



# MAJOR ELECTRICITY USERS' GROUP

8 October 2010

Lisa DuFall  
Electricity Commission  
By email to [submissions@electricitycommission.govt.nz](mailto:submissions@electricitycommission.govt.nz)

Dear Lisa

## **Submission on Customer Compensation Schemes**

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Commission (EC) consultation paper "Customer Compensation Schemes" published 7<sup>th</sup> September 2010<sup>1</sup>.
2. MEUG welcomes the additional analysis by the EC since the first consultation round late 2009. Splitting this work from scarcity pricing is also welcome. In late 2009 MEUG agreed further work on the default buy-back, now renamed the Customer Compensation Scheme, was warranted. That agreement for further work hinged on the material policy problem identified in the Hunt/Isles Review of Winter 2008 and the Ministerial Review of Electricity Market Performance 2009 that some suppliers had an incentive to socialise their own poor risk management decisions. Put another way, in prior dry-year events, large net exposed suppliers called for Public Conservation campaigns (PCC) ahead of when needed.
3. There have been many changes to the market since the last Public Conservation campaign (PCC) in 2008 and many more are being implemented. For example:
  - a) Physical asset swap and virtual asset swaps, plus development of a more liquid hedge market will facilitate better risk management strategies than suppliers using a "political hedge" to trigger PCC when things get tough;
  - b) Active monitoring of the market by the new Electricity Authority. The realization that there will be ongoing intense scrutiny of this market inefficiency will likely concentrate retailer's minds, and encourage a more measured approach to dealing with PCC's; and
  - c) Changes to SOE governance including likely improvements in risk management strategies and better transparency and accountability of net exposure compared to information provided to the market in prior dry year events.

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<sup>1</sup> Refer <http://www.electricitycommission.govt.nz/consultation/customer-compensation-scheme/view>

4. All of these will encourage better market responses to dry-year risk and therefore lower the incentive for large net exposed suppliers to game politicians and the public as observed in 2008 and earlier. In late 2009 and ahead of the above being enacted we saw a customer compensation scheme that targeted offending net exposed suppliers when a PCC was triggered and targeted rewards to consumers that saved more as worth exploring to complement other policies. The proposal in the consultation paper is at best a second best solution because it is not targeted and at worst will inhibit new entrants and simply add costs to all retail consumers without altering offending supplier behaviour.
5. Our conclusion is that the risks of implementing the proposal in the consultation paper are too high and more work is needed. It may be that taking a pause and review approach will allow time to assess if the various other market reforms listed in paragraph 3 above might collectively have reduced the risk sufficiently that a customer compensation scheme is not needed to change the behaviour of large net suppliers.
6. The table below sets out MEUG response to the questions in the consultation paper. In most cases we have responded as if a Customer Compensation Scheme will be implemented; though our preference as explained above is not to put such a scheme in place just yet.

Question No.	Response
Q1. Is 3000 kWh an appropriate minimum level to set for determining customer qualification? If not, what other level is more appropriate and why?	No comment.
Q2. Do you agree with the approach suggested in paragraph 3.2.9 or is it desirable and feasible to identify other customer types that might be excluded from within the proposed definition of a qualifying customer? If you hold the latter view, please explain what type(s) of customers you would seek to exclude, explain why they should be excluded and how they might be uniquely identified?	No comment.
Q3. Do you agree that a PCC trigger point should be pre-specified in either the EMP or the Code and that this should be set in terms of the HRC / security phase framework?	To avoid any uncertainty or unilateral regulatory intervention, we prefer the PCC trigger to be set in the Code.
Q4. Do you consider that the 10% HRC / security emergency phase is an appropriate PCC trigger point?	This is the earliest trigger that we would support, ie 10% or higher HRC. Setting a relatively high threshold will give scope and incentive for market participants exposed to high prices to find other market solutions.
Q5. Do you agree that preparation for a PCC should begin 14 days before a PCC is expected to be required?	Optimal timing likely to be event dependent, eg a nationwide PCC will take longer to prepare than managing an event that only

Question No.	Response
	affects part of one island.
Q6. Do you agree that a PCC end point should be pre-specified, and that the 8% HRC is an appropriate end point?	Agree end point should be pre-specified. See no good reason why it should not be same as trigger point, ie 10%.
Q7. Assuming the Electricity Industry Bill passes in its current form, do you agree that the roles and responsibilities set out in 3.3.33 are appropriate?	The SO activities presumably are managed under contract with the Authority. This would, where it was cost effective to do so, allow tendering out specialist work to other parties.
Q8. Should the value of savings (in \$/MWh) be established for future PCCs by using guidelines and be reviewed as required, or should a value be estimated now and codified?	No comment.
Q9. Do you agree that a differential payment level based on island (but not on residential versus non-residential or low fixed user class) is appropriate in certain circumstances?	More work is needed to differentiate between consumers that save and those that don't.
Q10. Do you agree that the Authority is the appropriate body to establish the value of savings (in \$/MWh), including inter-island differential, in future PCCs?	Yes.
Q11. What factors should be considered and what process might be used to establish such a value?	No comment.
Q12. Do you think that some level of minimum savings achievement as a precondition to triggering the payment obligation is desirable in the default CC scheme?	No comment.
Q13. If so, how should a suitable minimum condition be set?	No comment.
Q14. Do you think the principles proposed in respect of assessing an application for a customised CC scheme are sufficient and appropriate?	No comment.
Q15. What other principles should be considered for inclusion?	No comment.
Q16. Do you agree that a statutory declaration with a retained right to audit provides a sufficient approach to	No comment.

Question No.	Response
ensuring retailer compliance?	
Q17. Do you think the proposed treatment of qualifying customers that switch (and, similarly, newly connect, disconnect etc) as outlined in this section is reasonable?	No comment.
Q18. Are there any other circumstances like this that will require additional consideration?	No comment.
Q19. Do you agree with the proposed treatment for customers with pre-payment meters?	No comment.
Q20. Do you think the proposed treatment of non-FPVV customers as outlined in this section is reasonable?	No comment.
Q21. Are there any other reasonably practicable options?	Yes. A pause and re-consider option, ie reassess the risks and benefits after the present raft of changes to the market are made.
Q22. Do you agree with the methodology, inputs, assumptions and conclusions reached in the CBA?	No. Since 2008 there have been changes to the market and further changes are being implemented as a result of the Ministerial Review and passage of the Electricity Industry Act (refer paragraph 3 of this submission). The CBA is based on events of 2001, 2003 and 2008. The recent policy changes are likely to positively influence the behaviour of retailers and reduce the benefits estimated in the CBA. The CBA also overstates benefits because it does not take into account the diminishing reliance in the future on hydro generation in New Zealand's overall power supply portfolio and likely uptake by households with smart meters of products that offer dry year insurance.
Q23. Do you think the CC scheme as proposed raises significant negative retail competition impacts? (see Appendix 3)	<p>Because the proposal is not targeted at offending suppliers, the cost (probability of PCC being incurred times unit cost per consumer) will apply uniformly to all retailers and be treated as a standard pass through.</p> <p>There will also be back-room costs to implement and comply with the Code and any future amendments. There will be economies of scale disadvantages to new small entrants in compliance costs and to that extent a small detrimental effect on retail</p>

Question No.	Response
	competition.
Q24. If so, how should these be evaluated? (see Appendix 3)	See answer to Q23 above.

7. This submission is not confidential.

Yours sincerely



Ralph Matthes  
Executive Director