13 July 2015

Submissions
Electricity Authority
Via email submissions@ea.govt.nz

HVDC component of Transpower's proposed variation to the Transmission Pricing Methodology

Meridian welcomes the opportunity to provide feedback on the Electricity Authority's consultation paper "HVDC component of Transpower's proposed variation to the Transmission Pricing Methodology".

In previous submissions, Meridian has characterised the "per MWh" allocation as a "least-worst" solution. That is, our view has been that choosing between allocators within the current TPM guidelines cannot resolve the fundamental distortions and adverse competition, dynamic efficiency, and durability implications from levying the HVDC charge on South Island generators.

These concerns aside, the Authority/Transpower has done a good job on the Code alterations to make the best of the proposed "least-worst" solution by the way the transition from current to proposed arrangements is handled. While we do not generally favour blending old and new charges (due to the potentially confused price signals), we consider that no issues should arise in this particular context.

Please contact me if you would like to discuss any of these matters further.

Yours sincerely,

Dr Andrew Kerr
Regulatory Affairs Manager

DDI **04 382 7411**
Mobile **021 443 059**
Email **andrew.kerr@meridianenergy.co.nz**

Question	Meridian comment
Q1. Do you have any comments on the problem definition?	Meridian agrees that there are adverse efficiency impacts from the allocation of the HVDC costs to a limited subset of the beneficiaries. These inefficiencies are real and cannot be remedied within the existing TPM guidelines, as noted in 3.1.5. The "per MWh" allocation is therefore no more durable than the current approach. Because New Zealand has a national wholesale market for electricity, and is progressing towards national markets in ancillary services, the distortions are not limited to South Island generation – they distort the pricing signals and relative costs (and therefore competition) across numerous markets in the electricity system. Moving from a HAMI to a per MWh allocation does not solve these problems. In particular, the proposal does not address the distorted investment signals on generation between the North and South Islands, competition impacts on generation between the islands (and welfare impacts that result), nor the durability issues that result from an administrative charge that does not have a robust framework for allocation. As a concrete example, when Transpower upgraded the HVDC link in 2014 it added new controls that transfer, share and manage frequency keeping across the HVDC link. Significant reductions in frequency keeping costs have resulted, and these are passed on to spot market purchasers and end-use customers. This is a good outcome for the industry. However, the <u>cost</u> of that capability is paid for by South Island generators under the existing TPM (regardless of the allocation mechanism). A similar logic would apply for the reserve sharing facility on the HVDC link which the Authority expects to be available in the third quarter of 2015, with a national instantaneous reserve market operational by 2017. Changing the allocation of HVDC charges from one form to another does not remedy the mismatch been cost and benefit. The per MWh allocation is not efficient or durable relative to the other options being considered in the Authority's full review of the TPM.
Q2. Do you consider that the proposal is preferable to the status quo and other options? If not, please explain your preferred option in terms consistent with the Authority's statutory objective.	Meridian agrees that the proposal is probably better than status quo and should probably proceed. However, we have a number of concerns with the analysis. First, the assessment fails to accurately characterise the distortions created by the current HVDC charge and also overstates the potential benefits. With reference to [4.4.3] of the paper:

Meridian Energy Limited

Level 1, 33 Customhouse Quay
PO Box 10-840
Wellington 6143

Phone +64-4 381 1200
Fax +64-4 381 1272
www.meridianenergy.co.nz

New Zealand

Question	Meridian comment
Q3. Do you consider that the proposal complies with section 32(1) of the Act, and with the Code amendment principles, and should therefore proceed?	- The only real benefit from the per MWh proposal is that some South Island plant can be offered at full capacity without dispensation. - The benefits referred to in 4.4.3(a) and 4.4.3(b) are not quantified and we do not consider that identification of the positive impact on a particular generation technology is relevant when there are other technologies that would face a negative impact. - Even if the proposed approach results in costs being lower than they are presently for some generators (solely due to the impact of different generation asset ownership shares), the significant distortion on investment signals for <u>all</u> South Island plant remains in place. The costs of a South Island generation options are stated as being around \$7/MWh, while the same plant positioned in the North Island faces a cost of \$0/MWh, yet both options can earn generation revenue from the same wholesale market. Secondly, adopting this proposal will merely bring forward a subset of the potential gains from the Authority's full TPM review. This benefit also needs to be weighed against the costs of two rounds of changes (bearing in mind that a new TPM is likely to be implemented when the proposed SIMI charge is only half in place), potential delays to the main review process and the risk that the reform from the main review process is watered down as a result of this tinkering. As we have previously submitted, this dynamic is not reflected in the cost benefit analysis. Thirdly, the analysis fails to properly recognise that the per MWh charge will perpetuate most of the current problems with the HVDC charges. That is, Table 2 at [4.7.2] focuses on the promotion of competition, reliability and efficiency relative to the status quo. We observe that, relative to a full review, the table could be re-written to say that the proposed amendments will continue to distort competition, reduce reliability and hinder dynamic efficiency by imposing a cost on South Island plant relative to North Island plant.
Q4. Do you have any comments on the drafting of the proposal?	Clauses 34(2)(d) and 34(12) may need to refer to SIMI.