



**Submission on the Draft Government
Policy Statement on Electricity Governance
– February 2009**

From

Contact Energy Limited

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To:
Electricity Group
Energy & Communications Branch
Ministry of Economic Development
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By email to: electricity@med.govt.nz

This is a submission on the Draft Government Policy Statement on Electricity Governance – February 2009 (“Draft GPS”) by Contact Energy Limited (“Contact”).

This submission relates to all objectives and policies in the Draft GPS.

For any questions related to this submission, please contact:

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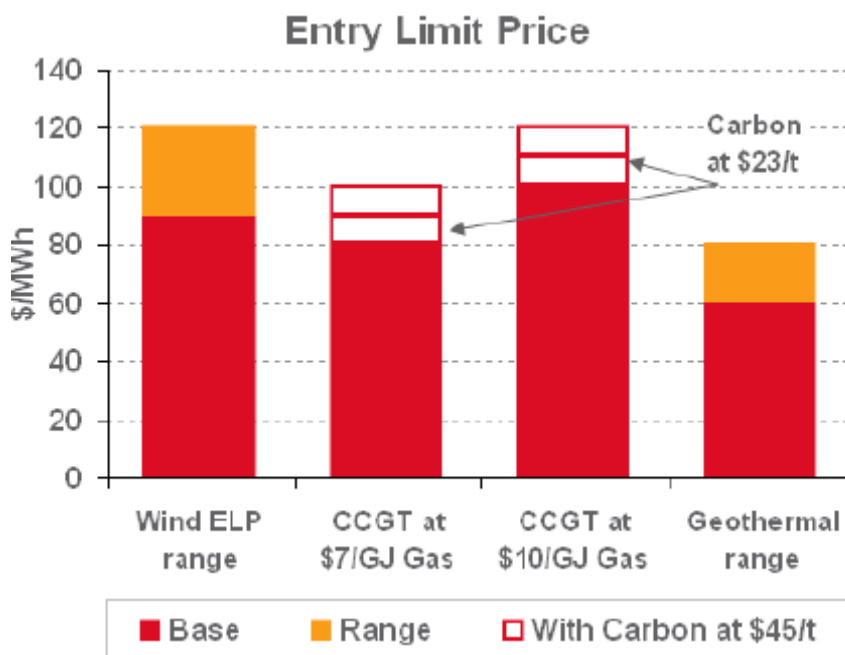
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Contact's Response to Draft Government Policy Statement on Electricity Governance

Deletion of references to the New Zealand Energy Strategy ("NZES") and New Zealand Energy Efficiency and Conservation Strategy

Contact believes there remains a powerful case for the development of renewable electricity generation in New Zealand. In general, renewable geothermal generation is the most cost effective new generation that can be built. Also, as electricity prices rise to reflect the cost of CO₂ emissions, the economics of wind generation will improve and the development of wind projects is likely to further reduce the emissions intensity of New Zealand's electricity generation sector.



Recent movements in the exchange rate have increased the cost of all potential generation types – given carbon and gas price uncertainties, wind still looks likely to set the long run marginal cost of generation (the above graph reflects exchange rates as of February 2008).

Contact supports finalising climate change policy, which will incentivize investment in renewable energy by allowing the market to price carbon emissions. This should result in a significant reduction in emissions in the electricity sector built around:

- Significant investments in renewable geothermal, wind, hydro, and wind supporting flexible gas-fired peaking generation, with these investments further supported by transmission network upgrades;
- The coal-fired Huntly power station moving into reserve, over time.

Contact is acting on its beliefs. We are investing in some of the country's most important energy projects, with current projects under construction including the Ahuroa underground gas storage facility, a 200 megawatt gas-fired peaking power station at Stratford and planning is underway for an investment in a geothermal power station near Taupo.

The peaking plant and gas storage project will both support intermittent wind generation and make a major contribution to achieving enhanced security of supply, reducing emissions and making New Zealand more self sufficient in energy. These projects will be providing income and jobs primarily in Taupo and the Taranaki.

Contact believes that the risk of a long run shortage of gas is enough of a concern that we have placed Otahuhu C, our large-scale combined-cycle gas-fired power project in South Auckland, on hold. We consider that Otahuhu C would be New Zealand's best thermal generation option. It is close to demand, already holds resource consents, and could easily link to existing electricity and gas transmission infrastructure.

While Otahuhu is on hold, renewable generation must be consented quickly and transmission investments made to get the renewable electricity to market. If this does not occur, baseload thermal options will be needed and in sufficient time to maintain security of supply. Building baseload gas plants will increase the likelihood of significantly more expensive imported fuels being required in the future, with a subsequent impact on electricity pricing. This is an option that should be avoided if possible.

Deletion of Requirement for the Commission to Make Extensive Use of Advisory Groups.

If this deletion led to abolishing advisory groups, it could reduce communication between the Electricity Commission ("EC") and the industry which may not be positive. However, consultation would be expected to continue and Contact would imagine that the EC could choose to continue to use these groups where it saw a need, in order to provide more focused feedback on key subject areas.

Discount Rate

Contact supports the straightforward appraisal of energy efficiency initiatives using a discount rate that reflects a suitable time value of money. Defining one discount rate is problematic as it cannot keep up with changes in discount rates that occur, for example, as a result of the current economic downturn. If a discount rate gives an incorrect picture of what value energy efficiency initiatives actually have for customers, it will not encourage them take up energy efficiency in the long term.

Integration Issues

Contact, Transpower, Meridian other energy companies have been studying the issue of the integration of more wind generation into the New Zealand electricity system. The EC's work in this area has generally been helpful and furthered the debate in this area. While a specific requirement to work on this area has been deleted from the draft GPS, we would expect the EC to continue to make a contribution in this area because of its importance to New Zealand in the medium to long term.

Investment in Minor Transmission Works and Transmission Alternatives

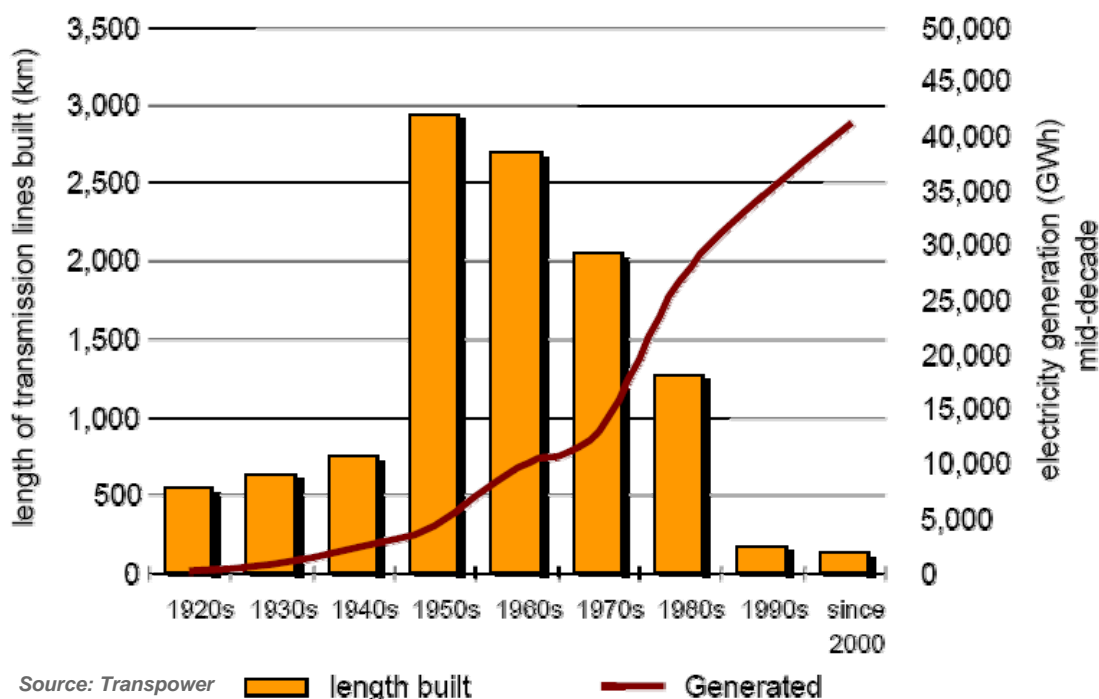
Contact strongly supports streamlining the approval of transmission investment and therefore supports the proposal that for projects less than \$20 million Transpower will:

- Develop and submit upgrade plans to the EC;
- Demonstrate the rationale for all expenditure in its plans and take account of good industry practice for power system operation; and
- Undertake the detailed planning role, consult with materially affected parties and have regard to all submissions or objections before submitting its plans to the EC.

Under the draft GPS, the EC will approve these plans quickly and will not be required to assess and evaluate the merits of these small investments. The EC is also exempted from needing to consider transmission alternatives for these smaller projects. Contact supports this as Transpower is moving from larger high priority projects to equally important small to medium projects. With the higher number of projects, stream lining is necessary to reduce duplication between the EC, Transpower and the industry.

The draft GPS should facilitate more effective operational planning and execution of projects by Transpower and reduce the time taken to get projects completed by reducing the time required for preparation and consultation relevant to the size and complexity of the project. The proposed changes involve a trade off between the value and saved costs of faster approval of projects against the risk that some less optimal expenditure will occur. Contact believes that this trade off is likely to come down strongly in favour of the proposed changes. Faster approval will build a more competitive wholesale market that is less subject to the kind of transmission constraints that bedevil the existing grid and caused such major problems in the winter of 2008 and summer of 2008/09. These changes will also help to tackle the “Catch 22” circularity of transmission investment depending on committed generation projects, and generation investment depending on committed transmission investment.

In light of this, Contact suggests that a higher threshold be investigated. If the level was set at under \$100 million it would allow Transpower to catch up with its investment programme and most efficiently address the very low level of investment in the grid that has occurred in recent decades. This low level of investment is clear in the diagram below.



A threshold of \$100 million would cover transmission requirements for the lower South Island, Lower North Island wind and most small to medium projects where real progress is needed. Increasing the threshold to this level may necessitate a new and different threshold covering when the EC should investigate transmission alternatives.

Transpower is a natural monopoly for many of its activities. The settlement between the Commerce Commission and Transpower is the basis of the current regulatory approach, designed to ensure that Transpower is subject to pressures to improve the delivery of cost effective services to customers. Approval by the EC is an important aspect of this process. Under the proposed GPS, the EC will still provide approvals.

Contact expects that the streamlined process will contain enough checks and balances to allow effective oversight by the Commerce Commission of its settlement with Transpower to continue. This is because the proposed GPS requires Transpower to demonstrate the rationale for all expenditure, take account of good industry practice, consult with materially affected parties and

have regard to all submissions or objections. Finally, if Transpower is unable to assuage objections, the project can be put back into the full Grid Investment Test approval.