



MAJOR ELECTRICITY USERS' GROUP

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By email to electricity@med.govt.nz

Dear Gentlemen

Submission on the preliminary report by ETAG and MED to the Ministerial Review of Electricity Market Performance

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Technical Advisory Group (ETAG) and Ministry of Economic Development (MED) preliminary report to the Ministerial Review of Electricity Market Performance, Improving Electricity Market Performance, released for consultation by Hon Gerry Brownlee, Minister of Energy and Resources, on 12th August 2009¹ (the "Discussion paper").
2. MEUG acknowledge that for government to embark on such a comprehensive Ministerial Review of the Electricity Market is not a trivial exercise. Government clearly recognised that the needs of households and businesses have not been met by the current market design. The Minister summarised the main issues when announcing details of the Ministerial Review on 1st April 2009²:

"The government has concerns about security of supply, the affordability of electricity, and duplication of electricity sector governance"
3. In our view the poor-performance of the entire electricity supply chain has been a significant drag on New Zealand's economic performance. Without major structural change the sector will continue to restrict economic growth. It is essential that the recommendations regarding asset swaps are carefully evaluated, i.e. structural changes precede any other remedies.
4. The market failure issues with the current market have both a policy and practical dimension:
 - a) The policy dimension relates to the classic economic market failure problems of market power, information asymmetry and mispricing of resources. All three policy problems are evident in various parts of the electricity supply chain.

¹ Refer the Ministers' media release: <http://www.beehive.govt.nz/release/electricity+review+released>. Refer the Discussion paper: http://www.med.govt.nz/templates/StandardSummary_41689.aspx

² Refer <http://www.beehive.govt.nz/release/ministerial+review+electricity+market>

For the monopoly parts of the supply chain the recent changes to Part 4 of the Commerce Act provide an improved economic regulatory framework.

The more difficult market failure problem to manage is the market power found in the wholesale electricity, ancillary services and retail electricity markets. Mitigating exercise of market power in those markets does not come within the Part 4 regulation of monopolies. The Commerce Commission Part 2 of the Commerce Act inquiry that undertook a partial review of the industry (it did not review the retail market) deferred any policies to manage market power to the Ministerial Review noting³:

"The Commission considers that it would be premature for it to consider such an inquiry. The Government has convened a Ministerial Working group that will be able to consider the Commission's investigation, along with other material. The Government, unlike the Commission, will be able to consider a full range of regulatory solutions."

Given the Commerce Commission decided not, at this stage, to pursue their Part 2 inquiry in relation to wholesale supplier behaviour between 2001 to mid 2007, the expectation of consumers is that the primary market failure problem of supplier market power will be addressed by the Ministerial Review.

- b) Examples of the practical implications of persistent supplier market power problems include:

- The often quoted \$600m impact on GDP for the dry-year scare in 2001. Hon Gerry Brownlee, while opposition energy spokesman in 2008 noted ⁴:

"In 2001, Street lights were turned off, hot water cylinders went cold, and shops stayed gloomy for most of the day. The economic impact was just as dark, with power savings clipping 0.6 percent off the gross domestic product, and carving \$600 million from the national bottom line."

- Anecdotal reports by MEUG members and other major users that raising capital from shareholders, both overseas and in New Zealand, just to continue existing operations is difficult because business owners view the New Zealand electricity market as unreliable, prices volatile without good reason and just too difficult to manage risk compared to other electricity markets overseas. This perception and lack of confidence in investment prospects in New Zealand is a matter of serious concern.

5. In terms of the analysis in the Discussion paper we have several criticisms:

- a) There is little recognition of the importance of the energy intensive sector to the New Zealand economy notwithstanding the critical role the dairy, meat, aluminium, wood processing, steel and petroleum refining sectors play in earning overseas funds.
- b) There is a lack of acknowledgement of the supplier market power problem in the Discussion paper though the recommendations themselves infer acceptance that there is a significant problem. MEUG commissioned the New Zealand Institute of Economic Research (NZIER) to review the Discussion paper's analysis of the work by Professor Wolak for the Commerce Commission. NZIER note:

"Although imperfect, Wolak's analysis has served the purpose of drawing attention to the problem of opportunity for exercise of market power in the wholesale market. The ETAG's discussion document swiftly moves the debate on from the findings and limitations of Wolak's analysis to the proposed solutions to this and the other problems and deficiencies of New Zealand's electricity market. We consider this judicious."

We do not believe that the options presented by the ETAG would have differed without the criticisms of Wolak's analysis, with the exception that the debate

³ Refer Commerce Commission, "Investigation Report – Commerce Act 1986 s27, s30 and s36 electricity investigation", paragraph xliii, 21st May 2009

⁴ Gerry Brownlee MP, media release, "What to expect in electricity crisis campaign", attachment titled "Emergency power savings measures in 2001 & 2003, 6th June 2008.

about the validity of Wolak's analysis may have tempered the reallocation of assets in the proposed restructure of state owned enterprise generator-retailers. The implications of the ETAG's comments on Wolak's analysis are therefore only that, in making submissions on the discussion document, MEUG may wish to pay particular attention to the restructuring options presented and possibly advocate investigating a more aggressive reallocation of assets.

MEUG may also like to suggest investigating extension of the ETAG's recommendation on improving pricing transparency and monitoring to include active market monitoring by the proposed Electricity Market Authority to assist market participants to manage their risk positions more effectively."

A copy of the NZIER report is attached to this submission.

- c) The focus of the recommendations is to solve retail market competition with an implied conclusion that less policy response is needed for the wholesale market. We think that focus is misdirected. The graph on page 12 of the Discussion Paper estimates retail costs and margins total 3 c/kWh or 14% of the total delivered price for a typical residential power user. Generation of wholesale market costs are 8 c/kWh or 36%. Modest gains on improving competition in the wholesale market could, for example, lower costs by 5% or 0.4 c/kWh. These would, with increased competition, flow through to all consumer classes. To get an equivalent decrease of 0.4 c/kWh from the retail margin would require a 13% decrease in the retail margin (ie 0.4 c/kWh divided by 3 c/kWh). We suggest there may be a better payback to households by facilitating modest improvements in the wholesale market rather than seeking more than double percentage reductions in retail margins to obtain equivalent savings.
- d) Figure 8 in the Discussion Paper illustrates a range of contract price indicators compared to estimated LRMC costs of a new Combined Gas Cycle Turbine (CCGT) plant for each year between 1998 to present. Based on the analysis in figure 8, paragraph 104 of the Discussion Paper concludes:

"Using the LRMC benchmark, there is no clear evidence of the sustained or long term exercise of market power."

MEUG dispute that conclusion can be drawn from figure 8 on three grounds:

- First, the data and method for calculating the LRMC estimates have not been disclosed. Full transparency on how those estimates have been calculated is needed to allow interested parties to assess the validity of the results. For example what exchange rates and gas prices were assumed? LRMC costs should use a prediction of gas prices over the life of the investment rather than short term spot gas prices. A long term gas price forecast made in one year is likely to be the same as a long term forecast the following year with occasional large step changes only when new material information became available. If we are correct, then there must be some other explanation for the largely upwards trend in LRMC estimates in figure 8.
- Second, the energyhedge prices used should be based on the longest term prices not short term prices because the comparison is with long term LRMC cost estimates. For example 2014 calendar year forward prices have been quoted since July 2009. The only trade for a 2014 calendar year forward contract has been \$99/MWh and the lowest closing price \$95/MWh. These are substantially higher than the energyhedge prices illustrated in figure 8.
- Genesis Energy built e3p in 2007 and according to figure 8 the LRMC for a CCGT built in that year ranged between approximately \$61/MWh and \$67/MWh. By 2009 energyhedge prices in figure 2009 are well above \$70/MWh (setting aside the point above that the energyhedge prices in figure 8 do not reflect higher longer term forward prices). In other words within 2 years of building e3p Genesis Energy are already earning well above LRMC. We don't think any capital intensive industry in a competitive market could expect to be earning economic rents in such a short time. Either the numbers in figure 8 are incorrect or if correct then suppliers expect to and are earning economic rents in a market with very poor competition.

As a supplementary point, note that one method to assess economic rents is to calculate Economic Value Added (EVA) over time. Many companies have used EVA accounts for this purpose, including Transpower. This is not a trivial exercise given published financial accounts do not always provide information in a form required to construct EVA accounts and generators have frequently re-valued assets without disclosing assumptions. The post re-valuation accounting profit can appear reasonable; though this does not reflect the true economic rent because re-valuations are in effect capitalised expected future economic rents.

6. Having established that there is a lack of competition in the electricity market and poor management of dry-year risk, the Discussion paper considers options for improvements and makes 28 preliminary recommendations. Detailed comments on each recommendation are set out in the appendix to this submission. In relation to the key recommendations MEUG:
 - a) Supports further work on asset and retail share re-allocations between State Owned Enterprises (SOE) as a structural solution to promote retail competition and a deeper hedge market. MEUG strongly supports an immediate and comprehensive study to deal with the three options (and other options that may emerge from the consultation phase) as structural solutions are most likely to provide long term benefits. MEUG believe this new piece of work should be given highest priority of any of the new work items. In addition MEUG supports existing work considering what type of financial instruments can be introduced to manage locational price risk.
 - b) Notes the use of a well designed floor price mechanism could assist mitigate the problem of net retailers shifting risk in dry-years. However if the mechanism is poorly designed there will be significant harm caused to the economy. For example the floor should only be triggered as a last resort on the expectation that rolling cuts are imminent and the formula for that trigger is set in legislation and not prone to political tampering. There also needs to be an efficient financial derivatives market for time-of-use (TOU) consumers to manage the risk of a floor being triggered. Investigation of a floor option with particular attention to understanding and mitigating risks should be a high priority.
 - c) Support government exiting the ownership of Whirinaki power station and greater disclosure requirements on the largest suppliers. The new idea of consumers with fixed priced variable volume tariffs being reimbursed by retailers if government needs to step in to request from the public a voluntary savings campaign might also be useful. All of this work is a high priority.
 - d) Supports policies that will overcome the information asymmetry market failure, ie improving the Powerswitch website (costs to be borne by retailers' not wholesale market purchasers) and information disclosure by suppliers.
 - e) Proposes that market monitoring be a new function for EMA. It is noted that most electricity markets have robust monitoring and accompanying investigative measures whereby events (which exceed specified criteria) are inquired into. The EMA must have the responsibility to identify market power and make rule changes to eliminate it.
 - f) Proposes that a sunset review policy be enacted requiring MED and EMA to review within 5 years the effectiveness on improving competition and management of dry-year risk of the policies introduced as a result of this Ministerial review. This Ministerial Review should have taken place after the second dry-year scare in 2003. We cannot afford to have a repeat of the situation where policy makers are reluctant to acknowledge or allow a review of policies that prove to have been poor decisions. A more realistic approach is needed. Electricity markets are complex and unintended consequences can happen. A legislated requirement for a review in 5 years will provide an opportunity to decide if more radical structural options are needed such as separation of vertically integrated suppliers or mandatory hedging requirements.
 - g) Proposes the best long-term solution for economic regulation of transmission is for the Commerce Commission to be solely accountable (ie complete transfer of Part F responsibilities), rather than make some changes but retain the existing split of accountability between the Commerce Commission and EMA as proposed in the Discussion paper.

We do not support government regulating details of economic regulation of transmission (or distribution) such as GIT when Part 4 of the Commerce Act already provides a legislative framework for the Commerce Commission to evolve such parameters taking into account the balance between the interests of consumers and line monopolies.

Shifting responsibility of Part F to the Commerce Commission will need careful design of a transition strategy to ensure scrutiny of Transpower's expenditure proposals and actual performance is not undermined. Expiry of the Settlement between Transpower and the Commerce Commission in July 2011 could provide an opportunity for a new regime to commence.

- h) Supports establishment of EMA as an independent Crown Entity.

More work is needed on the details of the governance of EMA. For example more detail is needed on how the Rulings Panel will work compared to other alternatives before MEUG could reach a definitive view. If MEUG proposal's that by 2011 all of Part F becomes the responsibility of the Commerce Commission and the EMA actively monitors the market, then the scope of work is significantly different from that of the Discussion paper and therefore so too should EMA governance arrangements be reviewed.

There are also some policy design elements that MEUG has concerns about. For example any change towards more of a mix of constituency representation has some attendant risks. Apart from the choice of organisations with the power to nominate representatives the use of working groups for recommending rule changes will require consumer representatives to have access to resources to allow a more effective countervailing view to the highly resourced and dominant supply side. It will be essential that consumer representatives are adequately resourced; but the problem of stalemate on controversial and complex issues remains.

It is best to get the governance of EMA right and with a high degree of consensus before amending legislation is tabled in Parliament. Rushing the establishment of EMA when important governance details are missing runs the risk of the new organisation failing to make any improvement over current governance arrangements.

- i) Supports the System Operator undertaking security of supply forecasting within the bounds of policies, rules and or contract to EMA.
- j) Proposes EMA and Transpower be required to complete a plan on how the System Operator can become a separate entity from the Transmission Asset Owner within one year. The plan may never be implemented; but undertaking that work will identify if there are any issues in the current integrated Transpower arrangement that need to be changed and will give us a better view of whether or not an ISO has value.

7. All of the above key conclusions by MEUG are subject to the caveat that no decisions should be made until robust cost-benefit-analysis of all feasible options have been made. We think bold decisions are needed to lift performance in the electricity market; but that should not be taken to read that decisions be made without full analysis. This submission was prepared within the 5 weeks consultation timeframe allowed. Considering how extensive and interrelated the recommendations in the Discussion Paper are, this has been a difficult submission to provide conclusive views. In many instances the detailed comments in the appendix provide conditional support. We suggest a further consultation round be undertaken on the more controversial recommendations to allow parties a second opportunity to consider more analysis by ETAG and MED. This step will probably also be of assistance to ETAG and MED.
8. Members of MEUG have been consulted in the preparation of this submission. Several members will also be making separate submissions. It is acknowledged there are divergent views within MEUG members.

Yours sincerely



Ralph Matthes
Executive Director

MEUG comments on preliminary recommendations to the Ministerial Review of Electricity Market Performance

<u>To improve the management of dry years</u>	MEUG comment
<p>1. Require retailers to make payments to consumers in the event of a public conservation campaign or enforced power cuts, with a graduated scale reflecting the level of nationwide savings (as determined by the System Operator), and with a minimum payment of, say, \$10 per week</p>	<p>Support subject to:</p> <ul style="list-style-type: none"> ▪ Confirmation this would apply to consumers with fixed price variable volume (FPVV) contracts. Consumers with FPVV contracts have no financial incentive to conserve power when spot prices increase. Most households and many SME have FPVV contracts. There are also some relatively large businesses with FPVV contracts. We see no difference in the need to incentivise both household and non-household consumers with FPVV contracts to conserve power in extreme dry-year events. ▪ Investigation of better ways of targeting a compulsory savings requirement on retailers supplying consumers under FPVV contracts as the proposal may have unintended consequences. For example with an emerging dry-year risk event, one supplier may start an active savings reward scheme for its FPVV consumers and another supplier, equivalent in all respects with the first, may not. Why should the first retailer be obliged to make the same per FPVV consumer payment as the second once the government actively steps in?
<p>2. Put a floor on spot prices during any public conservation campaign or during any enforced power cuts in a dry year of, say:</p> <p>2.1. \$500/MWh (50c/kWh) when a public conservation campaign is activated.</p> <p>2.2. \$1,000 - \$5,000/MWh (\$1 - \$5/kWh) if and when forced power cuts are activated.</p>	<p>This proposal was first suggested in the Winter 2008 Review. At that time MEUG supported further work on the proposal because it should, if properly implemented, create better incentives on suppliers to internalize dry-year management risk rather than shift that risk to others.</p> <p>The Discussion Paper is the first opportunity for more details of this option to be considered. The “devil-is-in-the-detail” is an appropriate comment at this stage. As an extreme last resort a regulated floor sends very strong incentives to suppliers and end users with net spot exposure. However there are potential difficulties if Ministers can activate a floor well ahead of an event becoming an extreme last resort. MEUG members remember clearly the intervention last year leading to Whirinaki being offered below SRMC. Unless we have better surety the rules on implementing a floor will not also be</p>

	shifted, then MEUG is reluctant to support this proposal. The onus is therefore on ETAG and MED to have a more detailed design drafted and tested of a floor mechanism in conjunction with other parts of the final package.
3. Clarify roles and responsibilities for security of supply (as set out in Table 2 on page 21).	Support provided more clarity on the role of the Security and Reliability Council is provided. Refer detailed comments on recommendation 29.
4. Phase out the reserve energy mechanism, and reassign the Whirinaki power station to an SOE or sell it.	Support.
5. Alternatively, if the Government wants to retain the reserve energy mechanism as a backstop, then it should: 5.1. Reassign Whirinaki to an SOE or sell it. 5.2. Ensure that a mechanism is developed (such as a surcharge on spot prices) through which parties that benefit from any reserve energy when it is called on (that is, parties that are exposed to spot prices) contribute to the standing costs of that reserve energy.	<p>This alternative should be considered in the next stage of a more comprehensive quantitative cost-benefit-analysis as a feasible alternative to the base case proposal comprising recommendations 1 to 4 above. That step needs to be taken, even though we expect it will endorse the qualitative assessment in the Decision paper and by the Winter 2008 Review that retention of the reserve energy mechanism will not be an optimal outcome.</p> <p>If recommendation 5.2 forms part of a final decision (and we expect it will not), then charges to recover a reserve energy mechanism should be targeted at parties that cause the need for that intervention. MEUG believe the current recovery of Whirinaki costs from all end users has been poorly targeted because it fails to take into account differences in end users' management of that risk such as onsite cogeneration and use of financial derivatives. Given Government is unlikely to exit ownership of Whirinaki before next winter, MEUG suggest there is a case as an interim step to change the levy for Whirinaki costs from end consumers to net retailers.</p>
6. Require SOEs to disclose their risk positions and other relevant information in the same way as private sector companies listed on the Stock Exchange, to improve the quality of information available on risk and sharpen risk management incentives.	<p>Support subject to:</p> <ul style="list-style-type: none">▪ More thorough analysis as to whether NZAX continuous disclosure rules are appropriate or sufficient. Continuous disclosure is primarily intended to inform and benefit investors of matters material to their investment decisions. Here we have a different group of intended beneficiaries with a specific set of needs, namely to understand the relevant dry-year risk position of suppliers and other information to gauge if suppliers are likely to attain a position of market dominance.▪ Considering if voluntary quarterly disclosures by listed companies⁵ should be made mandatory and expanded to ensure key data must be published (the Contact information is good but an analysis of whether it is sufficient for monitoring competitive behaviour is needed) and in a consistent and

⁵ For example Contact Energy publish quarterly operational data comprising:

- Electricity generation volumes by type of generation over the quarter
- Average national, SI and NI wholesale electricity price per quarter
- Total retail electricity purchase volumes per quarter
- Average national, SI and NI electricity purchase price per quarter
- Various gas disclosures (gas used for own generation and retail and wholesale gas sales and LGP sales volumes)
- Electricity, gas and LPG customer numbers at end of quarter.

Refer http://www.contactenergy.co.nz/web/view?page=/contentiw/pages/shared/quarterlyreports&vert=in#aJune_2008

	<p>easily accessible format. Note that NZAX requires more disclosure of listed Mining Companies because of information asymmetry between those companies and investors⁶. The same approach of having specific disclosure requirements may have relevance for major electricity suppliers.</p> <ul style="list-style-type: none"> ▪ Aligning disclosure requirements under this recommendation with the proposal in recommendation 24 for wholesale market data to be released the day after and the new proposal by MEUG that EMA have a new market monitoring function and responsibility to identify market power and make rule changes to eliminate it.
7. Investigate developing terms and conditions for accessing 'reserve water' in lakes in dry year emergencies which cap benefits to generators and provide for compensation to affected communities and mitigate or avoid environmental effects.	Support provided there is no abrogation of existing consents held by other parties or statutory bias in the future in favour of 'reserve water' compared to other claims on water resources.

⁶ Refer Rules 10.9 to 10.11 of the NZAX Listing Rules, http://static.nzx.stuff.co.nz/legacy/NZAX_Rules.pdf

<u>To help restrain the costs of generation</u>	MEUG comment
8. Ensure, when making decisions on climate change policy, that full weight is given to the importance of providing certainty for investors including, to the extent possible, providing for stability and predictability on the future cost of carbon and other emissions.	Support.
9. Ensure that the current reviews of the Resource Management Act and water allocation consider: <ul style="list-style-type: none"> 9.1. Whether and how the 'call-in' process could be used to better effect for generation projects (new and existing). 9.2. Other fast-track mechanisms for consenting (or re-consenting) nationally significant generation projects. 9.3. Providing for water and geothermal rights to match the life of the assets. 9.4. Whether certain types/sizes of generation could be deemed to be a permitted activity in predefined circumstances and areas. 9.5. The terms for consents, particularly the lapse provisions, to better recognise the nature of large-scale generation investment projects. 9.6. Whether powers such as compulsory acquisition of land, with appropriate compensation provisions, should be available for nationally significant generation projects. 	Support provided there is no bias in favour of large projects at the expense of: <ul style="list-style-type: none"> ▪ Smaller projects, eg niche onsite co-generation, demand side projects and transmission alternatives that have a lower cost than large scale projects. ▪ An abrogation of existing consents held by other parties or bias in the future.
10. Ensure that the current petroleum resources review takes full account of the importance of gas to electricity generation using existing or new assets.	Support.
11. Improve the quality of published information on gas reserves.	Support. For example there may be value in requiring publication of P10 petroleum reserves in addition to the requirement to publish P50 and P90 reserves every 6 months ⁷ . In addition to improved gas reserve information, MEUG suggest publication of coal stockpiles and gas contracts, as published by EC ⁸ , should be more regularly updated.
12. Identify barriers to the development of geothermal energy which	Support.

⁷ Refer Crown Minerals (Petroleum) Regulations 2007, Schedule 6, regulation 18(b), <http://www.legislation.govt.nz/regulation/public/2007/0138/latest/DLM438318.html>

⁸ Last thermal fuel report was updated 8th December 2008, refer <http://www.electricitycommission.govt.nz/opdev/secsupply/thermal-fuel>

can and should be addressed by the Government.	
<p>13. Consolidate responsibility for the promotion of energy efficiency in EECA, and remove it as a responsibility of the electricity regulator, while:</p> <p>13.1. Carrying out a strategic review of EECA to ensure it is well-focused and performing effectively</p> <p>13.2. Transferring best practice approaches developed by the Electricity Commission where possible.</p> <p>13.3. Reviewing funding for EECA, with a general principle that funding should be through levies where the beneficiaries can be clearly identified and administrative (collection) costs are low.</p>	Support.
<p>14. Review whether there are likely to be net benefits, compared to alternatives, in developing a National Environmental Standard for small-scale distributed generation, such as solar photovoltaics, micro-wind turbines and solar water heating panels.</p>	Support.

<p><u>To improve procedures for upgrading transmission services</u></p>	<p>MEUG comment</p> <ul style="list-style-type: none"> MEUG <u>proposes</u> the best long-term solution for economic regulation of transmission is for the Commerce Commission to be solely accountable (ie complete transfer of Part F responsibilities), rather than make some changes but retain the existing split of accountability between the Commerce Commission and EMA as proposed in the Discussion paper. <p>We do not support government regulating details of economic regulation of transmission (or distribution) such as GIT when Part 4 of the Commerce Act already provides a legislative framework for the Commerce Commission to evolve such parameters taking into account the balance between the interests of consumers and line monopolies.</p> <p>Shifting responsibility of Part F to the Commerce Commission will need careful design of a transition strategy to ensure scrutiny of Transpower's expenditure proposals and actual performance is not undermined. Expiry of the Settlement between Transpower and the Commerce Commission in July 2011 could provide an opportunity for a new regime to commence.</p>
<p>15. Amend the Grid Investment Test to make it clearer, simpler and less prescriptive, and to take into account wider competition benefits.</p>	<p>MEUG does not accept there is a compelling case that the GIT⁹ “may set the bar too high for approval of upgrades” and therefore the Minister should unilaterally intervene and amend the GIT definition to lower the bar. Even if we thought there was a compelling case, any regulatory intervention would need to be accompanied by a Regulatory Impact Analysis demonstrating a positive net benefit compared to other feasible alternatives, including retaining the existing GIT approach to competition benefits.</p> <p>The existing GIT provides for wider competition benefits as follows¹⁰ with text underlined for emphasis:</p> <p><i>“Competition benefits may be included in the market benefits of a proposed investment or alternative project if the Board reasonably considers this appropriate, provided the competition benefits can be <u>separately identified and calculated</u>.”</i></p> <p>There has been an ongoing debate on whether competition benefits, and other less tangible benefits and costs, should be included in the GIT as subjective factors or only if quantifiable. Those parties that gain from a lower GIT threshold but don't pay for transmission upgrades typically support including non-quantified benefits (ie generators, retailers and Transpower) and those that pay for transmission upgrades (ie consumers) prefer a GIT founded on quantifiable benefits and costs. There is no new argument in the Discussion Paper to alter the view of MEUG that only quantified benefits and costs should be included in the GIT.</p> <p>To illustrate that there is nothing new in this debate, consider the following extract from a report by Dr</p>

⁹ Discussion Paper paragraph 90

¹⁰ EGR, Part F, Schedule F4, clause 10

	<p>Brent Layton of NZIER to MEUG, Grid Investment Test – The Electricity Commission's Decisions," 7th December 2004, submitted to the EC ¹¹:</p> <p><i>"While the Commission adopted quite a number of Meridian and Transpower's detailed drafting suggestions, it firmly rejected the main thrusts of their submissions. In what is obviously a direct response to Meridian's call, the Commission states it "... intends retaining the principle of quantifying all aspects of its GIT assessment so that decision-making is transparent and so that the consistency of decision-making can be tracked over time and across assessments."</i></p> <p>And further on NZIER noted:</p> <p><i>"In regard to the calls for the use of a Net Public Benefits (NPB) test, the Commission carefully goes through the various provisions in the Rules and the GPS relating to objectives and considers whether they suggest an NPB test or an Net Market Benefit (NMB) test should be used. It finds most point to the NMB test and concludes "broadening the scope of the GIT would require a revision of part F rules."5 The Commission decided to stay with the NMB test and not broaden the scope essentially for the same reasons we initially supported its proposal; that it will make the test less open to uncertainty and debate from those with peripheral interests they wish to pursue."</i></p> <p>MEUG is unconvinced a change to a Net Public Benefits test, which is the essence of recommendation 15, is justified.</p> <p>Note that should MEUG's proposal that a managed transition be made to transfer to the Commerce Commission responsibility for all economic regulation of transmission services (refer comments on recommendation 16), then the Commerce Commission should be given the task of reviewing the GIT in terms of meeting the Part 4 of the Commerce Act Purpose Statement. That is a better process than the Minister unilaterally intervening to amend the GIT in response to lobbying by Transpower and suppliers in the same way the Government Policy Statement was amended in May 2009 requiring the EC to change the approval process for transmission capital expenditure approvals less than \$20m.</p>
<p>16. Transfer approval of major grid upgrades to the Commerce Commission to ensure integrated consideration of transmission expenditure, performance and prices, subject to rules on service and reliability standards, pricing methodologies and the grid investment test set by the electricity regulator.</p>	<p>MEUG do not support this proposal because of the risk that the statutory purpose statement of EMA in relation to economic regulation of transmission services will differ from that in Part 4 of the Commerce Act and therefore the current problem of two different regulatory regimes will continue.</p> <p>Currently the Commerce Commission has a statutory responsibility to implement a Price-Quality regulatory path for Transpower following expiry of the Settlement in July 2011. Under the Settlement and in the post Settlement arrangements, the Commerce Commission can take into account EC decisions to approve Grid Upgrade Plans (GUP) but is not bound to accept those as pass through costs. In practice the Commerce Commission does.</p> <p>If the shift from the EC to EMA creates differences in implementation of Part F or changes in Part F</p>

¹¹ Refer section 2, <http://www.electricitycommission.govt.nz/archives/Submissions/Trans/git2pdfs/meug-2.pdf>

	<p>itself (eg the Minister directing a change in GIT or other policies to reduce the scrutiny on transmission expenditure approvals) then to meet its own statutory requirements the Commerce Commission may decide to apply different tests and processes on Transpower. This problem could be overcome by having the statutory purpose statement for EMA in relation to economic regulation of transmission identical to that of Part 4 of the Commerce Act. However what would be the point of having two independent Crown entities with identical purpose statements for regulation of a single entity? Hence we have concluded the only stable long-term outcome is to have one regulator of transmission. The same argument applies to the distribution sector.</p> <p>MEUG emphasizes the need for a carefully managed transition from the EC to the Commerce Commission of responsibility for Part F because of the quantum of investment yet to be submitted for approval by Transpower. We have doubts that the Discussion Paper estimates that there is still \$2.5b of investment yet to be approved¹²; nevertheless there is still a significant amount to be approved and no relaxation of the excellent scrutiny to date by the EC should be considered.</p> <p>A managed transition to merge with the development by the Commerce Commission of a post Settlement (ends July 2011) Individual Price-Quality Regulatory Path is an option that should be investigated.</p>
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¹² Transpower Grid Upgrade Plan 2009 Installment 1 (dated September 2009) forecasts capital expenditure over the 10 years 2009/10 to 2018/19 totaling \$5,069.3 m (table 5-2). Of this total \$3,130.3 m is for development work and the balance capital replacements, enhancements, refurbishment, easements and minor fixed assets. Though not separately summarized in the report (refer <http://www.electricitycommission.govt.nz/pdfs/opdev/transmis/gup/2009/Parts-I-II.pdf>), it appears a significant percentage of the development and other work has already been approved by the EC or is likely to be non-Part F capital expenditure subject to ex ante approval and ex post checks by the Commerce Commission. The latter is material, eg for 2009/10 the approved non-Part F capital expenditure totals \$189.6m (refer <http://www.comcom.govt.nz/IndustryRegulation/Electricity/ElectricityLinesBusinesses/TargetedControl/transpowerintentiontodeclarecontrol.aspx#1245>).

<p><u>To improve wholesale and retail competition and help restrain prices</u></p>	<p>MEUG comment</p> <ul style="list-style-type: none"> • MEUG <u>supports</u> further work on asset and retail share re-allocations between SOE as a structural solution to promote retail competition and a deeper hedge market. MEUG strongly supports an immediate and comprehensive study to deal with the three options (and other options that may emerge from the consultation phase) as structural solutions are most likely to provide long term benefits. MEUG believe this new piece of work should be given highest priority of any of the new work items. In addition MEUG supports existing work considering what type of financial instruments can be introduced to manage locational price risk. • MEUG <u>supports</u> policies that will overcome the information asymmetry market failure, ie improving Powerswitch website (costs to be borne by retailers' not wholesale market purchasers) and information disclosure by suppliers. • MEUG <u>proposes</u> that market monitoring be a new function for EMA. It is noted that most electricity markets have robust monitoring and accompanying investigative measures whereby events (which exceed specified criteria) are inquired into. The EMA must have the responsibility to identify market power and make rule changes to eliminate it. • MEUG <u>proposes</u> that a sunset review policy be enacted requiring MED and EMA to review within 5 years the effectiveness on improving competition and management of dry-year risk of the policies introduced as a result of this Ministerial review. This Ministerial Review should have taken place after the second dry-year scare in 2003. We cannot afford to have a repeat of the situation where policy makers are reluctant to acknowledge or allow a review of policies that prove to have been poor decisions. A more realistic approach is needed. Electricity markets are complex and unintended consequences can happen. A legislated requirement for a review in 5 years will provide an opportunity to decide if more radical structural options are needed such as separation of vertically integrated suppliers or mandatory hedging requirements.
<p>17. Subject to further analysis following submissions, restructure SOE assets, by either:</p> <p>17.1. Option One: Create a new SOE generator-retailer comprising the Huntly and Manapouri power stations, and, additionally, transfer Tekapo A and B to Genesis and Whirinaki to Meridian.</p> <p>17.2. Option Two: Transfer the Huntly power station to Solid Energy, the Manapouri station to Genesis and the Whirinaki</p>	<p>Support the asset re-allocation proposals being advanced to the next stage of a more detailed cost-benefit-analysis and all three options proposed in the Discussion paper and variations on these considered as feasible options¹³. MEUG suggest this work should be considered the highest priority of all the new policies proposed in the Discussion Paper. In support of this view note:</p> <ul style="list-style-type: none"> ▪ We agree with the view of the Minister of Energy and Resources when reporting to Cabinet Economic Growth and Infrastructure Committee¹⁴ and repeated in paragraph 116 of the Discussion Paper that <p><i>"International electricity market experts generally agree that restructuring usually has the best potential to strengthen competition. This is because it can deal with market</i></p>

¹³ There will be many more asset re-allocation options that should be considered, eg Two Huntly units instead of e3p could be swapped for Manapouri.

¹⁴ Minister of Energy and Resources paper to Cabinet Economic Growth and Infrastructure Committee, "Ministerial review of Electricity Market performance: Release of Discussion Paper", 23rd July 2009. This paper was released to MEUG on 9th September in response to an OIA request of 15th August 2009.

<p>station to Meridian.</p> <p>17.3. Option Three: Transfer the e3p and P40 power stations from Genesis to Meridian and the Manapouri power station from Meridian to Genesis</p>	<p><i>power issues at source. Furthermore, the competitive benefits can be realised relatively quickly. Unlike regulatory options, the change is a one-off event, and on-going interventions and monitoring are not required."</i></p> <ul style="list-style-type: none"> ▪ The Cabinet Economic Growth and Infrastructure Committee requested further advice from officials on the SOE re-structuring options. That paper has only just been released¹⁵. Treasury and DPMC opposed the re-structuring option and listed a number of costs and risks they believed had not been considered by ETAG and MED. MEUG believes the best way forward to resolve those different views is to quickly move forward to a more robust analysis of asset restructuring options without any constraints based on preconceived and non-quantified constraints. ▪ The capital markets reaction to the proposed asset swap is informative. Sharechat reported the comments of Standard & Poors as follows ¹⁶: <p><i>"New Zealand's electricity companies face possible credit rating downgrades as proposed electricity reforms would make their operating environments riskier and more competitive, says the international credit rating agency, Standard & Poors.</i></p> <p><i>Most at risk are Genesis and Meridian, but only if proposals to swap assets between the two state-owned generator-retailers go ahead.</i></p> <p><i>All the power companies are expected to face additional business risk because of greater competitive pressures, decreased ability to raise tariffs, and increased costs caused by the emissions trading scheme.</i></p> <p><i>Known risks such as dry years and national grid constraints would continue. With new market structures, "the gentailers' ability to mitigate these by regularly raising prices to preserve earnings will be more restricted than previously, in our opinion", S&P said."</i></p> <p>In summary Standard & Poors predict more competition with an asset swap than without. This supports the view of MEUG that government should commence work to more thoroughly test asset re-structuring options as a high priority.</p> <p>In relation to the costs of the asset re-structuring options, paragraph 336 of Volume 2 of the Discussion Paper says:</p> <p><i>"There would be one-off costs for the provision of legal, technical and financial advice associated with asset transfers. These costs would be incurred by the Crown, and by the affected corporate entities."</i></p> <p>MEUG agrees with this approach. This is consistent with the approach when the SOE's were first</p>
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¹⁵ MED, Treasury and DPMC paper to the Prime Minister, Minister of Finance, Minister of Energy and Resources, Minister for State Owned Enterprises and Associate Minister for Infrastructure, "Electricity Market Review", 31st July 2009. This paper was released to MEUG on 9th September in response to an OIA request of 15th August 2009,

¹⁶ Sharechat news service, 19th August 2009, refer <http://www.sharechat.co.nz/article/cf952cc4/credit-downgrades-possible-with-energy-reforms.html>

¹⁷ Minister of Energy and Resources paper to Cabinet Economic Growth and Infrastructure Committee, "Ministerial review of Electricity Market performance: Release of Discussion Paper", paragraph 63, p21, 23rd July 2009. This paper was released to MEUG on 9th September in response to an OIA request of 15th August 2009

	<p>formed and provides an incentive on those businesses to keep one-off costs as low as possible and to be competitive to recover those costs. In paragraph 139 of Volume 1 of the Discussion Paper is reference to how much the one-off costs would be if recovered as a levy on customers. There is no specific recommendation that a levy be used, simply a reference to the quantum. The just released Cabinet papers note ¹⁷:</p> <p><i>“Release of the discussion paper does not have fiscal implications. If the recommendations in the discussion paper were to remain unchanged following consultations, and were accepted by Ministers, there would be costs involved in re-structuring the SOEs and in changing the governance arrangements. The costs are noted in the relevant sections in this Cabinet paper. However, the discussion paper proposes that the costs be met by way of adjustments to the electricity levy, since electricity consumers will benefit from the reforms.”</i></p> <p>MEUG agrees that changes to the EC and formation of EMA should be recovered by a levy. The above paragraph isn't clear on whether asset re-structuring costs are also intended to be recovered by way of a levy; if that is the case then MEUG disagrees with using a levy to cover asset re-structuring costs.</p>
18. Introduce, as a priority, a transmission hedging mechanism to assist retailers manage risks created by transmission congestion.	Support a transmission hedging instrument provided they will have a net gain in economic efficiency rather than simply redistributing loss and constraint rentals, ie the last Locational Rental Allocation (LRA) proposal from the EC (in July 2008) would not be supported.
<p>19. Facilitate greater demand-side participation in the wholesale market, including providing for:</p> <p>19.1. More accurate forecasting of spot prices.</p> <p>19.2. Real-time (not ex post) spot prices</p> <p>19.3. Demand response to be dispatched in the same way as generation.</p>	<p>Support and believe this is an exciting area that New Zealand can seek to innovate and be a world leader in. The recent initiative by the EC to commence investigation into dispatchable demand is fully supported.</p> <p>MEUG note that these and a number of other proposals to improve Part C and ancillary services management and procurement have been stalled while waiting for commencement by the System Operator of the new Market System Project. That project went live on 21st July 2009.</p> <p>Those other proposals relate to improvements to how frequency keeping and instantaneous reserves are procured. We view these as highly material because lack of competition in frequency keeping and occasional tight supply in the reserve markets have lead to spot price volatility and that in turn will have been reflected in higher margins for financial derivatives and FPVV tariffs.</p> <p>We assume EMA will be responsible for investigating these options with appropriate contracts with the System Operator to provide advice as needed.</p>
<p>20. Allow lines companies to provide electricity retailing services in their local areas subject to:</p> <p>20.1. Retaining the existing provisions in the Electricity Industry Reform Act that:</p> <ul style="list-style-type: none"> Require corporate separation and compliance with arms-length rules between lines and energy (generation and 	<p>Support provided the caveats in sub-recommendations 20.1 and 20.2 are implemented in full. In terms of implementation timing, MEUG note:</p> <ul style="list-style-type: none"> Industry and government resources need to first focus on policies such as SOE asset restructuring and transmission hedges that are expected to have a much higher benefit to implementation cost ratio. Distributors, users' of distribution services and the Commerce Commission are heavily committed

<p>retailing) businesses.</p> <ul style="list-style-type: none"> Require lines companies to put in place transparent and nondiscriminatory use-of-system agreements with their retail business. Have the effect of prohibiting common ownership between lines businesses and generators owning more than 100MW of generation connected to the national grid. <p>20.2. Prohibiting a retail business owned by a lines business from buying the customer base of an existing retailer (to ensure there is a net increase in retail competition)</p>	<p>to implementing Part 4 of the Commerce Act and we do not believe those parties will have any capacity to consider changes to the Electricity Industry Reform Act until after Part 4 has been bedded in.</p>
<p>21. Develop more standardised tariff structures and business rules for use-of-system agreements for lines businesses to facilitate access by retailers.</p>	<p>Support the current investigation by the EC on this issue¹⁸.</p> <p>MEUG suggest it should be mandatory for distributors to publish all terms and conditions for accessing line services including prices, credit terms and treatment of capital contributions¹⁹. This will ensure all users of a network can verify they are being treated equally. MEUG has received reports from new entrant retailers of difficulties in obtaining such information. MEUG is also pursuing this issue as part of the Commerce Commission implementation of Part 4 of the Commerce Act.</p>
<p>22. Ensure that guidelines and standards on smart meters provide for (or allow upgrades for) energy efficiency capability, open access communications, customer switching, and the development of smart networks.</p>	<p>Support the current investigation by the EC on this issue²⁰.</p>
<p>23. Encourage retailers to make tariffs available, as an option for consumers, that provide incentives to better manage electricity consumption including through shifting load to off-peak times and conservation during dry years.</p>	<p>Support provided “encourage” does not mean subsidise.</p>
<p>24. Ensure that all wholesale market data is publicly released the following day to improve scrutiny of and by market participants.</p>	<p>Support subject to:</p> <ul style="list-style-type: none"> EMA being responsible for analysis and reporting to the market with a summary of events and reports on significant events; and EMA being responsible for identifying market power and making rule changes to eliminate it. <p>Note that the NZIER report attached to this submission, “Improving Electricity Market performance – Discussion document’s comments on Wolak’s analysis”, 10th September 2009, also recommended</p>

¹⁸ Refer <http://www.electricitycommission.govt.nz/opdev/retail/model>

¹⁹ This is the same as the requirement in recommendation 20.1, bullet point 2, except that full transparency and non-discriminatory access should apply whether or not the lines monopoly decides to enter the retail market.

²⁰ Refer <http://www.electricitycommission.govt.nz/opdev/retail/metering>

	<p>active market monitoring be investigated (refer final paragraph):</p> <p><i>"MEUG may also like to suggest investigating extension of the ETAG's recommendation on improving pricing transparency and monitoring to include active market monitoring by the proposed Electricity Market Authority to assist market participants to manage their risk positions more effectively."</i></p>
<p>25. Encourage and facilitate customer switching through:</p> <p>25.1. Providing \$5 million a year, from electricity levy funding, to promote the benefits of customer switching. The fund should be contestable, and should continue for as long as demonstrated benefits, in terms of savings to consumers, exceed \$10 million a year.</p> <p>25.2. Shortening the timeframe for switching between retailers from 23 days to three days for customers with smart meters.</p> <p>25.3. Improving the Powerswitch website by requiring retailers to provide updated information to improve its accuracy and coverage.</p>	<p>Support improving the PowerSwitch website.</p> <p>No reason is given why 3 days timeframe for switching consumers with smart meters is optimal. Why not allow consumers to switch within the same working day?</p> <p>The contestable fund to promote the benefits of switching proposal is not supported because it substitutes for retailers having to spend their money to compete for customers. If this policy does proceed, then any levy should be directed at retail not wholesale consumers.</p>

<p><u>To improve the governance of the electricity sector</u></p>	<p>MEUG comment</p> <ul style="list-style-type: none"> • MEUG <u>supports</u> establishment of EMA as an independent Crown Entity. <p>More work is needed on the details of the governance of EMA. For example more detail is needed on how the Rulings Panel will work compared to other alternatives before MEUG could reach a definitive view. If MEUG proposal's that by 2011 all of Part F becomes the responsibility of the Commerce Commission and the EMA actively monitors the market, then the scope of work is significantly different from that of the Discussion paper and therefore so too should EMA governance arrangements be reviewed.</p> <p>There are also some policy design elements that MEUG has concerns about. For example any change towards more of a mix of constituency representation has some attendant risks. Apart from the choice of organisations with the power to nominate representatives the use of working groups for recommending rule changes will require consumer representatives to have access to resources to allow a more effective countervailing view to the highly resourced and dominant supply side. It will be essential that consumer representatives are adequately resourced; but the problem of stalemate on controversial and complex issues remains.</p> <p>It is best to get the governance of EMA right and with a high degree of consensus before amending legalisation is tabled in Parliament. Rushing the establishment of EMA when important governance details are missing runs the risk of the new organisation failing to make any improvement over current governance arrangements.</p> <ul style="list-style-type: none"> • <u>Supports</u> the System Operator undertaking security of supply forecasting within the bounds of policies, rules and or contract set by EMA. • MEUG <u>proposes</u> EMA and Transpower must complete a plan on how the System Operator can become a separate entity from the Transmission Asset Owner within one year. The plan may never be implemented; but undertaking that work will identify if there are any issues in the current integrated Transpower arrangement that need to be changed and will give us a better view of whether or not an ISO in the future has value.
<p>26. Replace the Electricity Commission with an Electricity Market Authority (EMA) as follows:</p> <p>26.1. The EMA would be an Independent Crown Entity under the Crown Entities Act 2004.</p> <p>26.2. The EMA's objective would be to ensure the efficiency of the</p>	<p>Support:</p> <ul style="list-style-type: none"> ▪ EMA being an Independent Crown Entity. ▪ The proposed legislative purpose statement of EMA provided there are two changes: <ul style="list-style-type: none"> – First, to include a reference to promoting competition consistent with the purpose statement of the Commerce Act²¹; and

²¹ The Commerce Act Purpose statement (s 1(A) is "*The purpose of this Act is to promote competition in markets for the long-term benefit of consumers within New Zealand.*" The Commerce Act Part 4 purpose statement is "*The purpose of this Part is to promote the long-term benefit of consumers in markets referred to in section 52 by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services—*

<p>electricity market, including reliability, for the long-term benefit of consumers.</p> <p>26.3. Board members would be appointed by the Governor-General on the recommendation of the Minister of Energy and Resources, and nominated as follows:</p> <ul style="list-style-type: none"> • Two members nominated by Consumer New Zealand and Business New Zealand respectively. • One member nominated by generators and retailers. • One member nominated by lines businesses including Transpower. • One member and an independent chair nominated by the Minister. <p>26.4. . The Minister would only be able to recommend appointments of persons nominated by market participants (as applicable), but would not be required to accept any particular nomination. Criteria for members would be set down in legislation (such as independence, expertise, and ability to work as a Board member).</p> <p>26.5. . The functions of the EMA would be:</p> <ul style="list-style-type: none"> • Developing and approving market rules (including guidelines and model contracts). • Monitoring compliance with rules and, through a Rulings Panel, penalising breaches. <p>26.6. The EMA would be required to set up working groups to prepare proposed rules, and the board would be required to hear representations on proposed rules from the chair of working groups before making decisions.</p>	<ul style="list-style-type: none"> – Second, to add a reference to “security” to reflect the importance of security of supply in the mandate of EMA. <p>The EMA Purpose Statement with additional text (and text displaced) proposed by MEUG underlined follows:</p> <p><i>“The EMA’s objective would be to <u>promote competition and ensure the efficiency of the electricity market, reliability, including the secure and reliable supply of electricity</u>, for the long-term benefit of consumers.”</i></p> <p>MEUG propose two important changes to the role of EMA compared to that in the Discussion paper:</p> <ul style="list-style-type: none"> ▪ Economic regulation of transmission should be carefully transitioned to the Commerce Commission consistent with a new Individual Price-Quality regulation for transmission replacing the Settlement that expires in July 2011; and ▪ EMA have a new market monitoring function and responsibility to identify market power and propose regulations and rules for approval by the Minister to eliminate that market power. <p>If both or either of these changes is accepted, this is likely to change the best design of EMA governance. For example should the market monitoring function be within EMA or part of the activities of the Rulings Panel? And if transmission and distribution line monopoly services are regulated through the Commerce Act, the residual activities of Transpower and distributors relevant to the energy market relate to metering and provision of ancillary services. These activities are not material to justify the line monopolies having the right to nominate a representative to the EMA Board.</p> <p>The Discussion paper favours a governance structure based primarily on representatives nominated by constituents rather than Ministerial appointees. MEUG has reservations on such a model unless:</p> <ul style="list-style-type: none"> ▪ Consumer representatives have access to resources equivalent to that of supply side representatives. Two examples of the disparity and difficulty consumers’ face in obtaining adequate resources follow: – The Supplier CEO Forum established late last year a process to review the Transmission Pricing Methodology. The suppliers have spent or plan to spend between \$0.5 and \$1 million on consultants to assist their deliberations. MEUG agreed to participate in the process and noted that the output of the CEO Forum process can only ever be an input into the formal EC process reviewing the Transmission Pricing Methodology. MEUG’s limited resources have meant we have only been able to spend a fraction (less than 5%) on external expertise to assist consumer representatives compared to the \$0.5 to \$1 million spent or to be spent by suppliers. If suppliers are prepared to spend this amount on what is in effect a warm-up to the
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(a) have incentives to innovate and to invest, including in replacement, upgraded, and new assets; and

(b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and

(c) share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and

(d) are limited in their ability to extract excessive profits.”

	<p>formal Transmission Pricing Methodology review by the EC, then the views of consumers and the ability to apply expertise will be overwhelmed by the resources suppliers can and do bring to debate key issues.</p> <ul style="list-style-type: none"> - Consumer representatives on EC advisory groups are reimbursed for reasonable travel expenses and time involved. The EC has recently established 4 new advisory groups with slightly modified terms of reference to replace 6 disestablished advisory groups. The rate for reimbursement for consumer representatives has been questioned by government departments and is likely to lead to a lower per diem rate. This is not helpful to the difficult task of finding competent consumer representatives prepared to be nominated for advisory groups. This doesn't bode well for MEUG's requirement that any shift towards more of a constituency based approach for EMA must provide for adequate resourcing of consumers. ▪ A solution is found to the risk of stalemate on policy decisions where winners equal losers. The Telecommunications Forum in the Telecommunications Act might be a useful model to consider for consideration of non-controversial rule changes. Even under that arrangement more complex and controversial proposals are not considered by the representative Telecommunications Forum but are instead considered by the Commerce Commission.
27. Transfer approval of major grid upgrades to the Commerce Commission as part of its overall regulation of Transpower under Part 4 of the Commerce Act, but with reliability and service standards, transmission pricing methodologies, and the Grid Investment Test set by the EMA.	Refer MEUG comments on recommendation 16.
<p>28. Transfer the following functions to the System Operator:</p> <p>28.1. Information and forecasting on security of supply. Long term forecasting, and preparation of the 'Statement of Opportunities' would be undertaken by MED alongside its preparation of the Energy Outlook.</p> <p>28.2. Emergency management.</p> <p>28.3. Operation of reserve energy (if retained).</p> <p>28.4. Contracting for market operations (for example, market clearance and reconciliation) pursuant to rules set by the EMA.</p>	<p>Support subject to:</p> <ul style="list-style-type: none"> ▪ Noting that, as we understand it, the proposed MED SOO is not the equivalent of the current EC SOO because there will be no Power Systems Analysis to support forecasts of generation sequencing dependent on the state of the grid. The intention seems to be that Transpower will take the high level demand forecast in the MED SOO and apply Power Systems Analysis to produce SOO equivalent to that currently produced by the EC. This approach is supported provided: <ul style="list-style-type: none"> - Transpower continue the full transparency approach adopted by the EC to allow other parties to replicate the detailed SOO (eg using publicly available tools such as the Grid Expansion Model developed by the EC); and - The regulator, not Transpower, having the final say on whether the SOO is reasonable for the regulatory purposes it is needed for. ▪ Emergency management functions (and reserve energy operations if retained) will be under contract to or subject to regulations and rules set by EMA. ▪ There is a clear business case that interposing the System Operator as the primary contractor is superior to EMA directly contracting with service providers. We are not convinced that the separation of policy and rule making from operations is necessary or desirable. The reverse may

	<p>be true, ie it's better for policy and rule makers to understand how the market works in detail so that practicable solutions can be designed and implemented. Retaining a direct relationship with service providers improves that knowledge.</p> <ul style="list-style-type: none"> MEUG have proposed that analysis of released data should be made by EMA (recommendation 24). This new role would be contracted to the System Operator or possibly other service providers. This expanded role of the System Operator leads to the question of whether we should have an Independent System Operator (ISO). MEUG believes the ISO option has merit and should be further developed as an option. MEUG suggest EMA and Transpower must complete a plan on how the System Operator can become a separate entity from the Transmission Asset Owner within one year. The plan may never be implemented; but undertaking that work will identify if there are any issues in the current integrated Transpower arrangement that need to be changed and will give us a better view of whether or not an ISO in the future has value.
<p>29. Require the EMA to set up and service a Security and Reliability Council, comprising senior level persons from the electricity market, to meet periodically to help monitor and provide advice on the System Operator's performance of its functions and on security of supply issues generally</p>	<p>There may be value in a Security and Reliability Council to work with EMA, the System Operator and the Minister on security of supply issues. MEUG wants to firmly set in legislation such matters as the trigger that will determine when a floor price will commence because we do not wish to leave such decisions at the whim of politicians. However not every dry-year "crisis" has been or is likely to be the same. The Security and Reliability Council could play a role in facilitating communication flows depending on the actual event.</p> <p>MEUG does not believe the Security and Reliability Council should have a role on:</p> <ul style="list-style-type: none"> Any matter in relation to the performance of the Transmission Asset Owner in terms of Business as Usual Part 4 or Part F matters. While recommendation 29 excludes these functions of Transpower, figure 17 of the Discussion Paper refers to the role of the Security and Reliability Council as <i>"Senior level advice on Transpower's performance and security of supply"</i> Any matter in relation to Part C. Development of rules to improve Part C should be the responsibility of EMA with the System Operator managing those and reporting on performance. Those processes should be identical to the existing role of the EC and System Operator including full transparency and obligations to consult with interested parties. <p>Formation of a Security and Reliability Council under statute will add costs to the economy and probably a levy will be needed to recover costs. MEUG suggest a cost benefit analysis of the value of establishing the Council against those costs should be prepared once the exact role has been defined; including comparison against the status quo where ad hoc voluntary committees are formed as needed.</p>