind of mechanism could be used. We understand that Transpower has been working on a Financial Transmission Right (**FTR**) proposal, and we are broadly supportive of Transpower's work in this area.
- 130 The proposal to develop a transmission hedging mechanism has strong links to other issues addressed by the Preliminary Report. For example, the Transmission Pricing Methodology is a critical component to this topic (and in particular the treatment of transmission rentals). Any move away from New Zealand's current nodal pricing framework will have an impact on the design, and ultimately the need for FTRs.
- 131 While Meridian is supportive of this recommendation, we note there is a question around whether the introduction of a transmission hedging mechanism will be sufficient to lower the barriers to entry in the retail market. Meridian submits that introducing transmission hedges could be considered in conjunction with a mandatory wholesale price hedge product to enable retailers to manage their wholesale risk in addition to their transmission risk.

Next steps

- 132 Meridian submits that this recommendation could be taken forward by the EMA consulting on and implementing rules establishing a transmission hedging mechanism.
- 133 In addition, the EMA should consider developing a rule to require generators over a certain size to enter into market making agreements with an approved New Zealand electricity futures trading exchange.

19. Facilitate greater demand-side participation in the wholesale market, including providing for:
 - 19.1 More accurate forecasting of spot prices.
 - 19.2 Real-time (not ex post) spot prices.
 - 19.3 Demand response to be dispatched in the same way as generation.

Meridian's response

- 134 Meridian supports these recommendations and we are hopeful that these developments will be available following the upgrade of the System Operator's IT systems.

Next steps

- 135 Meridian submits that this recommendation could be taken forward by the EMA consulting on and implementing the appropriate rules.

20. Allow lines companies to provide electricity retailing services in their local areas subject to:

20.1 Retaining the existing provisions in the Electricity Industry Reform Act that:

- Require corporate separation and compliance with arms-length rules between lines and energy (generation and retailing) businesses.
- Require lines companies to put in place transparent and non-discriminatory use-of-system agreements with their retail business.
- Have the effect of prohibiting common ownership between lines businesses and generators owning more than 100MW of generation connected to the national grid.

Meridian's response

136 Meridian agrees that removing the cap on retail volume will enhance the ability of lines companies to compete in retail markets.

Implementation issues

137 However, removing this cap in itself is likely to provide insufficient incentive for lines companies to provide a significant volume of retail services in their local areas – they will be as reluctant as any other company to establish a “long” position in the current retail market.

138 For this reason, developing a liquid hedge market will be important in order to increase retail competition, as discussed in our response to Recommendation 17. This reduces the barriers to entry and expansion faced by lines companies in the retail markets.

139 If the market rules can be changed to incentivise the lines companies to compete in retail, then the policy concerns with retail activities by lines companies that are currently addressed by the Electricity Industry Reform Act (**EIRA**) will have to be addressed a different way. Specifically, lines companies have an incentive to leverage off their competitive advantage as a lines business, being access to detailed usage information, and target the most profitable customers. In other words, to use the information gained as a lines business to cherry pick as a retailer.

140 To ameliorate this issue, Meridian suggests a requirement on lines businesses that a certain percentage of their retail base be mass market/household consumers. This will lessen the market power concerns, and also ensure that any increase in competition by lines companies flows through to household consumers and not just industrial consumers.

Next steps

141 Meridian submits that this recommendation could be taken forward by MED proposing amendments to the EIRA.

20.2 Prohibiting a retail business owned by a lines business from buying the customer base of an existing retailer (to ensure there is a net increase in retail competition).

Meridian's response

142 Meridian agrees that this would be sensible if the objective is for lines companies to increase competition in retail markets.

Implementation issue

143 Consideration may need to be given to the situation where a retailer has made a decision to exit a region (in the worst case scenario, in circumstances of financial distress). In such a scenario nothing is gained by preventing the lines company from purchasing the retail book, and the exiting retailer is potentially harmed. For this reason, this prohibition could be made subject to an opportunity to convince the Commerce Commission that the retailer wishing to sell would exit the region under any counterfactual.

Next steps

144 Meridian submits that this recommendation could be taken forward by MED proposing amendments to the EIRA.

21. Develop more standardised tariff structures and business rules for use-of-system agreements for lines businesses to facilitate access by retailers.

Meridian's response

- 145 Meridian supports this recommendation.
- 146 Meridian is a national retailer, retailing in every network in New Zealand. At the moment, due to multiple different use-of-system agreements with each distribution company, multiple load groups, and the low fixed charge regulations, we have over 2,000 tariffs. We welcome any rationalisation of tariff structures, business rules and use-of-system agreements across lines companies, and we are confident this will lower the barriers to retail competition.

Implementation issues

- 147 A key issue in this area has been the non-mandatory nature of the policy and the rules. Until now, the concerns with the multiplicity of use-of-system agreements (**UoSAs**) and tariff structures has been addressed by consulting on "model" UoSAs, and exhorting lines companies to adopt the UoSA.
- 148 This approach has been in place for several years. Meridian submits it is time for a stocktake. This should involve an effort to establish the facts, and a deadline for real progress.
- 149 Meridian submits a way forward is:
- 149.1 MED to conduct a survey on the current use of the model UoSA – who offers the agreement, who accepts it;
 - 149.2 monitoring and reporting of take up of the model UoSA between now and December 2010; and
 - 149.3 a decision made in December 2010 as to whether a mandatory model UoSA is required.
- 150 This should be coordinated with the current review of the low fixed charges regulations and the model approaches to distribution pricing.

Next steps

- 151 Meridian submits that this recommendation could be taken forward in the following way:
- 151.1 MED conducting the survey discussed above;
 - 151.2 the EMA monitoring take up of the model UoSA; and
 - 151.3 the EMA making a decision in December 2010 on the regulation of a model UoSA.

22. Ensure that guidelines and standards on smart meters provide for (or allow upgrades for) energy efficiency capability, open access communications, customer switching, and the development of smart networks.

Meridian's response

- 152 Meridian supports the establishment of guidelines in this area.

Implementation issues

- 153 We note that the current Electricity Commission guidelines for smart meters meet the objectives of this recommendation, by providing for or allowing upgrades for energy efficiency capability, open access communications, customer switching, and the development of smart networks. For this reason, the current guidelines would be a good place to start in terms of developing guidelines and standards going forward.
- 154 To the extent that a "standard" is intended to be more mandatory or directive than a guideline, Meridian does not favour the use of standards in this market at this time. A preferred technology standard has not emerged in any country. There would be a risk for the Government in regulating a smart meter standard at this point, as it may regulate a standard that is a technological dead-end. For this reason guidelines and standards should be set in terms of outcomes rather than technologies.

Next steps

- 155 Meridian submits that this recommendation could be taken forward by the EMA reviewing the Electricity Commission guidelines regularly, and monitoring market outcomes.

23. Encourage retailers to make tariffs available, as an option for consumers, that provide incentives to better manage electricity consumption including through shifting load to off-peak times and conservation during dry years.

Meridian's response

- 156 Meridian supports this recommendation.

Implementation issue

- 157 This recommendation will rely on smart meter infrastructure. In Christchurch, where the smart meter roll-out is complete, Powershop launched a smart tariff on 24 August 2009. Meridian launched its 'weekender tariff' on 14 September 2009 for customers on the Orion network. We expect more smart tariffs and products to emerge over the next twelve to eighteen months.
- 158 This recommendation appears to be focussed on residential customers. SME and small industrial consumers often have greater capacity to shift load, and will receive potentially greater benefit from shifting load. Broadening the focus of this recommendation to include SME and small industrial consumers as well as residential consumers will be useful.

Next steps

- 159 As smart meter infrastructure is rolled out across the retail market, retailers will compete to offer innovative tariffs. The key here is to facilitate the roll out of smart meter infrastructure. Once that is in place, retailers have strong incentives to make innovative tariff options available to stay competitive in the eyes of their customers. Meridian submits that no directive regulation is needed, or feasible, at this stage. It would most likely impose costs and stifle innovation at the expense of consumers.
- 160 MED and the EMA can monitor market outcomes.

24. Ensure that all wholesale market data is publicly released the following day to improve scrutiny of and by market participants.

Meridian's response

161 Meridian supports this recommendation.

Implementation issue

162 In the past, immediate release of wholesale market data has raised competition law questions as to whether this near-real time information would facilitate tacit collusion, and changes in market rules to allow quicker release of wholesale market data have been scrutinised by the Commerce Commission. It would be prudent to have the Commerce Commission or another competition law expert check the effects of following day release.

Next steps

163 Meridian submits that this recommendation could be taken forward in the following way:

163.1 EMA developing an appropriate draft rule.

163.2 The Commerce Commission advising on the competition effects, if any, of the draft rule.

25. Encourage and facilitate customer switching through:

- 25.1 Providing \$5 million a year, from electricity levy funding, to promote the benefits of customer switching. The fund should be contestable, and should continue for as long as demonstrated benefits, in terms of savings to consumers, exceed \$10 million a year.

Meridian's response

164 Meridian supports this recommendation.

Next steps

165 Meridian submits that this recommendation could be taken forward by the Ministry of Consumer Affairs (**MoCA**) preparing a detailed proposal for the fund. In doing so, MoCA could refer to the work of the Retail Market Advisory Group.

25.2 Shortening the timeframe for switching between retailers from 23 days to three days for customers with smart meters.

Meridian's response

166 Meridian supports this recommendation. Meridian further suggests that there is no reason why three day switching should be limited to smart meter customers. More than 90% of customers with regular meters can be switched within three days.

Implementation issue

167 Powershop has requested a rule-change with the Electricity Commission to create a rule that would require 90% of switches to be completed within three days. Meridian recommends that this rule change be expedited. With appropriate prioritisation, a three day switching rule could be completed by the Electricity Commission within several weeks.

Next steps

168 Meridian submits that this recommendation could be taken forward in the following way:

- 168.1 The Electricity Commission prioritising this request for a rule change and implementing a new rule this year.
- 168.2 MED considering any interaction with the Door to Door Sales Act, and the seven day cooling off period provided for in that Act.

25.3 Improving the Powerswitch website by requiring retailers to provide updated information to improve its accuracy and coverage.

Meridian's response

169 Meridian supports this recommendation.

Implementation issues

170 We do note that smart tariffs and other products that provide incentives for customers to move load to off-peak times (Recommendation 23) will make comparison of prices on the Powerswitch site more complicated. Indeed, Powerswitch is already unable to compare Powershop tariffs and Meridian's weekender tariffs with other tariffs in the market.

171 Powerswitch will need suitable resource to develop a tool that can usefully compare different smart tariffs.

Next steps

- 172 Meridian submits that this recommendation could be taken forward by Consumer NZ, the owner of the Powerswitch Website, scoping the proposed changes and submitting a proposal to MED for funding.

To improve governance

26. Replace the Electricity Commission with an Electricity Market Authority (EMA) as follows:

26.1 The EMA would be an Independent Crown Entity under the Crown Entities Act 2004.

Meridian's response

173 Meridian supports Recommendation 26.1.

Next steps

174 Meridian submits that this Recommendation should be taken forward by MED proposing amendments to the Electricity Act.

26.2 The EMA's objective would be to ensure the efficiency of the electricity market, including reliability, for the long-term benefit of consumers.

Meridian's response

175 Meridian supports this recommendation.

176 We note that there is a deliberate narrowing of the objectives of the EMA from those established for the Electricity Commission. These new objectives are "ensuring the efficiency of the market, including reliability, for the long-term benefit of consumers". Current Electricity Commission objectives are "Efficient, fair, reliable and environmentally sustainable"; fairness and sustainability objectives have been removed from the EMA and given to other agencies. Meridian agrees with these changes.

177 The Preliminary Report notes that the Commerce Commission would have responsibility for competition, EECA would have responsibility for energy efficiency, and environmental objectives would be pursued through the Resource Management Act and climate change policy. Fairness issues would be addressed through powers of the Minister of Energy and Resources to regulate (on advice from MED). Meridian agrees with this allocation of responsibilities.

Implementation issues

178 Replacing the Electricity Commission with an Independent Crown Entity raises the question of what to do with the current Government Policy Statement.

179 The current GPS would be inappropriate in the new context. It is essentially a list of specific changes that the Electricity Commission is required to make, given it must "give effect" to any GPS. In contrast, the EMA must only "have regard" to a GPS. This is likely to drive a GPS that is different in form and substance from the GPS today, focusing more on long term policy objectives than a task sheet of required changes.

180 Meridian submits that a new GPS will be a useful tool, but that it needs to articulate the long term policy objectives in the sector and will be quite different from the GPS today.

Next steps

181 Meridian submits that this recommendation could be taken forward by MED proposing amendments to the Electricity Act and a new GPS being consulted on.

26.3 Board members would be appointed by the Governor-General on the recommendation of the Minister of Energy and Resources, and nominated as follows:

- Two members nominated by Consumer New Zealand and Business New Zealand respectively.

- One member nominated by generators and retailers.
- One member nominated by lines businesses including Transpower.
- One member and an independent chair nominated by the Minister.

Meridian's response

182 Meridian requests clarification of this recommendation.

183 It is not clear how the nomination by stakeholder groups is intended to work. Using generators and retailers as an example, is it intended that:

183.1 generators and retailers will agree on a nominee, who the Minister will recommend for appointment by the Governor-General; or

183.2 generators and retailers would agree to nominate a number of nominees from which the Minister will recommend one for appointment; or

183.3 generators and retailers would each nominate their own nominee from which the Minister will recommend one for appointment?

Implementation issues

184 Meridian submits there are two broad implementation issues. First, and most practically, it may not be the most efficient option to leave it to the various stakeholder groups to settle on the process for how they arrive at a nomination. It may be more practical to prescribe nomination processes in regulations.

185 Second, care will need to be taken to ensure that this stakeholder approach to appointing members to the board does not undermine the independence of or confidence in the board.

186 Care should also be taken that the stakeholder nomination model does not undermine the capability of the EMA board. An important issue is the level of skills and mix of skills of board members. This cannot be left to the uncoordinated nominations of various stakeholder groups.

187 For this reason Meridian submits there must be an explicit point in the process where the Minister turns his or her mind to the issue of the desirable mix of skills on the board, takes advice on this issue, and makes his or her recommendations on that basis.

188 One way to achieve this would be to utilise the knowledge of stakeholder groups to build up a database or pool of suitable qualified board members, from which, as a separate exercise, the Minister selects an appropriate board or replacement director.

189 The issue of independence can probably be adequately addressed by setting criteria for the independence of nominees, and prescribing that all board members are required to exercise independent judgment. That said the stakeholder nomination approach to setting the board will inevitably undermine the perception of the independence of the EMA, and to that extent is a curious choice given the move to adopting an Independent Crown Entity model.

Next steps

190 Meridian submits that this Recommendation should be taken forward by MED proposing amendments to the Electricity Act that include provision for regulations to govern the nominating procedures for EMA board members.

26.4 The Minister would only be able to recommend appointments of persons nominated by market participants (as applicable), but would not be required to accept any particular nomination. Criteria for members would be set down in legislation (such as independence, expertise, and ability to work as a Board member).

Meridian response

191 Meridian supports this recommendation. It is important that the members do have sufficient

independence and expertise. This issue is discussed above.

Next steps

- 192 Meridian submits that this Recommendation should be taken forward by MED proposing amendments to the Electricity Act that include provision for regulations to govern the nominating procedures for EMA board members.

26.5 The functions of the EMA would be:

- Developing and approving market rules (including guidelines and model contracts).
- Monitoring compliance with rules and, through a Rulings Panel, penalising breaches.

Meridian's response

- 193 Meridian agrees with the recommendation for a more focused regulator. For the sake of clarification, we assume that the Advisory Group and MED accept that the EMA's enforcement role excludes enforcement of the Grid Investment Test.
- 194 Although we are concerned that the EMA will retain a degree of role conflict that troubled the Electricity Commission – i.e. an enforcement role as well as a rule-making one - in the scheme of things it is probably an appropriate compromise.
- 195 Meridian submits it would be appropriate for the EMA to have the explicit function of monitoring the performance of the market rules, the performance of the market, and engaging stakeholders on the future needs of the market. This should be a proactive and practical role, engaging market participants on trends and issues outside of any specific regulatory process.

Implementation issue

- 196 There are potentially some interesting implementation issues. Chief among them are:
- 196.1 whether the EMA wishes to adopt the current set of regulations and rules;
- 196.2 whether the EMA can do so, given these regulations and rules were developed to be consistent with a purpose statement that is different from the purpose statement that will set the legal test for the EMA;
- 196.3 whether an EMA establishment group will be required, and if so consulting on what that group will do now and what it will leave for the EMA to do;
- 196.4 determining the relationship of any such EMA Establishment Unit and the Electricity Commission (as the Electricity Commission will have an ongoing role until either its GPS is changed or legislative amendments take effect).
- 196.5 once the transition to the EMA is complete, going forward whether the current framework for rule changes that the Electricity Commission must work to – including selection of alternatives and the cost benefit assessment – is optional.

Next steps

- 197 Meridian submits that this recommendation could be taken forward by MED consulting on the implementation issues discussed above prior to preparing amendments to the Electricity Act.

26.6 The EMA would be required to set up working groups to prepare proposed rules, and the board would be required to hear representations on proposed rules from the chair of working groups before making decisions.

Meridian's response

- 198 Meridian agrees there is real value in establishing a structure where the industry can inform the rules (using that term in its widest sense) set by the regulator. A lot of the rules are technical and

do not raise issues of consumer protection or competition, but instead go to the efficient functioning of the market. The industry has a real role to play in contributing to the ongoing improvement of these market-making rules in particular.

- 199 Meridian also agrees that the EMA should be given a discretion to set up a much more effective structure to capture industry expertise and energy.

Implementation issues

- 200 We agree that the Electricity Commission working group structure was not a success. We have previously suggested improvements to the working group framework and it will be important that the lessons over the last five years inform the way forward.

- 201 For example, Meridian has made the following suggestions:

201.1 require working groups to produce a strategic plan for the subsequent 18-24 month period prior to the Electricity Commission's work-planning process;

201.2 give working groups a clear mandate to make recommendations to the Electricity Commission's Board (with the Electricity Commission to retain discretion to accept or reject those recommendations);

201.3 working groups should be invited to present all of their recommendations to the Electricity Commission's Board;

201.4 Board members should regularly attend working group meetings;

201.5 senior advisors or appropriate delegates from other working groups should provide a short update on the work programmes of their group to each other; and

201.6 working groups should invite other working groups to attend meetings where there are matters of common interest.

- 202 These points will apply equally to the EMA structure going forward.

- 203 The focus on regulator-established working groups is also too narrow. Whether the structure for developing rules goes by the label of working group is less important than getting the key features right. Key features would include:

203.1 tangible co-ownership of the rules. Regulation is not something that is done "to" the industry; it is the framework for market performance and something the industry participants care about;

203.2 proposals or input from the industry should not be viewed with suspicion, and onerous processes are unnecessary;

203.3 in particular, where a proposal has no consumer protection or competition implications, then the interests of the regulator are limited to checking the process involves industry expertise and consultation, rather than second-guessing the substance of the rule.

- 204 In short, the EMA should not feel constrained to any particular working group structure so long as it is satisfied that a rule change proposal has come from a group that:

204.1 is sufficiently expert having had regard to the nature of the rule; and

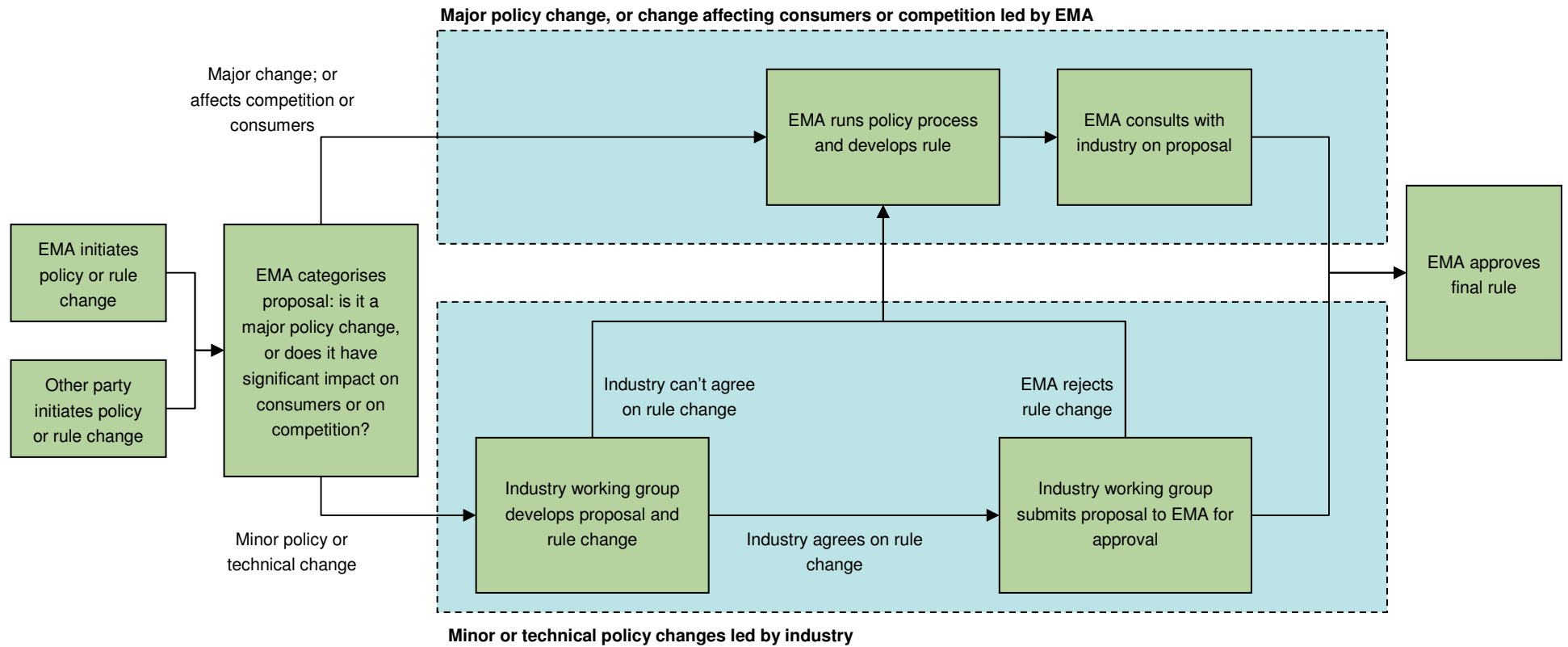
204.2 has consulted appropriately.

- 205 The Electricity Act should explicitly grant the EMA this flexibility, to put the process concerns beyond doubt. The ability of the EMA to focus on expertise and consultation rather than structure and bureaucracy could be a significant gain in efficient rule making. For example, only a select group of New Zealanders truly understand common quality issues. If such a group offers up an amendment to a common quality rule, and there has been an appropriate consultation process (perhaps under the auspices of the SRC), the default should be to accept the proposal. This is only one example. There will be a number of other areas where the EMA can efficiently leverage

off industry expertise outside of a formal working group structure.

206 For these reasons, Meridian proposes that a fast-track rule change process be adopted along the following lines:

Fast Track Model for Electricity Governance



Next steps

- 207 Meridian understands that this recommendation could be taken forward in the following way:
 - 207.1 MED to propose amendments to the Electricity Act that empower the EMA to make maximum use of industry input, clarifying that the EMA has significant flexibility in the way that it satisfies itself of the key issues of expertise and consultation.
 - 207.2 EMA to establish a working group framework that draws on the lessons learned over the last 5 years.

27. Transfer approval of major grid upgrades to the Commerce Commission as part of its overall regulation of Transpower under Part 4 of the Commerce Act, but with reliability and service standards, transmission pricing methodologies, and the Grid Investment Test set by the EMA.

Meridian's response

- 208 Meridian supports this recommendation. We think there is real value in clearly focusing the EMA's mandate on developing and implementing rules and the Commerce Commission's mandate on applying the Grid Investment Test. This is consistent with the appropriate allocation of functions to the body most expert to deal with them.
- 209 The Commerce Commission is better equipped to make cost-benefit assessments applicable under the Grid Investment Test. But for more technical decisions (for example, around common quality, etc), the EMA will be the appropriate decision-making body. We agree with the principle of allocating different functions to the most appropriate body.
- 210 Recommendation 27 recognises that the clear division of rule-making and rule-applying responsibilities is important. A rule-maker who will not be responsible for applying the rules it makes will be incentivised to make its rules clear and prescriptive to ensure they are applied in the manner anticipated by the rule-maker. The result will be clarity for both the rule-applier and market participants, and a limited scope for the rule-applier to engage in policy issues. The division of rule-making and rule-applying responsibilities between the Australian Energy Market Commission and Australian Energy Regulator works well in this respect and provides a useful comparator.

Next steps

- 211 Meridian submits that this Recommendation could be taken forward by MED proposing appropriate amendments to the Electricity Act and if needed the Commerce Act.

28. Transfer the following functions to the System Operator:

28.1 Information and forecasting on security of supply. Long term forecasting, and preparation of the 'Statement of Opportunities' would be undertaken by MED alongside its preparation of the Energy Outlook.

Meridian's response

212 Meridian notes that there are two recommendations proposed in this recommendation. The first is that forecasting security of supply be transferred to the System Operator, and the second is that preparation of the Statement of Opportunities and Energy Outlook be undertaken by MED. Meridian agrees with both of these recommendations.

Implementation issues

213 To the extent that the Statement of Opportunities (**SOO**) can help identify a genuine gap between demand and supply, the SOO is a useful forecasting tool. However, the identification of discrete commercial opportunities within any demand/supply gap should be left to market participants. The SOO should not, therefore, prescribe these. That approach is more likely to result in efficient and strategic investment over time and the delivery of better outcomes for consumers. It is also consistent with the Australian SOO model, which "is intended to assist existing and potential National Electricity Market (NEM) participants when assessing the future need for:

213.1 electricity supply capacity;

213.2 demand-side participation; and

213.3 transmission network augmentation in support of NEM operations."³

Next steps

214 Meridian submits that this recommendation could be implemented by:

214.1 The System Operator consulting on the way it will provide information and forecast security of supply.

214.2 MED consulting on how it will undertake its long term forecasting function, together with the preparation of the SOO and Energy Outlook.

28.2 Emergency management.

Meridian's response

215 Recommendation 28.2 recommends that the function of emergency management be transferred to the System Operator.

216 Meridian agrees that when an emergency is called by the Minister (as discussed in our response to Recommendation 3), the System Operator will be best placed to manage the emergency.

Next steps

217 Meridian submits that this recommendation could be taken forward by MED proposing amendments to the Electricity Act.

³ Australia's National Electricity Market Statement of Opportunities 2008, page 2.

28.3 Operation of reserve energy (if retained).

Meridian's response

218 As discussed in our response to Recommendation 4, Meridian supports the phasing out of the reserve energy scheme.

Next steps

219 If a decision is made that the reserve energy mechanism is to be retained in some form, then Meridian submits MED should consult further on who should operate the scheme, having regard to its design going forward.

28.4 Contracting for market operations (for example, market clearance and reconciliation) pursuant to rules set by the EMA.

Meridian's response

220 Meridian notes that this recommendation signals a significant change from the current regime, whereby the procurement/tendering function will move from the neutral regulator to the System Operator (which is itself a service provider).

Implementation issues

221 Important in the implementation of this recommendation will be establishing a way of ensuring that these service provider contracts are let on efficient terms. This may require:

221.1 the EMA or Commerce Commission setting standards or processes for contestable tenders that the System Operator must follow when letting these contracts. This will provide industry participants with a certain level of comfort that the System Operator is incurring costs in the most efficient manner; or

221.2 that the Commerce Commission second-guess the efficiency of the contract terms on review (though we think this option is less desirable).

222 Competition issues will also need to be addressed. In the past, a subsidiary of Transpower has competed for these service contracts and provided important competitive tension. If the contracts are now to be tendered by the System Operator then robust Chinese Wall arrangements will be required to preserve that tension.

223 A further question that will need to be addressed is how the System Operator will recover the cost of processing these services. Some options include:

223.1 recovering the cost by including it in Transpower's Transmission Pricing Methodology (although this has the potential to blur the boundary between Transpower as transmission services provider and Transpower's role as System Operator);

223.2 giving the System Operator a levying power, which would be unusual for a "private" party to have; or

223.3 requiring the EMA to levy industry participants on behalf of the System Operator (effectively including these costs in its general levy process).

224 We think the best way forward would be:

224.1 to have clear rules that ensure market operation services are procured by the System Operator through a contestable tender process, and on this basis,

224.2 to focus on recovering the costs of procuring those services from industry participants with the least transaction costs. This may be achieved most simply by leveraging off the EMA

levy process but with separate reporting of these costs for transparency.

Next steps

- 225 Meridian submits that this recommendation could be taken forward by MED proposing amendments to the Electricity Act.

29. Require the EMA to set up and service a Security and Reliability Council, comprising senior level persons from the electricity market, to meet periodically to help monitor and provide advice on the System Operator's performance of its functions and on security of supply issues generally.

Meridian's response

- 226 Meridian agrees that the proposal for an expert Security and Reliability Council (**SRC**) has value on the basis of two assumptions:
- 226.1 the SRC will fill an identifiable expertise and capability gap in the industry governance framework; and
- 226.2 the parties who receive advice from the SRC remain solely accountable for the decisions they make.
- 227 If either of these assumptions is missing, the SRC will pose a real risk to good governance in the sector.

Implementation issues

- 228 The success of the new industry governance regime will rely on there being clear roles, responsibilities and accountabilities. Consequently, it will need to be very clear that the Security and Reliability Council has an advisory role only and that other decision-makers are ultimately responsible for the decisions they make.
- 229 In terms of the composition of the SRC, there is a question around how to secure members that are both expert and independent. This may come down to a choice between senior level persons with current roles in the industry or retired industry leaders. Given the importance of independence in performing the advisory role of the SRC, Meridian supports the latter.
- 230 Securing the expertise, experience and independence of the SRC's members will rely on an appropriate appointment process. The Preliminary Report proposes that members of the SRC would be appointed by the EMA after seeking nominations from stakeholders, and that members would be required to have technical expertise in transmission, forecasting and security of supply.
- 231 Similar to our response to Recommendation 26.3, there is a need here for clarity around the process by which "stakeholders" (who qualifies?) will nominate people to the EMA and how the EMA will then select the SRC members from those nominations. We have already identified the potential for stakeholder nominations to undermine the perception of the independence and the appropriate balance of skills and skill-levels. We think that building up a pool of suitably qualified members from which the EMA shall select the SRC would be a good way to protect the perception and reality of the independence and capability of the SRC.

Next steps

- 232 Meridian submits that this Recommendation could be taken forward by MED proposing amendments to the Electricity Act that make it clear:
- 232.1 the SRC has an advisory role only and recipients of the SRC advice remain accountable for decisions; and
- 232.2 members of the SRC must be independent of any involvement in current market activity.