

John Rampton, General Manager Market Design
Electricity Authority
PO Box 10041
Wellington

8 August 2017

Dear John

Draft decision on Top Energy application for exemption from arm's-length rules

Thank you for the opportunity to comment on the Authority's draft decision in relation to the expansion of the Ngawha power station. No part of our submission is confidential. Mercury also supports the comments in the submission from the Electricity Retailers Association of New Zealand.

The Authority is considering two separate applications from Top Energy, an application for an exemption from compliance with rules 9 and 10 of Schedule 3 of the Electricity Industry Act 2010 in respect of the Ngawha power station from 32MW to 64MW and an application to install and operate an additional 26 MW of diesel generation for network support purposes. While our comments relate to the former application they would apply to the latter application as well.

The Authority's draft decision to grant the exemption will enable cross-governance of the Top Energy and Ngawha Generation Limited with the arm's length rules in Schedule 3 continuing to apply. The Authority considers that cross-governance will not adversely affect the local generation market, the national wholesale market or the emerging market for network support services. It also considers any adverse effects on the retail market can be addressed by a condition in the proposed exemption which prevents the two entities from selling electricity to customers connected to Top Energy's distribution network. A key factor in the Authority decision is its view that if the exemption is not granted Top Energy would proceed with the expansion and incur the cost of separate governance.

Mercury opposes allowing Top Energy to exceed the current 50MW threshold which we consider was increased from 10MW in 2010 after considerable analysis and debate and was designed to provide a "bright line" to ensure investor certainty and a strict legal safety net to prevent inefficient, anti-competitive cross-subsidisation. In our view any exemption would need to be minor in scale and for less than a 10 year period given market conditions are changing rapidly.

The 50MW threshold is in our view on the generous side in 2017 given the current trend towards smaller-scale, locally distributed energy resources driven by changes in cost structures, demand forecasts and the widespread availability of new technology. These changes mean unit sizes of generation and storage options are getting smaller and more cost effective. There is a material risk that monopoly distributors will use their regulated revenue to compete in other markets such as retail. Mercury is not satisfied that the Authority has given sufficient consideration to the reasons for the 50MW threshold.

In our view there is a significant risk that the draft decision will undermine investor certainty and has the potential to undermine retail market completion. Mercury is also concerned that the granting of this exemption would create a



precedent for future applications from network companies using similar reasoning which could further undermine the effectiveness of the regime.

In addition we do not believe that the Authority has given adequate consideration to the impacts of the proposed exemption on retail competition outside the local Northland retail market. The proposed exemption only limits Top Energy from retailing on their own network, there is no restriction as far as we are aware of that prevents retailing elsewhere.

With respect the impacts on the network services market we note that the Authority appears to believe that Ngawha power station needs to be upgraded to provide network support during outages and that this is a remote possibility. The draft decision ponders whether the work necessary to provide voltage support could be done by Top Energy engineers thereby creating a cross-subsidy. However, the Top Energy exemption application contains information that shows the station will immediately have the capability to provide both local voltage support during outages and voltage support to the national grid. This means that in the absence of the maintenance of the bright line 50KW threshold and full arms-length rules in place Top Energy will have the ability to potentially favour Ngawha power station and crowd out other suppliers of these network services. For example battery suppliers or owners of other power stations who may be able to provide voltage support to Transpower.

Finally, we are of the view that the belief that Top Energy and Ngawha Generation Limited will likely go ahead with the expansion regardless of whether the exemption is granted and incur the costs of separate governance is not necessarily correct and nor is it a relevant consideration, far more important are the issues raised above.

If you have any questions regarding this submission please contact nick.wilson@mercury.co.nz 09 5803623.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Nick Wilson', written over a horizontal line.

Nick Wilson
Manager Government and Regulatory Affairs

