MAJOR ELECTRICITY USERS' GROUP

17 October 2014

Hon Simon Bridges
Minister of Energy and Resources

Mr Paul Goldsmith
Minister of Commerce and Consumer Affairs

Dear Mr Bridges and Mr Goldsmith

Congratulations on Ministerial portfolio appointment

The members of the Major Electricity Users' Group (MEUG) congratulate you to your re-appointment for Energy and Resources and new appointment to the Commerce and Consumer Affairs portfolios respectively. This letter:

- Introduces MEUG and activities we are working on over the next year;
- Specific policy issues in your portfolios; and
- Requests an opportunity to meet to introduce MEUG.

Members of the group comprise large end user's of electricity. The largest are connected to the national transmission grid. Most of the 17 member companies have sites also directly connected to local distribution networks. A list of the members follows (alphabetical within each demand group and total spend on electricity):

>700 GWh pa (>$80m)	200-700 GWh pa ($20m to $80m)	<200 GWh pa (> $20m)
Carter Holt Harvey *	Fletcher Building	Dongwha
Fonterra *	Norske Skog Tasman *	Heinz-Wattie's
NZ Steel *	Pan Pac Forest Products *	Holcim
Pacific Aluminium	Progressive Enterprises	Lion
	Refining NZ	Oceana Gold
	Winstone Pulp	Ravensdown *
		Whakatane Mill
Industry group members: Business NZ; Wood Processors and Manufacturers Association of NZ		

Many members also have onsite co-generation. Those are marked with an asterisk.

MEUG members collectively use approximately a quarter of all electricity consumed. Members pay less than a quarter of all charges because they consume power at a more even rate day and night and at higher voltage than households. Therefore members have less peak time charges as a proportion of total charges and less share of lower voltage distribution network charges. Individual members manage their own energy portfolio risks. The role of MEUG is to act on behalf of members collectively on generic policy and energy sector issues.

The electricity industry has an annual turnover of $5 ½ to 6½ billion comprising approximately $3 to $4 billion for contestable energy and just over $2½ billion for regulated monopoly services.

The energy market

The contestable energy portion of the market is regulated by industry specific tertiary regulation administered by the Electricity Authority (EA), ie the Electricity Industry Participation Code 2010 or usually simply called the "Code". MEUG participates in multiple ways with the EA to continuously improve the Code and non-Code initiatives by the industry itself. Examples of our active participation in improving the Code include over the last year MEUG made 17 submissions to the EA on various formal consultations for Code amendments. Another example is that MEUG members are and have been members of EA working groups. EA representatives often attend MEUG monthly meetings to discuss specific and topical issues.

Most of the EA work can be described as incremental improvements to the Code; though some are nevertheless controversial. The highest profile and longest standing controversial issue is the review of the Transmission pricing Methodology (TPM). The EA is consulting on a series of detailed working papers prior to consolidating their proposal to change the TPM, if at all, in a second consultation paper in mid 2015. That measured almost pedantic approach is a welcome improvement to the launch and proposed decision making process with the first consultation paper in October 2012. Contrary to the view of some commentators that the EA has been on a crusade MEUG considers the EA is on a more thorough review track. MEUG is open to any proposed change to TPM provided it can be demonstrated to be in the long term interest of consumers, ie we have no preferred solution yet because the EA has yet to complete and consult on its work.

Apart from Code amendments and non-code initiatives facilitated by the EA, such as assisting the market to develop new financial derivatives and increasing liquidity of existing products, there are three other aspects to each of your Ministerial portfolios that we consider to be relevant. First there are various regulations administered by MBIE that govern parts of or relate to the energy portion of the electricity market. Second the contestable energy market is subject to the generic restrictive trade practice and business acquisition provisions of Parts 2 and 3 of the Commerce Act, the Fair Trading Act and the Consumer Guarantees Act. Third as Ministers you appoint members of the EA Board and approve the annual expenditure appropriations for the EA including the electricity levy charged on all consumers that partly funds EECA. All of these can at times become important.

The regulated monopolies

Whereas the energy market can be thought of as becoming mature with a focus on continuous improvement and ensuring market participants are motivated to be innovative and competitive; the regulatory regime governing Transpower (almost $1 billion per year charges) and the 29 distributors (≈$1.7 billion per year charges) has become an increasing focus of concern for MEUG and we believe it needs to be thoroughly reviewed.

At a broad level Transpower and the 29 distributors are subject to economic regulation in Part 4 of the Commerce Act administered by the Commerce Commission with contract terms and pricing regulated by the EA in terms of the Code. The regulators have a memorandum of understanding to ensure each understands changes being considered by the other.

Changes to the Code administered by the EA relating to the monopolies have an established process allowing identification of policy problems, opportunities for debating and submitting on alternative solutions and once decisions are made those being subject to judicial review. Some aspects of regulating electricity line monopolies pursuant to Part 4 of the Commerce Act are not as amenable to amendment as the Code. Hence policy problems have been building that will need resolution and in some cases consideration by Ministers.

Those policy issues include:

(1) A review of the merit review provisions. We believe there is a great deal of common ground between the Commerce Commission, monopolies and consumers on how improvements can be made as well as some options that will need more debate and analysis.

(2) Whether there are practical ways to improve participation by all classes of consumer in the consideration of and implementation of decisions by the Commerce Commission. Typically only MEUG has made submissions to the Commission on various aspects of setting price and quality paths. There is no obvious simple solution to ensuring other classes of consumer can have a say also but that shouldn't stop us considering possible options.

(3) The treatment of line assets that are not used or useful to consumers and yet consumers continue to have to pay for them. This is a material issue that we believe will require a creative approach to come to an equitable solution. This issue may well have an increasingly negative impact on some of the potential innovations for consumers in both electricity generation and use areas and potentially distort consumer response. For example analysis by the EA has estimated the cost of Transpower charges for the North Island Grid Upgrade Project (NIGUP) in 2017 will be in excess of $90 million per year but the benefit accruing to generators and consumers will only be $40 million[1].

These issues were signalled to Ministers in MEUG's letter of 17th June 2013. Ministers Foss and Bridges replied on 26th August 2013. Those letters are attached. Now we have concluded the merit review process and the multiple consultations by the Commerce Commission on resetting Transpower's IPP, the DPP that applies to non-consumer owned distributors and Weighted Average Cost of Capital the time is right to recommence the discussion on these policy issues.

We would value an opportunity to meet both of you to introduce MEUG and answer any questions you may have.

Yours sincerely

Lyndon Haugh
Acting Chair

[1] EA working paper, Transmission Pricing Methodology" Problem definition relating to interconnection and HVDC assets, 16th September 2014, Table 3, p51