



MAJOR ELECTRICITY USERS' GROUP

4 April 2006

Hon Trevor Mallard
Minister of Energy
Parliament
WELLINGTON

Dear Minister

Suggested comprehensive review of electricity market design

Before setting out the main purpose of this letter, it is my pleasure on behalf of members of the Major Electricity Users' Group (MEUG) to welcome your return to the energy portfolio. MEUG comprises 19 member companies and 2 industry group members. Collectively members of the group use approximately 30% of national electricity demand. A memorandum listing MEUG members, their consumption and onsite generation capability is attached for your information.

The main purpose of this letter is to suggest a comprehensive review be undertaken of the electricity market design.

This has been a long standing goal of MEUG although only recently have we raised the priority on our own work programme. MEUG recently published a three page memorandum titled *Headline Issues* with the purpose of setting out key aspects of policy MEUG considers important and suggesting either a process and/or options that need to be considered. A copy of that memorandum dated 10 February 2006 is attached. This replaces an earlier memorandum of 24 June 2005 that you may recall we discussed with you at a dinner on the same date. It is the intention of MEUG to periodically update the Headline issues memorandum as needed.

The first overall theme in the Headline Issues memorandum proposes,

“The electricity market will be a decade old this year and therefore should be subject to an independent, robust and rigorous review. This review should assess the costs and benefits of different market models to avoid making fundamental changes to the current market design unless the benefits are clearly demonstrable.”

Explanations of three points in regard to this proposal follow:

- First, MEUG support in principle the concept of the market model. The issue is whether there are improvements to the existing market model or a fundamental change in market design that would be welfare enhancing.
- Second, MEUG acknowledge the Electricity Commission has undertaken some studies on improving the market. However the studies fall short of being comprehensive. The Commission also has various work streams examining improvements to the market and suppliers have also commenced work, in some cases in consultation with MEUG, to improve the hedge market in particular. The current Part II of the Commerce Act inquiry by the Commerce Commission may also prove useful in identifying areas of improvement (whether or not prosecutions are sought). MEUG acknowledge government support for funding the Commerce Commission to undertake this work.

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- Third, changes to the market should only proceed where there are demonstrable benefits. The history of policy making in the electricity industry is littered with well meaning interventions that have turned out to have longer term detrimental outcomes such as undermining investor confidence. MEUG accept pragmatic decisions are sometimes needed although even in those cases an attempt should be made to identify and consider trade-offs between all feasible options. Consultation has been a very useful way to flush out alternative solutions for issues and to assist consideration of aspects of the market that ordinarily officials may not be aware of. MEUG is also aware of the risk at the other extreme of "paralysis by analysis."

There seems to be a broad consensus that the market can be improved. Some believe incremental changes are all that is needed. Others, including MEUG, believe that a check against other market models would be prudent and this could be undertaken in parallel to ongoing work on incremental changes.

A possible mechanism for such a review is to modify the Government policy Statement (GPS) to set out a terms of reference and timeline for the Electricity Commission to conduct a review.

The GPS has a similar requirement for the Electricity Commission to review "the efficiency and effectiveness of the reserve energy policy in meeting security of supply objectives while minimising distortions to incentives in the ordinary market" (refer paragraph 65 of the GPS). The reserve energy policy to be reviewed includes the objective to meet a 1 in 60 dry year before voluntary public savings are sought and the role and who should pay for the Whirinaki power station. The GPS review process requires the Commission to contract an independent third party to undertake the review including public consultation, report recommendations to the Commission by 31 December 2006 and the Commission to then make recommendations to you by 31 March 2007.

In undertaking a review of the security of supply policy the impact on the "ordinary" energy market is needed. This will require a view as to the current and likely status of the energy market. It's difficult to see how a proper review of security of supply won't in effect be a review of the whole market design of which security of supply is one, albeit important, element. A pragmatic path forward might be to amend the review of the security of supply requirements in the GPS to encompass a review of the whole market design. To allow the Commission to plan and implement such a review might require some slippage to the timeline; but this would be preferable to achieve a comprehensive market review rather than a piece meal review of security issues only.

Consistent with the MEUG general approach of no surprises to other members of the industry, copies of this letter have been forwarded to the Electricity Commission, Commerce Commission and Generators CEO Forum for their information.

Yours sincerely



Terrence Currie
Chairman

Copy:

Mr Roy Hemmingway, Chair Electricity Commission
Ms Paula Rebstock, Chair Commerce Commission
Mr David Hunt, Chair Generators CEO Forum

Attachments:

MEUG, *List of MEUG members and Mission Statement*, 4 April 2006
MEUG, *Headline Issues*, 10 February 2006