MAJOR ELECTRICITY USERS' GROUP

26 January 2009

Bronwyn Christie
Electricity Commission
By email to submissions@electricitycommission.govt.nz

Dear Bronwyn

Submission on proposed 2009/10 work priorities and appropriations

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Commission (the "Commission") consultation paper, "*Proposed work priorities and appropriations for the 2009/10 financial year*" published 19th December 2008. Submissions using the template provided by the Commission are set out in the attached appendix.

2. The five main themes of our submission are:

   a) The KEMA and Covec work that underpins the EC electricity efficiency work have not considered all possible options nor been adequately peer reviewed. In any case it is MED and not the EC that should design energy efficiency policies with EECA and other service providers implementing programmes. Accordingly MEUG oppose the proposed appropriation for the EC of $13m for this work in 2009/10.

   b) The proposed changes to the System Operator Service Provider Agreement (SOSPA) are welcome except for the WACC assumptions. Details are provided in table F.

   c) Developing a better contractual relationship and incentives between Transpower and its customers is a desirable goal that MEUG suggests needs a higher priority. The Commission proposes monitoring of Transmission Agreements as a BAU activity plus two tier 2 projects "New Investment process" and "New connection process." MEUG suggests these tier 2 projects, the BAU monitoring and a more proactive role for general improvement of Transmission Agreements be bundled into a new tier 1 project "Improving the Benchmark Agreement" in the Transmission work stream.

   d) MEUG opposes the $86m multi-year appropriation to cover instances where the EC decides Whirinaki should be dispatched below SRMC. Savings on tendering emergency services of $0.648m can be made.

   e) Including a new tier one project to consider the Review of 2008 Winter recommendations.

3. MEUG members have been consulted in the preparation of this submission.

Yours sincerely

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Appendix: MEUG comments using the format provided by the Commission

Table A: Overall appropriation proposal (refer Table 2 of the consultation paper).

Appropriation	Comment
Governance and market operations	Keeping appropriation the same as 2008/09 ($49.043m) plus an additional $5.076m for net SOSPA costs to give a total appropriation of $54.119m appears reasonable.
Electricity efficiency	MEUG oppose the proposed appropriation of $13.1m (see detailed comments in table D below).
Reserve energy and emergency measures—availability	The Review of 2008 Winter recommended[1] "*The market rules be changed to ensure decision-makers face the cost to consumers of any forced demand curtailment, and then that the present reserve energy scheme be discontinued or modified to ensure costs are targeted as closely as possible to those parties who benefit from its use*." If this recommendation or another equivalent policy were implemented, then the proposed appropriation of $29.981m could be removed. We think it's reasonable to assume the question is: when will those changes be made? not if? MEUG suggest policy changes will be made in time (or expectations on suppliers ahead of specific rule changes being made) to allow the EC to avoid the $0.648m for tendering emergency options proposed for 2009/10. Avoiding the fixed cost recovery of Whirinaki of $29.333m per annum contracted with the government will probably occur sometime during 2009/10. Without any better information, it's reasonable to assume the full $29.333m at this stage.
Reserve energy and emergency measures—variable (five-year appropriation)	MEUG oppose the proposed multi-year appropriation of $86m because it is needed only if the EC decides to run Whirinaki below SRMC. Such an action is inefficient and distortionary. The Security of Supply policy and any other relevant protocols should be amended to remove the option of the EC running Whirinaki below its SRMC.
Crown expense appropriation: Electricity Commission litigation fund	No comment.

Table B: breakdown of the governance and market operations appropriation (refer to appendix 1 of the consultation paper).

Work stream	Comment
Transmission	MEUG suggest a new tier one project be included to consider and where appropriate implement the recommendations of the Review of 2008 Winter. If the EC agree, then the appropriation for the Wholesale markets work stream will need to be increased and adjustments made to other work streams to keep the aggregate budget unchanged.
Market governance	
Common quality and system operations	
Retail	
Wholesale	
Modelling	
Security of supply	

[1] Review of 2008 Winter, Recommendation 1 (Preferred option), p 52.

Table C: governance and market operations (refer to appendix 1 of the consultation paper).

Note this table has been truncated because MEUG has no other comments on split of BAU and tier 1 and 2 projects.

Work stream	Tier	Project	Comment:
Transmission	2	New Investment process	In addition to improving the process as outlined in the consultation paper, there is value in simultaneously improving the contractual basis and incentives between Transpower and its customers for new investments and connections. These are both subsets of a broader activity to continuously improve the Benchmark Agreement. The consultation paper makes no mention of the EC planning to undertake such work; though BAU monitoring of the Benchmark Agreement and Interconnection Rules is mentioned. MEUG suggests the EC add a new tier 1 project "**Improving the Benchmark Agreement**" and include in that the related work of improving the New Investment process and improving the connection process.
	2	New connection process	See comment above.
Wholesale	New tier 1	Consider and implement Review 2008 Winter recommendations	The Review of 2008 Winter made 8 recommendations. MEUG suggests the EC appropriation for 2009/10 include resources to consider the first six[2] of these as summarised below: ▪ Recommendation 1 proposes options "*to reduce or remove the scope for participants to externalise the cost of their risk management decisions*." ▪ Recommendation 1 includes government exiting from provision of reserve energy through ownership of the 3 X 52 MW units at Whirinaki. If that proposal is not implemented the second recommendation of the Review is for an analysis be undertaken of alternative locations and fuels used by the Whirinaki units. ▪ Recommendations 3, 4, 5 and 6 cover pre-defining emergency triggers and measures, possible codifying informal information channels used during 2008, major sellers disclosing aggregate risk position and improving certainty for resource consents that specifically mention the EC.

Table D: breakdown of the electricity efficiency appropriation (refer appendix 2 of the consultation paper).

Project / programme	Comment
Research	MEUG recommend nil appropriation for EC electricity efficiency work. Identifying barriers to uptake of economically efficient levels of energy efficient behaviour and investment occurring and designing appropriate interventions is a complex policy activity that requires consideration of all energy forms, not just electricity. The EC has a mandate to consider electricity, but not other fuels. The EC has in the past justified expenditure of monies levied on power users' by reference to work by KEMA (the potentials study) and Covec. There is considerable academic literature that rebuts the assertions on market barriers assumed by KEMA and Covec. As far as MEUG are aware the EC has never considered those views.
Efficient lighting	
Compressed air	
Electric motors	
Commercial buildings	

[2] Recommendation 7 covers the role of the EC and Minister. This is a priority for the Minister and MED to consider, not the EC. Recommendation 8 notes the value of prioritizing initiatives to facilitate competition and thereby minimise costs. MEUG agrees with the general recommendation; however it is not sufficiently specific to be assigned a tier 1 or 2 label.

Project / programme	Comment
	The views and analysis of KEMA and Covec support interventions such as subsidies without, in our view, adequately canvassing other policy options such as improving pricing signals and considering barriers to inter-fuel substitution. In our view the agency that should undertake a review of policy options is MED, not the EC. EECA should be a delivery agency contracted by MED and in competition with other potential service providers. If MED or EECA or any other service provider requires EC advice over and above information available in the public domain (eg the SOO, GEM and CDS), then those parties should pay for that service. One final and separate point is the risk that the EC's work on researching market barriers, designing interventions and then implementing those become a distraction from the core functions of market governance and regulation of transmission services.

Table E: additional comment on specific projects

Project	Work stream	Tier	Comment
n.a.			

Table F: System Operator service provider agreement (refer appendix 3 of the consultation paper).

Project	Comment
SOSPA proposal from Transpower	The proposed 7.8% WACC is derived from the settlement agreed between Transpower and the Commerce Commission last year. There is an assumption the asset beta for the monopoly transmission business is the same as that for the monopoly System Operator business. MEUG disagrees. While both businesses have statutory protection as monopolies; the asset lives for the lines business is measured in decades and therefore there is a residual risk that legislation, and or regulations and or rules might change resulting in assets being stranded. The System Operator has no similar stranding risk because the SOSPA is an evergreen contract with a proposed 3 year notice of termination (increased from current 2 year notice) that is sufficient to cover the life of assets employed plus a contracted three year review of approved versus spent capital to manage unders-and-overs. The System Operator has much less stranding risk than the lines business and accordingly the asset beta should be lower. The SOSPA WACC assumes the risk free rate when Transpower and the Commerce Commission agreed the settlement last year. Using a risk free rate from last year is not consistent with how private sector enterprises would agree a WACC … in that case parties would use the most up to date information available, ie use a risk free rate as at the date that the new SOSPA commences. The current risk free rate is significantly less that the risk free rate at the time the settlement was agreed. Using a risk free rate from last year is simply giving a wind fall gain to the System Operator shareholders.