



MAJOR ELECTRICITY USERS' GROUP

24 December 2007

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

Dear Jenny

Submission on proposed 2008/09 work priorities and appropriations

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Commission (the "Commission" or "EC") consultation paper, "*Proposed work priorities and appropriations for the 2008/09 financial year*" published 30th November 2007. Detailed comments using the template provided by the Commission are set out in the attached appendix.
2. Please note the following four key submissions.
 - a) MEUG suggest the major context for deciding work priorities and proposed appropriations are the principal objectives in s172N of the Electricity Act (the "Act"); not the New Zealand Energy Strategy (NZES) and New Zealand Energy Efficiency and Conservation Strategy (NZECS). Refer detailed comments in table A of the appendix.
 - b) MEUG members object to paying electricity efficiency levies to subsidise other classes of consumers or Time-of-Use metered (TOU) consumers that are not efficient. Refer detailed comments in table E of the appendix.
 - c) MEUG objectives to any attempt to have retrospective recovery of unapproved expenditures claimed by Transpower under the System Operator Service Provider Agreement (SOSPA). Refer detailed comments in table C of the appendix.
 - d) The Commission could consider including a review of the longer term vision for all industry governance structures including the role of working groups as a tier one activity. Refer detailed comments in table F of the appendix.
3. MEUG members have been consulted in the preparation of this submission. Some MEUG members will be making separate supporting submissions.
4. Please contact me for any elaboration on points raised in this submission.

Yours sincerely

Ralph Matthes
Executive Director

Appendix: MEUG comments using the format provided by the Commission

Table A: "Big Picture" strategic issues		
Issue	Reference or information source	MEUG comment
Major context	<p>Paragraph 11 of the consultation paper states:</p> <p>"The finalised NZES and NZEECS were released by the Government in October 2007. The release of this Government strategy provides the major context for this year's planning."</p>	<p>While the NZES and NZEECS must be considered by the Commission as required by the Government Policy Statement (GPS), the primary or major context for the Commission should continue to be the principal objectives in s172N(1) of the Electricity Act, ie:</p> <ul style="list-style-type: none"> ▪ "To ensure that electricity is produced and delivered to all classes of consumers in an efficient, fair, reliable, and environmentally sustainable manner; and ▪ To promote and facilitate the efficient use of electricity." <p>As an aside, MEUG notes and welcomes the publication by the EC in appendix one of the EC Annual Report 2006/07 of explanatory statements on the key components of s172N(1).</p>
<p>Possible re-grouping work to:</p> <ul style="list-style-type: none"> ▪ Align with long term strategic vision of the industry governance structures; and ▪ To assist clarify the overlapping and sometimes conflicting objectives set out in the Act, the GPS, NZES and NZEECS. 	<p>Paragraph 3.4 of the consultation paper lists Business-as-usual (BAU) and other priorities under the following headings:</p> <ul style="list-style-type: none"> ▪ Electricity system and market operations ▪ Transmission ▪ Market governance ▪ Common Quality ▪ Retail ▪ Wholesale ▪ Modeling ▪ Electricity efficiency <p>These could be re-organised to match a longer term vision of where the industry governance should head.</p>	<p>The NZES does not outline a strategic vision for the overall governance of the electricity sector. This is an opportunity for the EC to provide some leadership by providing a longer term vision of governance structures.</p> <p>MEUG suggest an option the EC might consider is to separate the following three activities:</p> <ul style="list-style-type: none"> ▪ Facilitating markets for efficient supply and demand of electricity. This would include: <ul style="list-style-type: none"> - Real time, wholesale and retail markets for energy, ancillary services, security of supply products and demand side management products. <p>Note where there are proven market failures such as access to timely information on security of supply or energy efficiency products and services; then there may be a case for EC intervention until those markets self-correct. Where interventions to facilitate markets are made they should be coupled with an exit strategy.</p> - Overtime time less regulation should be possible of these markets as new technologies enhance competition and innovation to meet consumer needs. There may even be an opportunity to devolve any government involvement in the market if competing market arrangements become possible. <ul style="list-style-type: none"> ▪ Economic regulation of transmission. Devolving regulatory intervention in transmission is likely to be on a slower path than the above activity. Nevertheless there are opportunities to improve competition by allowing competing transmission service providers and having a more proactive approach to promoting a contractual basis for determining and delivering transmission services rather than regulatory intervention. A benefit of separating the economic regulation of transmission from the above strategic objective of facilitating markets is to avoid the risk of returning to centralized planning of both transmission and generation. ▪ Agent to government for managing the Whirinaki power station contract.

Table B: Overall appropriation proposal				
Appropriation (all \$000)	07-08 budget	08-09 proposed	Change	MEUG comment
Governance and market operations	49,043	49,043	Nil	No comment. This includes the current SOSPA terms and conditions.
Electricity efficiency	13,074	18,398	+5,324	Strongly oppose. Refer comments in table E
Reserve energy and emergency measures - availability	29,981	29,981	Nil	<p>We believe government should pay for this out of Consolidated Account because Whirinaki was not a least cost option; it was a politically decided option to solve a political problem not a market problem. Therefore we object to paying any share of this cost.</p> <p>This view was articulated in a report by NZIER for MEUG in support of our submission to Castalia as part of their review for the EC of the security of supply policy as follows¹:</p> <p><i>“Whirinaki is an asset which was bought principally for political purposes, and not for rational economic ones. As such, the costs of the plant in excess of its revenue should be a charge on the general tax payer. This will provide a clear signal that if politicians want to acquire assets for the management of their own political risks they should raise the taxes to pay for them transparently rather than foist the costs on consumers through a general levy.</i></p> <p><i>There is clear precedent in the legislative provisions under which the Crown Research Institutes and State-owned Enterprises operate for our suggested approach. If the Ministers in charge of these entities wants them to take on liabilities or activities that they do not want to take on then the organisations are entitled to request to have the consequential costs covered from general revenue.”</i></p>
Reserve energy and emergency measures - variable	5,000 (over 07/08 to 11/12)			No comment
EC litigation fund	444	444	Nil	No comment
Total excluding variable reserve energy and emergency measures	92,542	97,866	+5,324	

¹ NZIER report to MEUG, *Electricity Security of Supply Policy Review – Castalia's Consultation Paper*, 5 April 2007, p8

Table C: Breakdown of the governance and market operations appropriation	
Work stream	MEUG comment
SOSPA	In advance of the EC separately consulting on SOSPA, MEUG note the following. We understand Transpower is seeking ex post recovery through SOSPA of over-expenditure on the Market System Project (MSP). MEUG does not support levying consumers for any unapproved expenditure. We believe the auditor-general and appropriate Parliamentary select committees will also take a strong view of any proposed retrospective taxation or recovery by levies of unapproved expenditures.

Table D: Governance and market operations			
Work stream	Tier	Project	MEUG comment
All			MEUG welcomes the estimate of the NPV of benefits for each of the Common Quality activities in paragraph 47 of the consultation paper. In our submission last year (MEUG submission of 2 nd December 2006) we also commented on the value of the NPV estimates being provided for the Common Quality work. We also suggested estimates of NPV should be provided for other proposed work. It is disappointing that no other proposed work activities have attempted to estimate the NPV of benefits other than the electricity efficiency work stream. MEUG have serious concerns on that work and will be discussing those with EECA.
Transmission	BAU	2 nd SOO finalised by Sep-08	The SOO should be finalised earlier to enable the output to be used by Transpower for the 2008 Annual Planning Report (ARP). The ARP should be the definitive annual report for the industry based on the SOO assumptions and more detailed work by Transpower. Until that sequencing occurs, the SOO has and remains the more definitive analysis. There is risk this state of affairs will heighten the risk of the EC slipping into a central planning role.
	2	TPM improvement for locational pricing signals	Should be tier 1. For example in considering possible barriers to new remote renewable investment just considering possible changes to GIT ² without considering TPM could lead to inefficient outcomes. Work should begin now on a new TPM because it will take several years to analyse options, select a preferred new TPM, have that gazetted and then implemented. The sooner this begins the better.

² In bullet point 2, paragraph 12 of the consultation paper, only possible changes to GIT are mentioned.

Table E: Breakdown of the electricity efficiency appropriation				
Project/programme (all \$000)	07-08 budget	08-09 proposed	Change	MEUG comment
General	13,074	18,398	+5,324	<p>MEUG has in the past and continues to object to paying any levy to the Commission for electricity efficiency work. MEUG members have very strong commercial incentives to use electricity as efficiently as possible and most spend management and operating staff time and resources to improve efficient use. Other classes of consumers have muted pricing signals and little incentive to be efficient. Essentially MEUG members and other large TOU consumers are subsidising efficiency programmes for other classes of consumers that have weak pricing signals. The solution is to improve pricing signals to all consumers, not to continue levying industry to overcome that market failure.</p> <p>Recently the Commission has commenced some work on air compressors and electric motors – areas directly of interest to large TOU consumers such as MEUG members. MEUG does not believe the case for intervention has been proven and therefore does not support this work. The cross-subsidy in this case is between large TOU consumers that have already undertaken work to improve their compressors and motors to those companies that have been slow to make those changes. This is neither fair nor efficient and therefore breaches two of the principal objectives in s172N(1) of the Act.</p> <p>Covec note in their report for the EC on Compressed Air and Electric Motors³:</p> <p><i>“The existence of a market failure is a prerequisite to industrial interventions that use public funds. We evaluate the problems that are said to give rise to demand side efficiency potential, to determine whether they are actually market failures. That analysis concludes that the low priority firms attach to energy efficiency initiatives is not necessarily a market failure; rather it may be a reflection of the preferences of those entities. Market failure does exist in the areas of compressed air and electric motors however, largely because of poor information.”</i></p> <p>If Covec were correct in July 2007, then the solution is an information campaign and not the intensive intervention now planned. MEUG suggest the “market failure” of poor information Covec observed in the compressed air and electric motors market may also be the major market failure in other areas the EC is planning to intervene in.</p> <p>As MEUG members collectively consumer ≈ 29% of total electricity in NZ, the share of the proposed EC cost electricity efficiency work for 2008/09 is 29%*\$18.4m = \$5.3m. This is a very large tax on companies that already have very strong incentives to be efficient and to use electricity wisely.</p>

³ Covec report for EC, Interventions Analysis: Compressed Air and Electric Motors, Executive Summary, page 4, July 2007.

Research	500	500	Nil	<p>Research should be funded either through MoRST, EECA or Vote: Energy rather than through a levy on the market. MEUG do not believe the EC has any remit to conduct electricity efficiency research. For example the activity "research" in relation to electricity efficiency is not mentioned in any of the following:</p> <ul style="list-style-type: none"> ▪ The principal objectives in s172N(1) of the Act; ▪ The specific outcomes in s172N(2) of the Act; and ▪ The Electricity Efficiency section (paragraph 25 to 34) of the GPS. <p>If part of this work for 2007/08 relates to the KEMA potentials work then we believe that is a common public good of value for MED and EECA and should have been paid for by those agencies; not the EC.</p> <p>MEUG also has concerns that the final KEMA report has not been the subject of any formal or detailed review by consumers or the electricity industry. The KEMA approach when first announced in 2006 was criticised by a number of parties at presentations given by KEMA. We are unsure if those criticisms have been addressed because since 2006 there has been no conference or public forum that has gone through the extensive work by KEMA that has formed the basis for various cost-benefit-analysis of work proposed by the EC. Based on some very limited reading of the KEMA report and the various cost benefit analysis that used that material MEUG note some preliminary observations:</p> <ol style="list-style-type: none"> 1. On page h of the KEMA potentials study⁴ they note <i>"We recognize that the development of additional New Zealand-specific data could significantly improve the understanding of energy efficiency and building energy use. We recommend that the Electricity Commission and others in New Zealand conduct other research as discussed below."</i> In other words KEMA note there may be some source data issues that still need to be worked through. MEUG believe it would be prudent for the EC to work through those before embarking on an \$18m work programme a large part of which is based on the untested and un-critiqued work of KEMA. 2. The KEMA study assumes the 2005 SOO demand forecasts (p14 of the KEMA potentials study). This demand forecast has since been reduced and therefore the KEMA analysis overstates the base case demand forecast. 3. The KEMA analysis assumes the average cost of avoided transmission for the life of the programme. This overstates the benefit of reducing demand to save transmission costs. The value of reducing demand is to defer transmission not avoid it completely. The PW cost of deferral of planned transmission lines is significantly less than avoiding the average cost of new lines over the life of the programme assumed by KEMA.
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⁴ KEMA report for the EC, *NZ electric energy-efficiency potential study*, volume 1, 28 September 2007.

Efficient lighting	7,518	4,000	-3,518	<p>This should be levied on all non TOU consumers as it is that sector that is the main beneficiary of this intervention, not TOU consumers.</p> <p>MEUG do not believe the cost-benefit-analysis has been adequately explained including the source of the results of the work by KEMA (refer comments under "Research" in the top section of this table E), to give the industry or consumers any comfort that this proposed work truly has a net national benefit.</p>
Compressed air	1,200	1,000	-200	<p>MEUG do not believe there is any proven market failure in the compressed air industry to justify an EC intervention and therefore we do not support this proposed work.</p> <p>MEUG do not believe the cost-benefit-analysis has been adequately explained including the source of the results of the work by KEMA (refer comments under "Research" in the top section of this table E), to give the industry or consumers any comfort that this proposed work truly has a net national benefit.</p> <p>The estimated benefits of the compressed air work arise when audited companies realize there are efficiency gains they can make to save them money. MEUG is unsure why the EC needs to be involved in this because this appears to be a market opportunity for a compressor service company to provide that audit and advice to companies. If the compressor service company cannot demonstrate to the company how they can save money, then they don't get paid. However if they can show savings and split those savings with the company then that's a win-win. The EC should leave this service and opportunity to the market to evolve.</p>
Electric motors	1,860	2,500	+640	<p>MEUG do not believe there is any proven market failure in the electric motors industry to justify an EC intervention and therefore we do not support this proposed work.</p> <p>MEUG do not believe the cost-benefit-analysis has been adequately explained including the source of the results of the work by KEMA (refer comments under "Research" in the top section of this table E), to give the industry or consumers any comfort that this proposed work truly has a net national benefit.</p>
Commercial buildings	700	4,000	+3,300	<p>MEUG do not believe there is any proven market failure in the commercial buildings sector to justify an EC intervention and therefore we do not support this proposed work. If there is a market failure then the costs of any intervention should be levied across all commercial building owners as they would be the main beneficiary of any intervention, not households and other TOU consumers.</p> <p>MEUG do not believe the cost-benefit-analysis has been adequately explained including the source of the results of the work by KEMA (refer comments under "Research" in the top section of this table E), to give the industry or consumers any comfort that this proposed work truly has a net national benefit.</p>

Energywise homes	-	5,000	+5,000	<p>MEUG has five concerns with this work:</p> <ul style="list-style-type: none"> ▪ This should have been funded directly from Consolidated Account, ie <ul style="list-style-type: none"> - The energy efficiency portion through EECA because presumably it covers all energy forms not just electricity; and - Any work to achieve health related benefits should be funded from other Votes, eg Health or Social Welfare. This is not work the EC was established to undertake and is not mentioned in the principal objectives of s172N(1) of the Act. Page 41 of the consultation paper states: <p><i>"Indicators of healthy homes and air quality would be identified and the impact of the programme monitored as part of ongoing programme monitoring and reporting."</i></p> This clearly establishes that the Energywise homes work is not just about electricity efficiency; it is designed for and will be monitored for its health effects. MEUG object to electricity consumers having to pay through an EC levy for work that should be covered through general taxation. ▪ This work crowds out initiatives by market participants, eg Meridian has a new business for this; ▪ This work has not been the subject of a contestable tender process; ▪ Even if there is a case for the EC undertaking this work (which MEUG strongly believes there is not), then it should be levied on all non TOU consumers as it is that sector that is the main beneficiary of this intervention, not TOU consumers. ▪ MEUG do not believe the cost-benefit-analysis has been adequately explained including the source of the results of the work by KEMA (refer comments under "Research" in the top section of this table E), to give the industry or consumers any comfort that this proposed work truly has a net national benefit.
Personnel and other operating costs	1,296	1,398	+102	As MEUG believe the total requested appropriation for electricity efficiency work is far in excess of that needed, then the EC overheads can also be scaled back.
Total	13,074	18,398	+5,324	

Table F: Additional comment on specific projects			
Project	Work stream	Tier	MEUG comment
Improved industry governance in general			MEUG suggest strong governance arrangements both formal and informal between the Commission and stakeholders will assist in the range of tasks the Commission must undertake. This isn't mentioned in the consultation paper. In particular MEUG suggest some work to review how the various working groups are arranged and interact with the Commission might be of value. This suggestion is discussed in more detail in table A as a major issue, ie deciding and taking action to meet a long-term strategic vision of the best governance structure for the industry.