



FletcherBuilding

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2 April 2004

Mr Gari Bickers
Electricity Commission
PO Box 1473
WELLINGTON

Dear Mr Bickers

Thank you for your email dated 17 March 2004. As the Executive Committee member most involved in energy matters Ralph Waters has requested I respond on behalf of Fletcher Building.

Fletcher Building appreciates the opportunity to provide comment on the need for additional reserve energy in 2005. As one of New Zealand's largest users of electricity, Fletcher Building has tried to assist in the development of an electricity supply industry (ESI) that provides long-term, sustainable and secure electricity at a reasonable and stable price.

Fletcher Building is concerned that "The Assessment of Reserve Generation Requirements for 2005" has concluded that security of supply concerns in 2005 should be less than 2003.

Our concerns relate specifically to;

1. the assumption made in the assessment modelling and by the Ministry for Environment that thermal stations will be fully fuelled during 2005 and,
2. the finding that the "combined risk of an extended forced outage of one of New Zealand's largest thermal units occurring at the same time as a 1:60 dry year would have a return well in excess of 60 years". We concur with this finding but consider the likelihood of both a dry year and an extended thermal plant outage has not been adequately factored into the assessment,
3. Concern that "the extent to which transmission constraints impact on Whirinaki" should a dry year occur has not been adequately factored by the assessment.

The points raised above are immediate concerns relating to the assessment of energy supply in 2005. Fletcher Building also has a number of more general concerns regarding the approach to such security of supply and proposes some initiatives the Electricity Commission may wish to consider.

The current market structure and operation has not provided the correct generation investment signals and incentives to all participants and, as a result our national electricity generation portfolio has an over reliance on the water and natural gas fuel mix and generation. Neither further investment into wind and other "renewable" sources of fuel nor the development of rarely used, distillate based, reserve generation will adequately balance this fuel dependency. As a minimum, New Zealand requires at least one fuel source that is linked internationally through both supply and price. This would provide competition to both hydro and gas generation, and remove the potential for the ESI and New Zealand to be captive to a dominant local source of fuel supply.

A practical solution in this regard would be to follow Europe's lead in the development of modern, environmentally sustainable, coal fired generation capable of using internationally sourced fuel. Economic efficiency suggests that if the Government ensured this generation was developed and introduced into the ESI, the addition of such capacity to the market may remove the need for any reserve generation. We note that modern flue gas cleaning techniques having largely reduced the adverse environmental effects of coal fired power generation.

In order for any market mechanism to operate efficiently all participants must be able to access market information. Without such information a liquid hedge market cannot be expected to function as part of the ESI. Lack of market information to ESI participants regarding fuel, generation capacity and transmission needs to be addressed. This lack of information appears to be exacerbating an already imperfect market. The Electricity Commission could require generators to report in these areas. In addition, fuel suppliers need to provide more information on fuel quantities; logistics, and pricing while, Transpower and lines companies should equally make available information on transmission investment and capability.

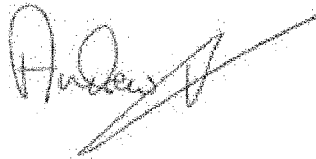
Fletcher Building considers that any reserve capacity should be available all of the time and provided when either a hydro or thermal generator suffers a fuel shortage. Pricing should be at a fixed price and borne by all generators (with no pass through to users) on a pro-rata to shortfall basis. Such an approach would need to price reserve supply high enough to encourage both new generation and cross hedging between generators. Additionally, it should promote competition between the generation companies to signal short-term supply restrictions and operating costs while minimising the "game playing" observed over the last few years during times of fuel shortage.

Fletcher Building are concerned at the risk of energy shortages in 2005 and some of the design elements of the dry-year reserve. Once additional information and clarity have been provided around elements of implementation and operational detail, Fletcher Building would be very pleased to provide further comment and input.

Fletcher Building wishes to reiterate that new generation is required in the electricity market and if this is achieved using reserve generation then it should be in conjunction with the development of a more balanced fuel portfolio and increased market information and market transparency.

We are happy to provide further information and to discuss any aspects of this letter with the Electricity Commission.

Yours sincerely

A handwritten signature in black ink, appearing to read "Andrew Reding", with a long, sweeping horizontal stroke extending to the right.

Andrew Reding
Chief Executive – Building Products Group