MAJOR ELECTRICITY USERS' GROUP

9 May 2008

Mr Gerry Brownlee
Chairman
Commerce Committee
Parliament

By email to steven.mitchell@parliament.govt.nz

Dear Mr Brownlee

Submission on the Commerce Amendment Bill

1. This is a submission to the Commerce Committee (the "Committee") by the Major Electricity Users' Group (MEUG) on the Commerce Amendment Bill. MEUG comprises 19 individual companies and 2 trade associations as listed in appendix 1.

Comments on the Bill

2. Comments on each clause as they arise in the Bill follow.

3. The **purpose statement in s.52A (1)** could be improved by adding the following text in italics and underlined:

   - s.52A(1)(a) "have incentives *and commensurate risks* to innovate …"
   - s.52A(1)(b) "have incentives *and commensurate risks* to improve …"

4. The above change would provide some balance to the need to achieve "outcomes that are consistent with outcomes produced in competitive markets." In markets companies have financial incentives to innovate and improve their services to consumers but they also face risks. MEUG agrees electricity line monopolies should have incentives but they must also bear some risk if they fail. A regime where no line company achieves less than a predefined WACC but some companies achieve more is neither balanced nor reflective of outcomes in a market.

5. **Sections 52H(2) and 52H(3)** require only a qualitative analysis. A quantitative analysis is only needed if practicable. MEUG suggest any proposal to impose Part 4 regulation that cannot be quantified is unsatisfactory. The case for regulation should be absolutely clear and quantifiable. If it is not, then the rationale for regulation may be something other than for economic reasons, ie a political objective. Before the Commission can make a recommendation for any Part 4 regulation to be imposed on a sector (not already subject to Part 4), MEUG believe it should be essential a quantitative analysis is made. Section 52H needs to be amended accordingly.

PO Box 8085, Level 8, Wakefield House, 90 The Terrace, Wellington, New Zealand
T +64-4 494 0996, F +64-4 494 0997, info@meug.co.nz , www.meug.co.nz

6. It's difficult to see how electricity end consumers could possible have sufficient resources to effectively participate in a negotiate/arbitrate regime proposed in **Subpart 5 (s.53G to s.53J)**. We don't think relying on electricity retailers to negotiate on behalf of consumers will always result in the best outcome for those consumers. End consumers and their representatives, such as MEUG, will participate in any negotiation process to the extent they can. However to assist end consumers manage their limited resources for such processes, MEUG suggest the Committee consider lengthening the time for negotiations and limit the number of negotiations that can be underway to one in any sector at a time.

7. The Bill limits the Commission to setting a price-quality path for 5 years or less but no shorter than 4 years (**s.53M(2) and (3)**). MEUG agrees setting a maximum of 5 years is reasonable. We do not see any reason to limit in statute how short the Commission might set a price-quality path. With more information available to it, the Commission will be in a much better position to decide on a case-by-case basis if and by how much a term less than 5 years would best meet the new Part 4 purpose statement.

8. Consumer-owned electricity line monopolies will be exempt from price-quality regulation (**s.54G(2)**) and instead will be subject only to information disclosure regulation. MEUG opposes any group of electricity line monopolies being given an exemption. In support of this view we note:

   a) Government never consulted on this proposal;

   b) In the explanatory note to the Bill (p8) it states:

      "*The reason for this relatively light-handed regime is because consumers, as owners, are able to ensure that the business acts in their interests*."

      It is a significant leap of faith that consumers of such companies will have the information and skill to assess more effectively than the Commerce Commission if their local line monopoly is indeed as efficient compared to other companies; and

   c) The propensity for such organisations to be captured by local political cliques and to redistribute "profits" to activities other than back to consumers is almost guaranteed. The Bill does provide a process to bring such behaviour under control, but at an enormous transaction cost. This mechanism looks unwieldy and biased, ie favours household consumers over business consumers in terms of voting mechanisms in s.54H(3).

9. A timetable for commencement of initial default price-quality paths for electricity monopolies are proposed in **s.54J**. MEUG does not understand how the Commission might have new thresholds in place by 1 April 2010 pursuant to these new provisions when it will not have completed the new input methodologies due 30 June 2010 (s52T). MEUG suggest this timing needs to be reconsidered. The Commission will be in a position to set new thresholds from 1 April 2009 for a 5 year period ending 31 March 2014. It would be better to allow that process to be completed and give certainty to the industry for the next 5 years. The Commission would then determine input methodologies by 30 June 2010 and apply those methodologies for establishing the new price–quality regulation pursuant to the Bill effective from 1 April 2014.

10. Incentives to improve energy efficiency and demand side management, and reduce line losses are explicitly noted as a requirement of the Commission in **s5.4Q**. MEUG suggest this section is redundant because as part of considering the regulatory regime to apply to line monopolies the Commission already considers such matters to the extent they have material economic efficiency effects. Therefore s.54Q is redundant.

11. The option of the Minister deciding to transfer jurisdiction of functions in relation to electricity line monopolies from the Commission to the Electricity Commission (**s.54R to s.54U**) is opposed by MEUG. The Bill attempts to overcome one our long standing criticisms that the Commission is independent of government whereas the Electricity Commission is not. The solution in the Bill is only a partial solution and does not overcome for example the Minister of Energy having more control on the appointment and removal of Electricity Commissioners than does the Minister of Commerce over Commerce Commissioners.

Regulatory Impact Statement

12. The opening sentence of the section titled "status quo and problem" in the Regulatory Impact Statement that prefaces the Bill states:

"Electricity lines businesses (ELBs) have argued that the Part 4A regime has increased uncertainty in the sector. This uncertainty can affect their cost of capital, thereby deterring investment."

13. The evidence though does not support this claim by the electricity line monopolies, eg

- Investment in most electricity line monopolies is above the rate of deprecation reported; and
- The recent sale by Vector of the Wellington electricity network demonstrates that the capital market does not view the sector being over-regulated; despite what commentators in the market might actually say. If as reported the sale price exceeds ODV, then it's end consumers that should be worried because that implies investors still believe they can achieve financial returns above that implied if the assets had been valued at ODV. The existing regime is still very light-handed.

14. MEUG believes it is important for the Committee not to be swayed by claims of over-regulation by electricity line monopolies and therefore to have parts of the Bill watered down in their favour.

Concluding comments

15. In summary MEUG recommend the Committee:

a) Amend the purpose statement (s.52A(1)(a) and (b)) to better reflect a balance between incentives and risks;

b) Amend s.52H(2) to require the Commission to undertake a quantitative analysis;

c) Limit the number of negotiate/arbitrate proposals to one per sector and lengthen the time allowed for those to be considered in Subpart 5 (s.53G to s.53J);

d) Remove the minimum period of 4 years price-quality thresholds can be set (s.53M(2));

e) Remove the exemption for consumer-owned electricity line monopolies in s.54G(2);

f) Change the commencement of the new default price-threshold path for electricity monopolies in s.54J from 1 April 2010 to 1 April 2014 to allow the Commission to use the input methodologies due for completion 30 June 2010;

g) Remove s.54Q (Energy efficiency) as it is adequately covered in the broader purpose statement; and

h) Remove the provisions in the Bill and the Act that give an option to the Minister to transfer responsibility for Part 4 as applied to electricity line monopolies from the Commerce Commission to the Electricity Commission.

16. MEUG request to be heard before the Committee to make representations on the Bill.

Yours sincerely

Ralph Matthes
Executive Director

Appendix 1: List of MEUG members and Mission Statement

As at 1 April 2008 there were 19 member companies in MEUG plus two industry group members as listed below along with estimated annual load, onsite generation and peak demand.

MEUG member[1]	Load GWh/y	Onsite generation GWh/y	Net Load GWh/y	Peak demand
Rio Tinto Aluminium New Zealand Limited	5,000	-	5,000	580 MW
Norske Skog Tasman Limited	1,300	230	1,070	170 MW
Carter Holt Harvey Limited	1,105	260	845	130 MW
New Zealand Steel Limited	1,045	600	445	106 MW
Pan Pac Forest Products Limited	550	66	550	78 MW
Fletcher Building Limited	454	-	454	
Winstone Pulp International Limited	330	-	330	48 MW
The New Zealand Refining Company Limited	235	-	235	
Telecom New Zealand Limited	190	-	190	
Oceana Gold Limited	152	-	152	16.5 MW
Holcim (New Zealand) Limited	70	-	70	
Dongwha Patinna NZ Limited	58	-	58	9 MW
Heinz Wattie's Limited	56	-	56	
Tegel Foods Limited	56	-	56	
ANZCO Foods Limited	41	-	41	
Solid Energy New Zealand Limited	29	-	29	
Ravensdown Fertiliser Co-op	28	22	6	
Auckland International Airport Limited	23	-	23	13 MVA
Lion Breweries	23	-	23	6.5 MW
Business NZ	…			
Wood Processors Association of NZ	…			
	10,745	1,178	9,567	
NZ total demand[2]	36,898			
MEUG as percentage of total[3]	29%			

The Mission Statement for MEUG is:

"*The members of the Major Electricity Users' Group are committed to ensuring the continuing availability of electricity services, at the lowest cost to the economy as a whole, consistent with sustainable development. Within this framework, the Group seeks to ensure competitive electricity prices and security of supply to the members of MEUG*."

The 2007/08 external strategic objectives for MEUG are:

1) Improve competition;

2) Environmental policies that support the primary goal of economic growth;

3) Security of supply arrangements do not distort the market;

4) Most cost efficient transmission; and

5) Most cost efficient distribution.

[1] Load, generation and peak load data may not be up to date because of changes in operations by individual companies since last surveyed by MEUG.
[2] Refer Ministry of Economic Development, Energy Data File, January 2006, p139, demand for year ended 30 March 2005
[3] Excluding demand by non-MEUG members of Business NZ and Wood Processors Association