MAJOR ELECTRICITY USERS' GROUP

5 April 2013

Hon Simon Bridges
Minister of Energy and Resources
Parliament
By email to s.bridges@ministers.govt.nz

Dear Minister

Congratulations and briefing on electricity policy

On behalf of the members of the Major Electricity Users' group (MEUG) we extend our congratulations to you on being appointed to the Ministerial portfolio for energy and resources. MEUG members comprise 18 large power consumers collectively using over 25% of power demand and two trade associations (Business NZ and Wood Processors Association). Member companies of MEUG and our mission statement is listed below. Asterisks indicate companies with onsite generation:

ANZCO Foods	Holcim	Pan Pac Forest Products *
Carter Holt Harvey *	Lion Breweries	Ravensdown Fertiliser *
Dongwha Patinna	New Zealand Steel *	Refining NZ
Fletcher Building	Norske Skog Tasman *	Solid Energy
Fonterra Cooperative *	Oceana Gold	Whakatane Mill
Heinz-Wattie's Australasia	Pacific Aluminium	Winstone Pulp International
Mission statement: To add value to MEUG members' management of electricity costs and risks through market intelligence, networking, facilitating solutions to improve competition, maintain reliability, promote efficient operations and regulate monopolies to achieve outcomes consistent with competitive markets for the long-term benefit of electricity consumers.		

MEUG members are substantial contributors to GDP. Members operate in highly competitive export and or import substitution sectors of the economy. Aggregate export receipts alone exceed $13 billion per annum. To be internationally competitive MEUG members must innovate, are often adopters of new technologies and operate as niche commodity suppliers.

To remain competitive input resources, including energy, must be efficiently priced. Turnover in the electricity industry is approximately 6 billion dollars per annum comprising:

- $4 billion in the "contestable" energy market; and
- $2 billion in regulated line monopolies (Transpower and 29 distributors).

Since 2010 policy work for the contestable part of the sector has been dominated by implementation of the reforms following the Ministerial Inquiry into the electricity sector. Current policy making for the wholesale and retail sectors can be described as evolutionary rather than revolutionary. This does not infer the pace of change should ease up. Quite the reverse; we need to continuously improve the market if we are to keep NZ Inc. competitive. Continuous change is needed partly to unwind features of the market that have favoured suppliers from its inception and partly to adapt to a range of new generation and demand side technologies.

Futures prices on the ASX electricity futures market to 2016 are flat on an annualised basis. On average this should lead to flat wholesale hedge prices and flat retail prices in the near term.

In contrast transmission charges are forecast to increase greater than inflation and distributor charges on average at the rate of inflation. Until 2015 we expect most controversial policy issues will revolve around transmission and distribution. For example:

- The increasing line charges reflect a pre Global Financial Crisis (GFC) environment where demand was expected to grow and monopolies were given certainty and a premium in guaranteed rates of return.

  With energy demand expected to be flat and perhaps decreasing (as occurred last year with demand for Transpower's interconnection services), consumers have an increased risk in the near term that increasing line revenue requirements being spread over a declining peak demand base will lead to a double hit on unit line charge increases. The regulatory regime that worked in the pre 2009 GFC environment is no longer fit for purpose. Consumers will quickly recognise that each April when their electricity invoices increase.

- By March 2015 the Commerce Commission will have revised the Individual Price-Quality Path (IPP) that regulates Transpower and the Default Price-Quality Path (DPP) that applies to 16 distributors (Orion is an exception and the balance being community owned and small are subject to information disclosure only).

- Over the next year the Electricity Authority will progress reviews of the Transmission Pricing Methodology and alignment of distributor pricing with the voluntary pricing principles.

- In the very near term the High Court will publish decisions on merit review claims on Input Methodologies (IMs).

  MEUG was the only non-monopoly party to lodge a merit review on the electricity and gas related IMs. We had a narrow focus on certain parts of the cost of capital IM whereas the line monopolies in some cases used a scatter gun approach across all IM (cost of capital, asset valuation, treatment or tax, etc). The resources the monopolies applied to the High Court merit review would have been millions of dollars. We have spent several hundreds of thousands of dollars over the last three years on just the narrow points of our arguments. If we are successful then all customers will benefit. The overwhelming resources available to the monopolies and MEUG's shouldering of a countervailing view for all customers has been a harsh lesson in whether the merit review provisions are reasonable and in turn if Part 4 as a whole is effective.

- The application by Orion for the first ever Customised Price-Quality Path (CPP) regulatory regime was lodged early 2013 and has already raised significant policy questions.

- Transpower are likely to seek approval to charge customers for cost overruns in excess of $100m on the new 400 kV capable line between Whakamaru and South Auckland (abbreviated NIGUP, the North Island Grid Upgrade Project).

  NIGUP is controversial because arguably it is currently uneconomic, ie the benefits that accrue to the market are less than NIGUP regulated annual charges before cost overruns are considered.

All of these have the potential to significantly increase line charges that will be passed onto end customers. The monetary values at stake in some cases are very large, eg if the High Court merit review decision on cost of capital finds in favour of Transpower, Vector and other distributors, then line charges could increase by up to $600m per annum, equivalent to a 30% increase in line charges for all classes of customer[1].

Over and above the regulatory functions of the Commerce Commission and Electricity Authority to improve performance of Transpower and the 29 distributors, the government has three main decision roles in the debate on electricity line monopoly charges:

1. To determine if Part 4 of the Commerce Act that sets out the regulatory regime is fit for purpose and in particular how customers can better participate in regulatory decision making by regulators and precedents set by the Courts;

2. To ensure the Commerce Commission, the agency responsible for administering Part 4 of the Commerce act, is well resourced and well run; and

3. To consider under what circumstances Government should take a write down in the value of the monopoly business it owns, namely Transpower.

While these matters are primarily for consideration of the Minister of Commerce or Minister of State Owned Enterprises, they are very relevant to expected future delivered power prices and hence likely to be of interest to you. Further details of these and other Ministerial, Commerce Commission and Electricity Authority decision making issues currently in hand or emerging issues are summarised in the appendix.

[1] Franks & Ogilvie, Cross-submissions on behalf of MEUG in response to submissions of Transpower, Appendix 1: MEUG's summary of party claim effects on WACC estimates, tabled with the High Court 3rd September 2012

Finally, brief comments on two other current policy issues:

- On 27th February 2013 a change in generator offers led to a rapid escalation in spot prices peaking 10 days later on 8th March at approximately $350/MWh/day nationwide. The Electricity Authority commenced a stage I enquiry on 4th March. Recent spot prices have been $100/MWh or less. The Authority has yet to report its findings. Note:

  - Generator behaviour appears to be different from prior high price events although it is difficult to assess given the effect of HVDC Pole 3 commissioning tests being undertaken over this time. For example MEUG members have reported greater volatility in forecast and actual spot prices than prior high priced events making it difficult to optimise their own production runs each day. Surveillance of market participant behaviour and evolution of the Code is an ongoing and essential task for the Authority. We support the Authority being funded to undertake this type of monitoring and enquiry; whereas suppliers would probably prefer that work was wound down.

  - There is no quick fix to improving productivity and competition by suppliers. A range of improvements to the Code and non-Code initiatives are needed. For example if we had in place Code amendments being considered for dispatchable demand, changes to the settlement and prudential security requirements and better alignment of close to real time dispatch forecast spot prices and final settlement prices, then the impact of the recent event would have been less harmful to MEUG members and other time of use businesses. This is no time for the Authority to delay making these market improvements.

  - There is a common misconception that if time of use customers were fully hedged then they need not worry about such high spot price events. Being fully hedged may not be efficient, particularly where there is a risk of misalignment between actual production and hedge position. Companies could also respond by reducing demand if their SRMC with high spot electricity prices exceeds the price they can sell their product. Such a response is good for the company and the nation.

    The emphasis by the Electricity Authority to facilitate development of the hedge and futures markets needs to be balanced with more emphasis on improved spot price discovery. Only with improved spot price discovery will we get improved and higher levels of demand side response. Because spot price discovery currently favours suppliers, possible direct spot participation by consumers is lower than optimal and the flight of those customers to the hedge market results in higher demand and hence higher hedge prices than optimal. With better spot price discovery the margin between spot and hedge would close.

    Note we do not want the Authority to reduce its efforts on improving the hedge and futures market. Having the futures price curve is better than not having one. Some market responses such as volatility in the back end of the futures curve seem to be driven by near term market conditions such as hydrology. This in our view reflects a less than optimal level of liquidity. We support the ASX and Authority trying to find ways to improve liquidity.

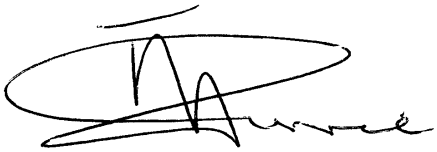
- The review of the Transmission Pricing Methodology (TPM) is controversial for two reasons. First, the Authority proposal of October 2012 is new and complex. We are confident the range of submissions and cross-submissions made will deter the Authority from acting precipitously and proceeding to issue TPM guidelines based on that proposal.

  The second controversial aspect was the decision by the Authority to make this a priority work item over 2012. We are annoyed with this because we had no choice but to engage in the TPM consultation process and our time and external consulting resources would have been better employed on market improvement work.

Unfortunately I cannot attend the introductory meeting being arranged with Ralph Matthes, MEUG's Executive Director, and two of the MEUG Executive Committee, Ray Deacon (Pacific Aluminium, and MEUG Deputy Chair) and Richard Hale (representing Refining NZ) on 10th April. Mr Hale is also the co-ordinator of the Major Gas Users' Group (MGUG) that has similar concerns over regulation of gas monopolies.

An important outcome of the introductory meeting is to invite you to visit MEUG member sites to gain insights into operational and policy issues at a grass roots customer level. I hope you can find time to visit some MEUG member sites and as opportunities arise we would welcome arranging a meeting with MEUG members.

Yours sincerely



Terrence Currie
Chairman

Appendix

Supply Chain	Policy issue and options (this excludes BAU activities)	Decision makers
Industry governance and taxes	Can customer participation be improved in Commerce Act Part 4 and EA processes?	Minister of Commerce and Minister of E&R
	Well run and resourced EA and CC: High calibre, balanced and independent Board members and Elec. Ruling Panel appointments. Resources for EA and CC to match benefits from outputs rather than constrain as likely to be advocated by monopolies and suppliers.	Minister of E&R and Minister of Commerce
	Amend Electricity Industry Act to allow EA to charge fees for specified activities: MEUG support this proposal.	Minister of E&R
	EECA levy on power users' an unwarranted subsidy because it does not address a market failure: remove the EECA levy.	Minister of E&R
	Should EA and GIC be merged?	Minister of E&R
Energy	Detailed Code and other non-code improvements to the market	EA
	Review of Electricity Industry Act s.42 New Matters. For example stress test is, in our view, a waste of time. Another example is frustration with implementation of Dispatchable Demand because of delays by the system operator.	Minister of E&R intervention under s.43 on s.42 matters expires 31st October 2013. EA to undertake post implementation review of s.42 New Matters.
System operator monopoly	All round poor performance: Either remove system operator's statutory monopoly and or improve SOSPA and or change Code and or make system operator subject to Part 4 regulation.	Minister of E&R, EA and CC
Line monopolies	Review of Part 4 of Commerce Act as a whole given appalling experience with merit review process in particular. See also under industry governance above the need to review how customer participation can be improved.	Minister of Commerce
	Revised Transpower IPP and EDB DPP from 1st April 2015, decisions on Orion's CPP and evolution of Information Disclosure regime.	CC
	Review of TPM and distribution pricing.	EA
	Write down of uneconomic Transpower assets.	Minister of SOE
	Are 29 distributors too many?	Minister of E&R