



# MAJOR ELECTRICITY USERS' GROUP

23 April 2013

Dr John Rampton  
General Manager Market Design  
Electricity Authority  
By email to [submissions@ea.govt.nz](mailto:submissions@ea.govt.nz)

Dear John

## Consultation Paper – Strategic directions for market development

This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Authority consultation paper<sup>1</sup> "Strategic directions for market development" dated 12<sup>th</sup> March 2013. We welcome this initiative by the Authority to consider every three years the medium to longer term "strategic directions" three to ten years as a complement to the existing:

- "Strategic framework" in the annual Statement of Intent (SOI) covering forecast years one to three; and
- Detailed year-ahead work programme.

A final set of strategic directions will be published<sup>2</sup> along with the 2013/14 SOI following the government budget later in May 2013. Responses to the questions in the paper follow:

Question	MEUG response
1. What are your views on the proposed purpose of the strategic directions?	<p>Agree the strategic directions should focus on<sup>3</sup> "enhancing market processes" in order to promote competition, reliability and efficiency (the "CRE" troika) as set out in the Authority's statutory objective; rather than have a prescriptive plan of what the market should be evolving towards.</p> <p>The market enhancing processes themselves need to be efficient and innovative. By innovative we mean making pro-active initiatives for improvement that include improved understanding and accessibility for customers to participate in "enhancing market processes". This is the key endogenous factor controllable by the Authority that should be given more prominence in the strategic directions.</p>

<sup>1</sup> <http://www.ea.govt.nz/dmsdocument/14495>

<sup>2</sup> Consultation paper paragraph 2.1.4

<sup>3</sup> Ibid paragraph 2.3.1

Question	MEUG response
2. How else might the Authority indicate how the work programme will evolve in response to emerging circumstances? Please describe your proposal	MEUG has no suggested alternatives.
3. Do you agree or disagree with the Authority's assessment of the challenges facing the electricity sector in the coming 10 years or so? Please provide your reasons	<p>The three high level challenges in the paper<sup>4</sup> "in the coming 10 years or so: "uncertainty; rapid development of technology; and changing consumer expectations" are:</p> <ul style="list-style-type: none"> <li>• Inter-dependent.</li> </ul> <p>For example changes in technology are likely, provided the regulatory regime is well designed, to facilitate:</p> <ul style="list-style-type: none"> <li>– better real time price discovery as SPD modelling to estimate the actual intersection of demand and supply evolves;</li> <li>– more retail (residential) and wholesale demand side participation across energy and reserve markets; and</li> <li>– More opportunities for new supply side initiatives including small and micro embedded generation.</li> </ul> <ul style="list-style-type: none"> <li>• Incomplete.</li> </ul> <p>The announcements by the Labour Party last week of a policy to return to a central planned sector are a reminder of ongoing political uncertainties. We don't think this risk will necessarily be extinguished within the next three years. This risk is not mentioned in the paper but should be acknowledged. For practical purposes the work of the Authority should remain on course to facilitate the CRE objectives because success on those is the best rebuttal to proposals to dismantle the market.</p> <p>While the Labour Party proposals are extreme, there are other more incremental uncertainties on industry structure that might occur, eg</p> <ul style="list-style-type: none"> <li>– The ongoing policy question as to whether 29 electricity distributors makes sense for a country the size of New Zealand may lead to changes that affect the achievement of the CRE troika; and</li> <li>– Should the reform package of 2010 post the Ministerial review the year prior fail to deliver expected productivity gains then the next option may be to separate the generation and retail arms of vertically integrated suppliers.</li> </ul>

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<sup>4</sup> Ibid paragraph 2.4.1

Question	MEUG response
	<p>The other uncertainty not covered in the paper surrounds the regulatory regime that governs the “enhancing market processes” discussed in response to question 1 above. In addition to the political threats to the stability of the regulatory regime is the never ending friction with some incumbent suppliers to reduce the influence of the Authority. The driver for those suppliers is the threat their incumbency benefits based on legacy rules designed by and for suppliers are eroded by an effective Authority. Offsetting these threats will be ongoing regulatory regime evolution opportunities such as:</p> <ul style="list-style-type: none"> <li>– Removal of the system operator statutory monopoly; and</li> <li>– Consideration of merging the regulatory and market facilitation work of the Authority and the Gas Industry Company.</li> </ul> <p>Note we also see near term, that is work on regulatory governance within the next one to three years and hence part of the immediate “strategic framework” rather than “strategic directions” as follows:</p> <ul style="list-style-type: none"> <li>– Developing performance measures and targets to assess the Authority's vision to be recognised as a world-class regulator. We acknowledge the Authority is considering how to develop these metrics.</li> <li>– Developing policies to better enable customer participation in code development. All classes of customers struggle to engage on the numerous consultation rounds and to have sufficient direct participation on Authority working and technical groups. The inability of customer participation in regulatory processes is a major issue in regulation of monopolies by the Commerce Commission pursuant to Part 4 of the Commerce Act. In particular the unfortunate experience to date in the merit review process where customers were effectively disenfranchised is likely to lead to re-consideration of how to facilitate consumer involvement. Policies to improve customer involvement in Part 4 Regulation should align with improvements in customer involvement in work governed by the Authority.</li> <li>– The possibility of a review of the outcomes of the reform package of 2010 just within or the year following the term for the next as that will be 5 to 7 years since the reforms commenced. This review may be by the Ministry of Business Innovation and Employment rather than the Authority.</li> </ul>

Question	MEUG response
<p>4. Do you agree or disagree with the proposed strategic directions? Please provide your reasons.</p>	<p>MEUG suggests the strategic directions should be revised taking into account:</p> <ul style="list-style-type: none"> <li>• The first two draft strategic directions of “reducing barriers ...” and “facilitating consumer participation ...” in effect are the same. The second of these is simply a focus on reducing barriers to demand side participation. MEUG suggests combining these two strategic directions.</li> <li>• The third draft strategic direction “providing efficient price signals ...” misses the more important problem in the market that work has not finished on discovery of efficient real time spot prices. There is no point having efficient price signals in WITS pre-real-time schedules or hedge markets if the underlying spot price discovered in the market doesn't reflect the true solution where demand, supply and the real time state of the grid intersect. The paper fails to mention anywhere the necessity for discovery of efficient real time spot prices; the focus is instead on price signals in the hedge market in particular.</li> </ul> <p>A fundamental challenge for electricity markets is that real time pricing relies on complex models rather than observable trades between buyers and suppliers. These models are unlikely to ever exactly replicate the interface of real time decisions by multiple buyers and suppliers over a mixed HVAC and HVDC network. The status quo models cannot be considered the best there will ever be. In addition the rules of the real time market will need ongoing evolution as the models change. Immediate opportunities to improve real time price discovery include:</p> <ul style="list-style-type: none"> <li>– Improving alignment of forecast spot and settlement prices;</li> <li>– Dispatchable demand; and</li> <li>– Increasing the number of loss tranches used in SPD for modelling line losses<sup>5</sup>.</li> </ul> <p>The above three issues should be completed within the next three years. They are illustrative though of the ongoing complex, incremental and important strategic issue in the longer term to continuously improve real time price discovery.</p> <ul style="list-style-type: none"> <li>• The fourth strategic direction “promoting flexibility and resilience ...” should recognise the key strategic issue of regulatory innovation detailed in our response to question 3 above.</li> </ul>

<sup>5</sup> EA 2012/13 work programme project D19, Improved market modelling of losses, first proposed by MEUG in 2005.

Question	MEUG response	
	The table below summaries the revised strategic directions proposed by MEUG.	
	Draft proposal	MEUG's suggestion
	reducing barriers, involving facilitating the entry, expansion and exit of parties from electricity markets	Reducing barriers, involving facilitating the entry, expansion and exit of parties from electricity markets, <u>and facilitating consumers exercising choice of supplier and product.</u>
	facilitating consumer participation, involving facilitating consumers exercising choice of supplier and product	
	providing efficient price signals, involving facilitating informed decision-making by disseminating price data and information	<u>Improving real-time price discovery and</u> providing efficient price signals, involving facilitating informed decision-making by disseminating price data and information
	promoting flexibility and resilience, involving facilitating the efficient operation of the electricity system and markets	promoting flexibility and resilience, involving facilitating the efficient operation of the electricity system and markets <u>and regulatory innovation<sup>6</sup></u>
5. Do you consider there are other strategic directions for market development? Please provide your reasons.	No additional comments to those in response to question 4 above.	

<sup>6</sup> Note in response to question 1 of this submission we note "By innovative we mean making pro-active initiatives for improvement that include improved understanding and accessibility for customers to participate in "enhancing market processes"

There is one aspect of the consultation paper where the Authority did not seek a response. That is whether parties had any views on figure 1: Relationship between projects on the 2012/13 work programme. That figure is a useful example of how the final strategic directions may complement the 2013/14 to 2015/16 strategic framework and 2013/14 work programme. However in the detail of the example for the 2012/13 work programme MEUG note three important differences of view from that portrayed in figure 1:

- 1) "Hedge market development" appears twice. First in the left hand side bubble between efficient price signals and reducing barriers and second in the consumer participation quadrant. This reinforces our view that reducing barriers and consumer participation strategic directions are one and the same.
- 2) There is no recognition of the need for efficient real time spot price discovery as discussed in response to question 4 above.
- 3) There is no recognition of the need for efficiency and innovation in regulatory processes that govern the "enhancing market processes".
- 4) Stress test does not appear in the figure. We agree omitting stress test is appropriate because it adds no value and in fact decreases the efficiency of the market through compliance costs.

This submission is not confidential.

Yours sincerely



Ralph Matthes  
Executive Director