

Major Electricity Users' Group

20 July 2012

Libby Masterton Ministry for the Environment By email to <u>etsconsultation@climatechange.govt.nz</u>

Dear Libby

EAF submission

- This is a submission by the Major Electricity Users' Group on the factsheet titled "An Electricity Allocation Factor for 2013 and beyond" published by the Ministry on 12th June 2012¹. This submission is not confidential. MEUG members were consulted in the preparation of this submission and the overall submission's approach and detail is as agreed by those allocated units. Some MEUG members will be making separate submissions.
- 2. Deciding an EAF is non-trivial. The approach by the Ministry to use an EAF contact group with specialists and to have input from the group when contracting independent expert advisors and modellers was well managed and transparent. As a member of the group I can attest to robust debate and compromises by all to reach the group's consensus decisions. MEUG responses below reflect the confidence in the consensus views and agreement with the trade-offs reached.

Question		MEUG response
Q1.	Do you support EAF option (a) or (b) or (c)?	MEUG support option (c).
Q2.	What are the reasons for your preference?	In the absence of an ETS regime, more weight should be given to the likelihood that new thermally efficient base load coal fired power stations would have been built with a resulting relatively low electricity price path compared to the status quo. Assuming this counterfactual the impact of the ETS on power prices is substantial and therefore the upper band of the three options is appropriate.

¹ Published at <u>http://www.climatechange.govt.nz/emissions-trading-scheme/building/regulatory-updates/eaf-</u> <u>consultation.html</u> including EAF contact group "Development of an EAF Recommendation for 2013 Onwards", June 2012 and Energy Modelling Consultants Ltd report "Generation System Modelling for the 2013-2017 EAF" 30th November 2011

Level 1, 93 The Terrace, Wellington 6011, New Zealand

Question	MEUG response
	There is also, in our view, a high likelihood that further gas discoveries will at a minimum extend the time horizon for existing levels of gas used in power stations and a good probability gas reserves will increase to enable new CCGT to be built. These scenarios also support the highest proposed EAF.
	MEUG places great emphasis on the asymmetric social costs described by NZIER ² as
	" the potential social costs from setting the EAF too low compared with the social costs of setting it too high. In our opinion, this should have been a key consideration; the objective of the ETS is presumably to provide a positive net benefit to New Zealand and the world."
	Only option (c) takes this social cost into account ³ . The factsheet gives readers little appreciation of this cost to the economy but does detail the fiscal cost to the Crown:
	"Options (b) and (c) cost the Crown (and therefore benefit businesses) approximately 20,000 units and 100,000 units per annum respectively, relatively to option (a)."
	With respect to this statement MEUG notes:
	 Factually the calculation of units is assumed correct;
	• Factually the direct cost to the Crown is also assumed correct but some recognition should have been made of the net cost should the EAF be set too low resulting in EITE businesses reducing production or exiting the economy resulting in decreased company tax and PAYE receipts by government and further second order effects associated with a contracting economy.
	• Characterization of adoption of higher EAF "benefiting" businesses makes us wonder if the authors understand the purpose of the EAF at all. The EAF needs to be set to make EITE enterprises indifferent to the effect of an ETS so they can continue to compete in international markets on an even footing, employ people and contribute to GDP. A correctly set EAF does not lead to those businesses benefiting.

 ² NZIER report to MEUG, Review of the Electricity Allocation Factor", 2nd July 2010, section 4.2.4, p16, <u>http://www.meug.co.nz/includes/download.aspx?ID=111587</u>
 ³ EAF contact group report, bottom row of table comparing options, p11

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Question		MEUG response
Q3.	Should the EAF be set at some other level?	There is a case for an EAF higher than (c); however MEUG accepts sufficient debate on that possibility has been conducted within the EAF contact group and therefore the upper bound of 0.606 (option (c)) is supported.
Q4.	If so, what level and why?	See answer above.
Q5.	Should the EAF be durable until significant events occur warranting a reassessment?	Yes.
Q6.	What variables do you consider key to the durability of an EAF?	We agree with those identified by the EAF contact group ⁴ of emissions price, prices of key thermal fuels like gas and coal, major plant changes to the generation network and market structure changes.
Q7.	Do you have any comments on the contact group advice, as outlined in part 2 of its recommendation, on how future EAF revisions are undertaken?	MEUG appreciates the Ministry considering price effects based on likely behaviour when occasional periods of market power can be exercised (a feature of electricity markets worldwide), ie the imperfect competition or Cournot behaviour modelling approaches. We agree that little reliance can be given to the modelling results in this round; partly because of problems in having certainty on assumptions used and part with lack of peer review and ability to replicate the model used. The EAF contact group report in providing guidance for estimating future EAF notes ⁵ "consideration should be given to any complementary analyses that would add confidence to an EAF recommendation". We agree that having alternative methods of estimation, such as SRMC and imperfect competition approaches, should be considered in future rounds.

Another of the recommendations by NZIER⁶ to MEUG when reviewing the EAF process in July 2010 was that:

"The Minister should issue a draft decision paper on the EAF and, after he or she has considered submissions and cross-submissions, a final decision paper, together with an analysis of all submissions and his or her response to them."

4. We think this is still good advice given the controversial and sometimes polar opposite analysis of some submissions in the inaugural EAF consultation round between December 2009 and February 2010. MEUG suggest a cross-submission phase would be useful to allow a transparent process for rebuttals to be lodged.

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⁴₂ Ibid, section 3.7

⁵ Ibid, section 3.2

⁶ NZIER, p16

Yours sincerely

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Ralph Matthes Executive Director