# MAJOR ELECTRICITY USERS' GROUP

16 October 2006

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Electricity Commission
By email to info@electricitycommission.govt.nz

Dear Jenny

**Submission on 2007/08 Planning Round – Big Picture Input**

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Commission (the "Commission" or "EC") invitation for views on the big picture issues to be considered in preparing appropriation bids for 2007/08.

2. MEUG notes the Principle Objectives for the Commission in s.172N(1) of the Electricity Act. MEUG believes it is appropriate to approach the Big Picture question from an economy wide perspective. Comments on the priorities and outcome indicators for the Commission have then been made with reference to that wider national economy perspective.

3. In the long term MEUG believe the following strategic policy outcomes would best serve both consumers and the economy:

   a) Robust competition;

   b) Quality regulation where competition weak;

   c) Facilitating the transition of traditional "monopoly" activities to services with more accountability to the needs of end consumers and more contestability as technological, contract and regulatory design improvements allow; and

   d) Removal of political discretion from the market.

4. Some of these are clearly within the scope of the Commission and others less so.

5. The MEUG response to the questions posed in the template tables is attached using the above four national strategic policy outcomes as guidance. An additional table 4 has been added explaining reasons why MEUG believe some of the example Outcome Indicators in the original Commission memo are better described as interesting statistics rather than indicators the Commission should strive to achieve and be accountable for.

Yours sincerely

Ralph Matthes
Executive Director

**Table 1— what are the important issues to be examined in planning for 2007/08?**

| Your issue | Your comment |
|---|---|
| Part F implementation | This is consistent with the broad strategic policy outcomes of "Quality regulation" and in some cases "transitioning from monopoly to more accountable and contestable services."<br><br>Detailed comments covered in tables below |
| Improving competition and hence choice for all classes of consumer | This is consistent with the broad strategic policy outcome of "Robust Competition"<br><br>Detailed comments covered in tables below |
| Proving the case for and type of intervention, including who pays, for electricity efficiency projects before expanding these programmes | This is consistent with the broad strategic policy outcomes of "Robust Competition" and "Quality regulation."<br><br>Detailed comments covered in tables below, refer table 2, Commission draft strategic priority "Contributing to environmental goals." |

**Table 2—please comment on the draft strategic priorities set out below**

| Draft strategic priority | Examples of outputs and projects in the SOI 2006–09 | Your comment | Suggested focus areas for EC work |
|---|---|---|---|
| Sufficient supply<br>• Ensuring electricity supply continues to meet New Zealand's growing needs.<br>• Ensuring that electricity is transported to demand location.<br>• Eliminating waste throughout the electricity system. | • Statement of Opportunities, Centralised Dataset.<br>• Wind project.<br>• Transmission investment decision-making.<br>• Security of supply, including review of reserve energy needs and policy<br>• Security of supply provision for possible market failure including non-market reserve energy capacity.<br>• Electricity efficiency research and programmes. | It's unclear if "sufficient" (underlined in far LHS column) covers the necessary condition that the efficient level of supply is that which consumers are willing to pay for. Hence MEUG suggest the outputs for this strategic priority are better considered under the strategic policy outcome "Robust Competition." Details of "Robust Competition" are set out in table 2A below.<br>The reference to "eliminating waste" (underlined in far LHS column) is inconsistent with efficient outcomes because there will always be a point where the marginal cost of reducing waste exceeds the marginal benefit. Therefore that draft strategic priority should be removed. | |
| System security<br>• Ensuring the electricity system operates effectively and efficiently in real-time, with a high level of reliability.<br>• Ensuring system ability to deal with changes in generation and use patterns, especially intermittent generation. | • Rules development and compliance.<br>• System operation.<br>• Common quality development.<br>• Wind project.<br>• Load management | This is better described as "Robust Competition," refer Table 2A below.<br>Note the use of "effectively" in far left column (as underlined) is a new term not in the Principle Objectives. It doesn't seem to add anything new and hence should be removed – of if it does add a new dimension over and above the factors in the Principle Objectives, then that should be explained. | |
| Fair and efficient markets<br>• Ensuring the electricity market operates openly, fairly, efficiently and effectively. | • Rules development and compliance, including market-design refinement, hedges and pricing rules review.<br>• Wholesale and retail information provision.<br>• Reconciliation project. | Same comments as box above. | |
| Contributing to environmental goals<br>• Ensuring the Commission and electricity industry play their parts in creating a sustainable future in terms of Government environmental and climate change goals. | • Electricity efficiency programmes.<br>• Removing unnecessary barriers to distributed and renewable generation. | This is a subset of both Robust Competition and Quality Regulation as set out in Table 2A below. Interventions to overcome market failure for electricity efficiency programmes contribute to more efficient markets and hence Robust Competition. And the intervention needs to be high quality otherwise it can easily lead to subsidies, rent seeking behaviour and deadweight losses. | |

**Table 2A—are there any additional strategic priorities you would suggest?**

| Suggested strategic ~~priority~~ outcomes | Your comment<br>Principal Objectives underlined | Suggested focus areas for Commission work |
|---|---|---|
| Robust competition | With respect to the principal objectives:<br>a) Robust competition will facilitate efficient resource use<br>b) Robust competition will lead to fairness in that efficient markets are open markets<br>c) Robust competition will lead to improved consumer choices about the trade-off between different levels of reliability and price.<br>d) To have truly competitive markets will require efficient markets. By definition efficient markets have minimal market failures such as externalities not being priced or information asymmetry barriers. It is often these market failures that are quoted as barriers (actual or perceived) to renewable generation and thermally efficient use of energy. Therefore having robust competition implies fixing proven market failures and is therefore consistent with the principle objectives of being "environmentally sustainable" and "efficient use." | Support fundamental review of market design. Because this should include market governance, perhaps MED rather than EC should be responsible agency<br>Consider and if welfare enhancing implement various incremental improvement strategies to market, eg:<br>▪ Implementing proposals arising form the CC Part II inquiry<br>▪ Improved information particularly free-to-public information eg EMS TPiX replacement Project. SOO and CDS continuous improvement.<br>▪ NZIER Market Design Report, August 2005<br>▪ Finding a breakthrough to allow efficient demand side response<br>▪ Continue work on finding and removing barriers to competition. Not just new generators and retailers, also competition from DSM<br>▪ HMDSG recommendations<br>▪ Possible Part C improvements, eg<br>⇒ "FK" market<br>⇒ AGC post MSU<br>⇒ Changes to facilitate wind<br>▪ Possible Part D, E, G and H improvements, eg<br>⇒ Reconciliation project<br>⇒ Load management project |
| Quality Regulation where competition weak | Quality regulation should closely mimic outcomes expected if there were robust competition; hence same alignment with Principal Objectives will occur.<br>More emphasis needed on paragraph. 4 of GPS that states, "*In particular, whenever possible, the Commission should use its powers of persuasion and promotion, and provision of information and model arrangements to achieve its objectives rather than recommending regulations and rules*." | ▪ Promoting non-regulatory solutions<br>▪ Implement Part F<br>▪ Resist political intervention overriding sound public policy and economic principles, eg attempts to re-litigate HVDC decision<br>▪ Efficient EC governance and operations, eg efficient service provider contracts<br>▪ Ensuring no overlaps or gaps in interface with Commerce Commission and EECA |
| Facilitating accountability to end consumer needs and contestability to traditional "monopoly" services | This is the bridge between Quality Regulation and Robust competition above. | ▪ Remove statutory monopoly enjoyed by Transpower as the only party that can have approved projects funded<br>▪ Find a way to assist transmission alternatives that is not distortionary |
| Removal of political discretion from the market | | ▪ Constant vigilance and preparedness to blow the whistle, eg when Mr Hemmingway challenged government on the underwrite of e3p gas supply risk |

**Table 3—are there any outcome indicators you would suggest?**

| Suggested outcome indicator | Your comment | Information source (where the indicator is currently reported, or data source) |
|---|---|---|
| Robust Competition indicators:<br>▪ Market concentration ratios, eg HHI | | |
| ▪ Frequency of product and service innovation measures | | |
| ▪ Availability of price information | | Eg availability and timeliness of detailed spot price info. Eg invoice details for non-TOU consumers |
| ▪ Breaches of Commerce Act and Fair Trading Act by suppliers successfully prosecuted or concluded by settlement | Provided monitoring robust these measures are useful. If monitoring poor then indicator will be a poor indicator. | Supplement this indicator with survey data. |
| ▪ Consumer churn | Robust competition can lead to low churn as can alternatives being as unattractive as current terms and conditions. | Supplement this indicator with survey data. |
| ▪ Customer satisfaction and possibly measures of hedged to un-hedged. | Qualitative and quantitative | Possibly use some quantitative factors from UMR survey |
| ▪ EGCC dispute resolution statistics by supplier | Change to EGCC to allow publication | |
| ▪ New entrant retailers/suppliers and or gens for each of: energy, FK, IR, black-start, voltage support, dry-year reserve | Quantitative. Use number of participants as indicator as well as market share ratios | |
| Quality regulation indicators:<br>▪ Number of voluntary self-regulating arrangements to avoid or replace mandatory regulations | Eg EGCC and energyhedge protocol | |
| ▪ Number of Benchmark Agreement disputes | | |
| ▪ Common quality indicators, eg SAIDI | | CC quality threshold indicators |
| ▪ Efficiency of transmission peak demand charge signal | Improvement (ie flatter over all hours) in load duration curve is more efficient | |
| ▪ MW (and or MWh) saved as measure of electricity efficiency programmes | | Require independent audit that programmes actually achieved savings |
| Facilitating accountability and contestability to traditional "monopolies":<br>▪ Number of competing requests for approval for transmission projects received. | Change Part F to allow competing transmission providers | |
| ▪ Ratio connection to interconnection assets | Connection assets likely to be more contestable than interconnection assets | |
| Removing political discretion indicators:<br>▪ Number of times per year government intervenes in the market. | Qualitative and quantitative | Eg count interventions such as:<br>▪ the gas supply underwrite for e3p<br>▪ the request for the EC to defer consideration of the 1st GUP<br>▪ MED proposing DG regs rather than EC using EGR process to draft regs |

**Table 4— Comments on example indicators MEUG do not support**

| Example outcome indicator in EC invitation memo of 26/9/06 | MEUG comment on why these are not suitable as Commission Outcome Indicators |
|---|---|
| ▪ Prices in relation to CPI | Changes in fuel and capital costs are unlikely to be correlated to CPI for a number of reasons and therefore difficult to require and measure EC performance on minimising real rate of change in prices. A better outcome indicator is whether prices reflect efficient costs. This is difficult to do without accessing detailed information from suppliers.<br><br>Better to publish real prices as an interesting statistic than an Outcome Indicator. |
| ▪ One in 60 supply available reserves | This is an arbitrary political goal. More work needed to find an economic description of the optimal level and frequency that the public be requested to save power to avoid blackouts in very dry years. This may turn out to be 1 in 60 years – but the work needs to be done first before this can be described as a credible strategic outcome indicator. |
| ▪ Transmission investment approval value | This is an interesting statistic on resource inputs but it is not an output indicator the EC should aim to maximise or minimise. For example if aimed to maximise transmission investment approved then likely to get over-investment compared to the efficient level of investment where there would be an optimal mix of transmission, generation and demand side management investment. |
| ▪ New generation capacity installed | This is an interesting statistic on resource inputs but it is not an output indicator the EC should aim to maximise or minimise. For example if aimed to maximise new generation capacity installed then likely to get over-investment compared to the efficient level of investment where there would be an optimal mix of transmission, generation and demand side management investment. |
| ▪ Renewable % of supply | This is an interesting statistic on resource inputs but it is not an output indicator the EC should aim to maximise or minimise. For example if aimed to maximise the percentage of renewable generation in relation to overall installed generation this may lead to:<br>▪ The EC supporting changes to the market to accommodate expensive new renewable generation in preference to lower cost non-renewable generation and, or<br>▪ Premature retirement of low cost but non-renewable generation and replacement with higher cost but renewable generation<br><br>The important output is that the mix of existing and new renewable generation, non-renewable generation, transmission and demand side management investment is efficient. |