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Electricity Market Review
Energy and Communications Branch
Ministry of Economic Development
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SUBMISSION ON “IMPROVING ELECTRICITY MARKET PERFORMANCE”

- 1 Orion New Zealand Limited (**Orion**) welcomes the opportunity to respond to “Improving Electricity Market Performance”, a preliminary report to the Ministerial Review of Electricity Market Performance (**the report**).
- 2 Orion congratulates the Advisory Group and the Ministry of Economic Development for preparing the report across such a wide range of areas, and in a relatively short period of time. We are pleased that the report is action oriented and not just a think piece.
- 3 However, Orion urges caution in the selection of which of the recommended actions to take, and when to take them.
- 4 The remainder of our submission follows the structure of the paper. We have also include a schedule which summarises Orion’s position with respect to each recommendation.

Security of supply

- 5 We consider that this is one of the most important sections of the report, as it goes to the heart of widely expressed concerns relating to the number of “dry years” that have occurred over the last 10 years. However we believe that their may be too many solutions being proposed for the problems identified.
- 6 In Orion’s view the nub of the problem is the Reserve Energy Scheme. We agree this has created the perverse incentives on parties to lobby

government and government agencies. However there can be no doubt that this lobbying is commercially sensible behaviour given the existence of the scheme. We thus endorse the paper's recommendation 4, that the reserve energy scheme be phased out. (This does not necessarily mean that the Whirinaki site or plant will cease to be used: it should find its highest value use in the absence of an administrative constraint on spot prices.)

- 7 However, there is an important difference between participants managing the financial risks of supply constraints, and their taking action to ensure adequate physical supply. Just because participants adequately manage financial risk does not guarantee physical supply, and indeed we are not sure that the latter is possible. No significant element of the electricity supply system, from generator, through transmission and distribution to points of connection, is 100% reliable. This reflects the implicit or explicit conclusion that such reliability is simply too expensive.
- 8 New Zealand has experienced hydro shortages under a number of structural regimes, including government department, SOE dominated (ECNZ), and market. While we do not suggest that structure can have no effect on outcomes, we are sure that structure cannot make it rain. This raises potential issues with both the proposed price floor and the compensation scheme:
 - 8.1 Generators dry year financial risk is based on their fixed price contract obligations, however this is defined. Any changes that increase the dry year risk (which is driven by the level to which prices go) will incentivise generators to take such actions as contracting less, placing higher premiums on contracts, and introducing more force majeure style terms in contracts.
 - 8.2 There appears to be an underlying presumption that all "fixed price" contractual arrangements are of a particular sort. Not only is this not true, in Orion's view it would be undesirable if innovative contracting was in some sense not allowed. We note in this regard that most residential and small business customers are likely to be on contracts where prices can change on 30 days notice, and that at least one generator/retailer – Meridian - has a clause in its Terms and Conditions that allows it to change price at 48 hours notice in the event of a "constrained supply situation". (As far as we are aware this clause has never been invoked.) As has been noted for many years, and in fact again in the report, demand side response to high spot prices is limited. This may primarily reflect lack of exposure to those prices.

- 8.3 If, despite the management of financial risk, there occurs in future a risk to physical supply, it is unclear either who would trigger the spot price floor or the compensated conservation campaign, and in any case who would actually incur the costs of any compensation. It would be unfortunate if participants ended up with incentives to deny or understate risks to physical security.
- 8.4 Physical shortage has many of the common quality aspects that occur in other parts of the industry, in the sense that parties cannot readily contract for physical priority over others, and rational individual decisions may well place collective supply security at risk.
- 9 We note in this regard the paper's comment in the Executive Summary on page 5 that: "On occasion, public savings campaigns are required because demand savings can be lower cost than building expensive spare generating capacity." This comment is left somewhat hanging, and perhaps deserves more attention. In each of the shortage years since (and including) 1992, New Zealand Inc. has successfully managed the situation without resorting to involuntary outages. If this has in fact been the lowest cost solution, why would we want to change? We acknowledge that such shortages may be poorly perceived by investors, but perhaps the impact of significant involuntary outages – Auckland CBD, the "D" shackle, Pole 1 of the HVDC and a number of weather related physical outages – may be more culpable.
- 10 The idea of price floors, while it will clearly provide greater incentive for parties to manage risk, raises some quite fundamental questions about the wholesale market. To a large extent the market we now have grew out of the perceived failings of an administered price regime during the 1992 shortage. If the industry is still of the view that the market cannot handle shortage situations appropriately, and that an administrative response – via price floors – is now needed, perhaps the market needs a more comprehensive review?
- 11 We thus conclude that:
- 11.1 The termination of the reserve energy scheme of itself may well resolve perverse incentive issues and lead to more prudent risk management, and should be given the chance to work before other actions are taken. We acknowledge that the actual physical event – of shortage - may not happen for some time, but evidence of new risk management arrangements and contracts should be detectable sooner.
- 11.2 More prudent management will place upward pressure on wholesale prices, both spot and forward.

11.3 Compensation schemes and price floors:

- (a) potentially create additional risk and uncertainty, and will possibly discourage both market entry by non-traditional players, and market expansion by existing players
- (b) would seem to penalise all retailers equally, when most will not have contributed to the shortage
- (c) may also introduce perverse incentives on participants to avoid a shortage being called
- (d) suggest that, despite all the developments since 1992, the market still requires administrative intervention in shortage situations
- (e) tend to cut across potential innovation that would lead to greater demand side participation, which elsewhere in the report is encouraged

11.4 Financial arrangements do not ensure security of physical supply

11.5 Public conservation campaigns – whether compensated or not - may well assist with maintaining physical supply, and may in fact be the lowest cost economic solution.

Costs of new supply

12 This section provides a good summary of the various options and issues. We note however the overall conclusion that there has been, and continues to be, upward pressure on LRMC, and this is likely to continue to place pressure on retail prices.

13 Orion agrees with recommendation 13 that energy efficiency responsibilities should be consolidated with EECA. We do however also note the obligations in regard to energy efficiency on the Commerce Commission under section 54Q of the Commerce Act:

“The Commission must promote incentives and must avoid imposing disincentives, for suppliers of electricity lines services to invest in energy efficiency and demand side management, and to reduce energy losses, when applying this Part in relation to electricity lines services.”

Transmission and Distribution

- 14 In relation to transmission, we note that there are two other processes currently reviewing transmission pricing and related transmission issues in considerable detail, and as such make no comment on the paper's analysis. Those other workstreams do however suggest that it would be unwise to move quickly to implement the recommendations in this section (15 and 16).
- 15 In relation to distribution we welcome the paper's favourable assessment of this part of the value chain, and endorse the decision to make no recommendations in this area.

Wholesale and retail prices

- 16 Orion is in general agreement with the description of the various generation options and associated LRMCs, and notes the general upward trend in LRMC even without any impact from initiatives to reduce greenhouse gas emissions.
- 17 We agree that the level of actual and proposed investment in new generation capacity suggests there is no particular concern with medium term generation capability, and we also take the view that ending the reserve energy scheme should make it more likely that investors are prepared to build reserve or peaking style plant.
- 18 Overall we interpret the report's assessment of the components of current and future retail prices, and in particular residential customer retail prices, as being that:
- generation is currently about right, with future upward pressure due to the LRMC of new generation and emission related costs
 - transmission and distribution are reasonable with – other things equal - increases expected to be around or below CPI, but noting requirements for significant new investment will create further upward pressure
 - metering is reasonable, with no particular reason why costs should increase much above CPI
 - retail costs are possibly somewhat high, at least when compared with overseas markets
 - retail margins, at least in some areas, are somewhat high when compared with overall average margins, lowest cost retailer margins, and margins in overseas markets.

- 19 If we allow that the last two points add as much as 10% to the costs faced by residential consumers, a corollary of this analysis is that, of the touted “72%” increase in residential prices over the last 10 years, 62 percentage points is considered ‘justified’ by the paper’s authors.

Hedge markets and nodal risk

- 20 While it is hard to argue against a more liquid hedge market, Orion wonders whether this has fundamentally always been and remains about the overall balance between generator / retailer’s generation capability and their fixed price retail obligations. If this is so, then, while the dominant players remain vertically integrated¹ we can only ever expect competition around the fringes, with retailers chipping away at each other’s market shares (and consequently making relatively small changes to their positions via the hedge market), rather than see them seeking to move very far beyond their generation capability. This does not mean that competition will be ineffective, but only that it will be of a particular type: that which we currently see.
- 21 However as the report notes, hedge markets continue to develop, and in particular the addition to Energy Hedge of products going out to 2014, and similar products referencing Otahuhu and Haywards now being traded on ASX is worthy of note. Despite the, so far, relatively low volumes being traded, these developments do improve participants, and potential entrants, ability to manage significant elements of forward price and nodal price risk.
- 22 More generally Orion wonders whether much of the frequent comment about lack of liquidity in the hedge market, is actually a comment about price level. Markets are liquid because people transact. A decision not to hedge because a party would rather take spot price risk given the price of the hedge, or not to enter the market because resultant margins are deemed insufficient may be what it looks like: a commercial decision.

Increased competition

- 23 This section of the paper seems to work backwards from general observations about retail margins particularly in some smaller rural areas to some quite dramatic proposals regarding the allocation and ownership

¹ Orion agrees that vertical separation of generation and retailing is not an appropriate option, at least at this stage. But arguably it is the only change that would create a very active competitive environment, though quite possibly, due to the different allocation of risk, not lower prices.

of SOE generation assets. Orion is unsure that the punishment fits the crime.

- 24 That competition in some smaller rural areas is less than in urban areas is an observation that can probably be made about many goods and services, so it does not of itself indicate a public policy issue with respect to electricity. However, if a public policy response is indeed called for, then in Orion's view it should start with responses that deal with the specific problem. In that sense, it would seem that, of the responses in the report, the following are the most appropriate (and in this order):

24.1 Encourage customer switching – while customers are in no way to blame for the state of the electricity market, it is nevertheless true that for a large number of customers there are significant savings to be made, even in the smaller areas, and nothing focuses the minds of retailers like actual customers switching, or threatening to do so. On its own network Orion has on a number of occasions noticed considerable competitive response by larger players to the activities of aggressive entrants. In terms of the specific recommendations in this section of the report:

- (a) We are not sure that \$5 million is needed for the purpose, and it would be sensible to review the value for money means other than the ongoing existence of savings greater than \$10 million. The first value represents the use of real resources, while the second is a largely theoretical wealth transfer.
- (b) While shorter switching times are inherently desirable, we note that the industry average switching time is actually between 5 and 10 days, not 23 days (which is the *maximum* under the rules). Any move to shorten time frames needs to reflect reality, not misunderstanding. We are also unsure why smart metering should be the key factor here: It is possibly more about the rules supporting switching on estimates or customer reads. Perhaps of equal use in relation to switching are some sort of statistics around how many switches go right: much media comment focuses on what goes wrong, but we believe there are only problems in a small proportion of cases. Or there could be much more publicising of “good news” switching stories.
- (c) Powerswitch is a very useful vehicle for residential customer comparisons, and also the source of frequent comparisons published in newspapers. A possible useful addition to Powerswitch is an “at a glance” map of potential savings in each area, and perhaps also a “switch me now” link to retailer

websites. We note that for the Orion network, retailer prices appear to be kept up to date and cover all of the relevant pricing plans.

- 24.2 Allow line companies to retail in their areas – which has the benefit that it will tend to be targeted at those areas where margins are currently relatively high and competition is limited. In this regard we do not understand the proposed limitation on line companies buying an existing customer base. Such transactions would still be subject to the Commerce Act, and any such transaction would presumably be a commercial decision by both parties. Note that one option here, which would help address possible scale problems for smaller EDBs in any particular area, would be a joint venture by a number of them across several areas. (Note that Orion has publically stated that it has no intention of becoming an electricity retailer.)
- 25 Recommendations in the report that we believe should either not be progressed or should only be progressed with great care and after significantly more work are:
- 25.1 Demand-side bidding – this idea has been around for some time. While it is important to facilitate demand-side response, Orion is of the view that the system security impacts of large amounts of load shedding, and in particular restoring, in an uncoordinated manner need to be carefully considered before any such changes are made.
- 25.2 Simplify and standardise line tariffs – This is an area where both the Commerce commission and the Electricity Commission have responsibilities to develop pricing principles or pricing methodologies. We consider that the development of pricing principles is the appropriate level of regulatory intervention. In any case the diagnosis of the problem of lack of retail competition appears to indicate that the cause is lack of scale in some areas. It is unclear how standardisation of line pricing addresses that problem, and we have seen no information presented that suggests the variety of delivery pricing structures is actually a material barrier to entry or expansion. Moreover on our own network we have seven retailers currently trading, four of them very actively, despite our unique pricing structure.²

² More generally Orion takes the view that delivery pricing plays a critical role in the overall market, and is an area where significant innovation can, has and should occur. Two examples from our own experience:

- 25.3 Facilitate smart meters and smart tariffs – again there is already work in this area being carried out by the Electricity Commission.
- 25.4 Introduce a transmission hedging mechanism – this proposal, which has been around in a number of forms for many years, is predicated on the competition problem being largely the result of nodal price risk, or more specifically basis risk between the location of generation – or the reference of hedge contracts – and the location of the retail load. We are not sure that the evidence supports this conclusion, and in any case we note the development of new hedge products referred to above.
- 25.5 Restructure SOEs – this is a very significant and potentially disruptive step, particularly if the problem is concern about the level of retail competition in some smaller rural areas. Orion does not support it, and considers that very similar outcomes could be achieved via some form of contracting between Meridian and Genesis.
- 26 Possible actions not canvassed in the report include:
- 26.1 Encouraging, or perhaps requiring retailers to offer spot price based pricing plans – including to “mums and dads”, with a view to:
- (a) Providing choice for those customers who are willing or able to take on spot price risk
 - (b) Providing greater transparency about risk margins inherent in existing retail prices
 - (c) Helping to ensure greater clarity about what exactly are the terms of standard options (and in particular who bears the risk) and,
 - (d) Encouraging more explicit longer term contracting with smaller customers

- Some years ago we changed the definition of the start of night time to 9pm from 11pm. Not only did this lead to better management of a late evening peak, it gave consumers much more opportunity to move consumption to the lower priced “night” period.

- We make payment with respect to irrigation connections where we have the right to interrupt supply in (very infrequent) emergency situations. As a result we have been able to supply very similar energy volumes over a smaller network, and also maintain supply to more critical uses in emergencies.

- 26.2 The creation of a “retail only” SOE, like Kiwibank, to shake up the retail market (perhaps this already exists in the form of Powershop?)
- 26.3 Give distributors a more central role in coordination of aspects of the wider market - Distributors inevitably end up with the problem of physically disconnecting supply and management of rolling outages resulting from supply side failure and as such they need to be directly involved with the system operator in managing a response. We consider that developing a local system operator (LSO) co-ordination role for distributors to manage the supply and demand balance at the distribution level is desirable not only to manage shortages but more generally in managing the day to day supply and demand balance. With increased small scale DG and the impacts that a large scale take up of electric vehicles would have on the security of the networks at a local level, it will be imperative that distributors are actively involved in the role of co-ordination at a local level. This may also be better facilitated if distributors are also made responsible for smart metering. Experience in the UK is beginning to recognise the important and wide ranging role that distributors can and should play in the overall co-ordination and management of the industry.³

Governance

- 27 Orion agrees with the general approach recommended in the paper, and in particular with the creation of an independent market authority with more closely defined responsibilities than those of the Electricity Commission.
- 28 Orion urges the Government to not see this as an opportunity to somehow punish the Electricity Commission: its functions and responsibilities, and indeed its organisational form, were established by government. The fact that these elements can be improved does not mean that the Electricity Commission did not have good staff doing good work.
- 29 However we have some concerns about the recommended approach to some functions currently performed by the Electricity Commission:
- 29.1 We do not think that it is appropriate for Transpower to take on the roles of contract management for the functions of appointing service providers for the Clearing and Settlement Manager, Reconciliation Manager and Pricing Manager functions. We believe that Transpower’s commercial interests could lead to a perception of lack

³ As evidenced by the very recent restructuring of the UK regulator Ofgem to focus on smart technologies and price controls.

of neutrality, and in any case we do not believe that Transpower has any particular expertise in these functions. We do not believe that this is a major function of the EC, and can see no particular problem in it remaining a function of a refocused authority.

- 29.2 Likewise there is an implication that Transpower would be specifying the contract with the System Operator. Again we do not think this sits well with Transpower while it is also providing the service.
- 30 We note that, whatever the failings of the existing governance arrangements, the funding mechanism – via the EC levy - is a single one, reasonably transparent and reasonably well understood. With functions being separated out, it is possible that this will become more confused, for no good reason.
- 31 On the other hand, if a new authority is to be constituted with similar funding arrangements, Orion would urge that its funding not be subjected to an annual washup, but rather that any overs and unders be carried forward from one year to the next.

CONCLUDING REMARKS

- 32 Orion urges the Government to think carefully about which of the recommendations in the report it implements, and when. In many cases there a number of potential solutions, some of which are substitutes rather than complements.
- 33 Thank you for the opportunity to make this submission. We do not consider that any part of this submission is confidential. If you have any questions relating to this submission, please contact myself DDI 03 363 9846, email roger.sutton@oriongroup.co.nz or Bruce Rogers (Pricing Manager) DDI 03 363 9870, email bruce.rogers@oriongroup.co.nz.

Yours faithfully



Roger Sutton
Chief Executive

Schedule – Orion’s response to specific recommendations.

Recommendation	Orion view
<p>Recommendation 1 Require retailers to make payments to consumers in the event of a public conservation campaign or enforced power cuts, with a graduated scale reflecting the level of nationwide savings (as determined by the System Operator), and with a minimum payment of, say, \$10 per week.</p>	<p>If the problem is inappropriate management of resources by one generator, it is unclear why this obligation should be placed on all retailers?</p> <p>It seems likely that it will simply introduce further risk premiums into hedge contracts and thence retail prices, and perhaps also discourage new entry.</p> <p>It tends to cut across other contractual arrangements which seek to find those consumers best able to bear and / or respond to spot price risk.</p>
<p>Recommendation 2 Put a floor on spot prices during any public conservation campaign or during any enforced power cuts in a dry year of, say: 2.1 \$500/MWh (50c/kWh) when a public conservation campaign is activated. 2.2 \$1,000 - \$5,000/MWh (\$1 - \$5/kWh) if and when forced power cuts are activated.</p>	<p>While this would clearly provide stronger price signals in shortage situations, it represents an administrative intervention in the wholesale market which would seem to raise more fundamental issues with that market. We would question why this situation would not trigger a suspension of the market and in the event of actual enforced power cuts why a price equivalent to VOLL should not be signalled.</p> <p>As with compulsory compensation schemes, it seems likely that such floors will be reflected in higher risk premiums.</p> <p>There will also be issues of determining which part of the market this should apply to, as “shortage” can be just a South Island issue, and in fact could potentially</p>
<p>Recommendation 3 Clarify roles and responsibilities for security of supply (as set out in Table 2 on page 21).</p>	<p>Agree clarification is needed. Orion broadly agrees with the proposal. We consider that the problem of managing real time load shedding will inevitably fall to distributors and they need to be actively</p>

	involved in co-ordinating a response.
<p>Recommendation 4 Phase out the reserve energy mechanism, and reassign the Whirinaki power station to an SOE or sell it.</p>	<p>Agree, however need to acknowledge that while this will sharpen incentives for risk management, and reduce the incentive to lobby, it will not guarantee physical supply. It may also actually increase the risk of loss of physical supply if no one is prepared to invest in peaking plant that will be rarely used, however Orion considers that removal of the scheme will improve the business case for such investment.</p> <p>Consideration could be given to selling spot price caps that become part of the Whirinaki assets.</p>
<p>Recommendation 5 Alternatively, if the Government wants to retain the reserve energy mechanism as a backstop, then it should: 5.1 Reassign Whirinaki to an SOE or sell it. 5.2 Ensure that a mechanism is developed (such as a surcharge on spot prices) through which parties that benefit from any reserve energy when it is called on (that is, parties that are exposed to spot prices) contribute to the standing costs of that reserve energy.</p>	<p>If a reserve energy scheme is aimed at managing physical supply risk, then it is difficult to say who benefits from it.</p>
<p>Recommendation 6 Require SOEs to disclose their risk positions and other relevant information in the same way as private sector companies listed on the Stock Exchange, to improve the quality of information available on risk and sharpen risk management incentives.</p>	<p>Orion has no objection, as it probably levels the playing field between the listed and SOE participants. Note that financial risk management does not guarantee physical supply.</p>
<p>Recommendation 7 Investigate developing terms and conditions for accessing 'reserve water' in lakes in dry year emergencies which cap benefits to generators and provide for compensation to affected communities and mitigate or avoid environmental effects.</p>	<p>This may be a useful mechanism and would be similar to the requirement on thermal stations to hold a stockpile of coal.</p>

<p>Recommendation 8 Ensure, when making decisions on climate change policy, that full weight is given to the importance of providing certainty for investors including, to the extent possible, providing for stability and predictability on the future cost of carbon and other emissions.</p>	No comment.
<p>Recommendation 9 Ensure that the current reviews of the Resource Management Act and water allocation consider: 9.1 Whether and how the 'call-in' process could be used to better effect for generation projects (new and existing). 9.2 Other fast-track mechanisms for consenting (or re-consenting) nationally significant generation projects. 9.3 Providing for water and geothermal rights to match the life of the assets. 9.4 Whether certain types/sizes of generation could be deemed to be a permitted activity in predefined circumstances and areas. 9.5 The terms for consents, particularly the lapse provisions, to better recognise the nature of large-scale generation investment projects. 9.6 Whether powers such as compulsory acquisition of land, with appropriate compensation provisions, should be available for nationally significant generation projects.</p>	No comment.
<p>Recommendations 10 Ensure that the current petroleum resources review takes full account of the importance of gas to electricity generation using existing or new assets.</p>	No comment.
<p>Recommendation 11 Improve the quality of published information on gas reserves.</p>	No comment.
<p>Recommendation 12 Identify barriers to the development of geothermal energy which can and should be addressed by the Government.</p>	No comment.
<p>Recommendation 13 Consolidate responsibility for the promotion of energy efficiency in EECA, and</p>	Agree. However, we would question whether a levy is appropriate compared to say funding from general taxation. We also

<p>remove it as a responsibility of the electricity regulator, while:</p> <p>13.1 Carrying out a strategic review of EECA to ensure it is well-focused and performing effectively.</p> <p>13.2 Transferring best practice approaches developed by the Electricity Commission where possible.</p> <p>13.3 Reviewing funding for EECA, with a general principle that funding should be through levies where the beneficiaries can be clearly identified and administrative (collection) costs are low.</p>	<p>note the requirement of section 54Q of the Commerce Act which requires:</p> <p><i>“The Commission must promote incentives and must avoid imposing disincentives, for suppliers of electricity lines services to invest in energy efficiency and demand side management, and to reduce energy losses, when applying this Part in relation to electricity lines services.”</i></p>
<p>Recommendation 14 Review whether there are likely to be net benefits, compared to alternatives, in developing a National Environmental Standard for small-scale distributed generation, such as solar photovoltaics, micro-wind turbines and solar water heating panels.</p>	<p>We have no objection, but we are not sure how this relates to existing DG regulations? We question what is meant by small-scale distributed generation – does this relate to the 10kW level in the DG regulations? We are also concerned that of the examples given these are quite different technologies and it is unclear how a national environmental standard would be applied.</p>
<p>Recommendation 15 Amend the Grid Investment Test to make it clearer, simpler and less prescriptive, and to take into account wider competition benefits.</p>	<p>GI should develop over time, this will not be an easy issue to resolve and we consider that a process for governing its development would be useful.</p>
<p>Recommendation 16 Transfer approval of major grid upgrades to the Commerce Commission to ensure integrated consideration of transmission expenditure, performance and prices, subject to rules on service and reliability standards, pricing methodologies and the grid investment test set by the electricity regulator.</p>	<p>We agree that the approval of major grid upgrades should be dealt with by the Commerce Commission. We would envisage that the key role in this would be ensuring that Transpower has:</p> <ul style="list-style-type: none"> • considered sufficient options; • put forward a reasonable solution (not necessary to look for a perfect solution) • have consulted properly <p>We consider that there will be a requirement for the Commerce Commission to have (or contract) a</p>

	reasonable level of technical expertise.
<p>Recommendation 17 Subject to further analysis following submissions, restructure SOE assets, by either:</p> <p>17.1 Option One: Create a new SOE generator-retailer comprising the Huntly and Manapouri power stations, and, additionally, transfer Tekapo A and B to Genesis and Whirinaki to Meridian.</p> <p>17.2 Option Two: Transfer the Huntly power station to Solid Energy, the Manapouri station³² to Genesis and the Whirinaki station to Meridian.</p> <p>17.3 Option Three: Transfer the e3p and P40 power stations from Genesis to Meridian and the Manapouri power station from Meridian to Genesis.</p>	<p>It is not clear to us that this proposal will resolve the perceived problem. We do agree that further analysis would be required before this option is progressed further.</p> <p>We consider that there is also risk of loss of efficiency through reduced specialisation, and also some damage to established branding, eg “renewables”.</p> <p>We believe contractual solutions are possible, and could, in the last resort, be forced on SOEs by the owners.</p>
<p>Recommendation 18 Introduce, as a priority, a transmission hedging mechanism to assist retailers manage risks created by transmission congestion.</p>	<p>Is this really the problem? We are concerned that previous attempts to introduce Transmission hedging have always involved distributors taking on a unacceptable level of risk for no return. Any future developments of transmission hedge products need to avoid this problem.</p> <p>Requiring transparency of the ‘transmission congestion risk margin’ may draw out the magnitude of this problem.</p>
<p>Recommendation 19 Facilitate greater demand-side participation in the wholesale market, including providing for:</p> <p>19.1 More accurate forecasting of spot prices.</p> <p>19.2 Real-time (not ex post) spot prices.</p> <p>19.3 Demand response to be dispatched in the same way as generation.</p>	<p>While facilitating demand side response is generally desirable, overall we consider that this is a longer term energy shortage issue that is possibly not well resolved through short term DSM. Orion urges caution in relation to demand response being dispatched in the same way as generation: we believe that there are potentially serious coordination issues with demand side dispatch, that may jeopardise system security. We consider that load management in New Zealand demonstrates a level of response that many overseas countries can only aspire to. There may be more load response to be achieved, and more ways to extract</p>

	<p>value from existing load management capability, but these should be viewed from the perspective of building on decades of success.</p> <p>We note the significant amount of work that the Electricity Commission has already carried out in the area of demand side participation in the wholesale market and property rights for load management.</p>
<p>Recommendation 20 Allow lines companies to provide electricity retailing services in their local areas subject to:</p> <p>20.1 Retaining the existing provisions in the Electricity Industry Reform Act that:</p> <ul style="list-style-type: none"> • Require corporate separation and compliance with arms-length rules between lines and energy (generation and retailing) businesses. • Require lines companies to put in place transparent and non-discriminatory use-of-system agreements with their retail business. • Have the effect of prohibiting common ownership between lines businesses and generators owning more than 100MW of generation connected to the national grid. <p>20.2 Prohibiting a retail business owned by a lines business from buying the customer base of an existing retailer (to ensure there is a net increase in retail competition).</p>	<p>We do not believe that the prohibition in 20.2 is needed.</p>
<p>Recommendation 21 Develop more standardised tariff structures and business rules for use-of-system agreements for lines businesses to facilitate access by retailers.</p>	<p>We question whether this is the real problem? In any case the Commerce Commission and Electricity Commission are both looking at pricing, and the EC is looking at model agreements.</p> <p>However, we do not consider that the development of a standardised tariff structure and business rules for use of system agreements for line businesses are appropriate. Orion has made a number of submissions to papers by the Electricity Commission on these issues. The latest being a submission on proposed model approach to distribution pricing</p>

	<p>methodology July 2009. In summary we:</p> <ul style="list-style-type: none">• did not agree with the Commission's preferred approach of a retail delivery model (RDM), as the Commission did not present a compelling case for a single model, or for RDM as that model• considered that the paper had misconceived the wholesale delivery model (WDM) and misinterpreted RDM as envisaged by the Pricing Approaches Working Group (PAWG)• recommended that the Commission adopt a set of principles that electricity lines businesses (ELBs) should take into account when developing their own pricing methodologies, and that the Commission should use the Commerce Commission's pricing principles as a starting point• noted that the pricing principles should be consistent with the preliminary views of the Commerce Commission that, in relation to default price-quality paths (DPPs), the costs associated with applying pricing methodologies to DPPs may outweigh the benefits and, in relation to customised price-quality paths (CPPs), that a principles-based approach to pricing methodologies is appropriate for ELBs• submitted that the prescriptive nature of the Commission's proposed pricing methodology would remove incentives for ELBs to develop innovative pricing methodologies and products that would promote the long term benefits of customers, as required under section 52A of Part 4 of the Commerce Act• concluded that while there may be a case for rationalising distribution price
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	<p>structures, the primary focus of the Commission's review should be to establish what barriers prevent ELBs from rationalising legacy pricing methods or innovating.</p> <p>This issue is also closely related to the Commerce commission's work on Part 4 of the Commerce Act</p>
<p>Recommendation 22 Ensure that guidelines and standards on smart meters provide for (or allow upgrades for) energy efficiency capability, open access communications, customer switching, and the development of smart networks.</p>	<p>Need to think about impact on existing investment.</p> <p>Are there real problems here that cannot be resolved by commercial arrangements?</p> <p>Again this is an issue that the Electricity Commission has a work stream on and is expected to report back to the Minister by December 2009. In Orion's network area there has been a substantial roll out of smart meters by Meridian which we applaud.</p> <p>While there is merit in having some form of standardisation in the attributes that advanced metering systems should have, we would be concerned if the roll out of advanced metering systems was delayed while waiting for industry consensus to be reached on this issue.</p> <p>The provision of metering is a competitive sector of the industry and the roll out of advanced metering systems is not without risk, including regulatory risk. Clearly, Meridian has determined that there is a business case for rolling out advanced metering. Whether customers value the potential benefits that advanced metering could provide, to the extent that it provides a competitive advantage is the risk Meridian take.</p> <p>We do however consider that this is an area where Network operators may be</p>

	better placed to take responsibility for metering.
<p>Recommendation 23 Encourage retailers to make tariffs available, as an option for consumers, that provide incentives to better manage electricity consumption including through shifting load to off-peak times and conservation during dry years.</p>	<p>Retailers generally already make these available, at least the former, as this is largely driven by distribution pricing, although we note they are, in Orion's experience, slow to innovate more widely.</p> <p>The latter (conservation) is somewhat undermined by the proposed compulsory compensation scheme.</p> <p>Perhaps if retailers made spot price options available to more customers we might see considerably more response.</p>
<p>Recommendation 24 Ensure that all wholesale market data is publicly released the following day to improve scrutiny of and by market participants.</p>	No comment.
<p>Recommendation 25 Encourage and facilitate customer switching through: 25.1 Providing \$5 million a year, from electricity levy funding, to promote the benefits of customer switching. The fund should be contestable, and should continue for as long as demonstrated benefits, in terms of savings to consumers, exceed \$10 million a year. 25.2 Shortening the timeframe for switching between retailers from 23 days to three days for customers with smart meters. 25.3 Improving the Powerswitch website by requiring retailers to provide updated information to improve its accuracy and coverage.</p>	<p>\$5 million is a lot. Search costs and switching costs for consumers are already very low. Should review after one year to test effectiveness. Perhaps some of the money could be spent gaining a good understanding of why more customers do not switch.</p> <p>23 days is actually the maximum under the rules. If 3 days is ideal, then the industry average of 5 to 10 days does not look so bad. Smart meters do not obviously add to speed of switching, however we do concede that they may provide for more accurate pro-rating of the account when a switch occurs.</p>
<p>Recommendation 26 Replace the Electricity Commission with an Electricity Market Authority (EMA) as follows: 26.1 The EMA would be an Independent Crown Entity under the Crown Entities Act 2004.</p>	Generally agree. In particular we consider that the independence of the proposed EMA would be an advantage over the existing Electricity Commission governance

<p>26.2 The EMA's objective would be to ensure the efficiency of the electricity market, including reliability, for the long-term benefit of consumers.</p> <p>26.3 Board members would be appointed by the Governor-General on the recommendation of the Minister of Energy and Resources, and nominated as follows:</p> <ul style="list-style-type: none"> • Two members nominated by Consumer New Zealand and Business New Zealand respectively. • One member nominated by generators and retailers. • One member nominated by lines businesses including Transpower. • One member and an independent chair nominated by the Minister. <p>26.4 The Minister would only be able to recommend appointments of persons nominated by market participants (as applicable), but would not be required to accept any particular nomination. Criteria for members would be set down in legislation (such as independence, expertise, and ability to work as a Board member).</p> <p>26.5 The functions of the EMA would be:</p> <ul style="list-style-type: none"> • Developing and approving market rules (including guidelines and model contracts). • Monitoring compliance with rules and, through a Rulings Panel, penalising breaches. <p>26.6 The EMA would be required to set up working groups to prepare proposed rules, and the board would be required to hear representations on proposed rules from the chair of working groups before making decisions.</p>	<p>requirements.</p> <p>However we consider that it would be essential that any decisions made by the EMA should be subject to both judicial and merits review.</p>
<p>Recommendation 27 Transfer approval of major grid upgrades to the Commerce Commission as part of its overall regulation of Transpower under Part 4 of the Commerce Act, but with reliability and service standards, transmission pricing methodologies, and the Grid Investment Test set by the EMA.</p>	<p>We are unsure if the Commerce Commission currently has sufficient expertise. It may need to duplicate EMA functions and capability?</p>
<p>Recommendation 28 Transfer the following functions to the System Operator: 28.1 Information and forecasting on security of supply. Long term forecasting, and preparation of the 'Statement of Opportunities' would be undertaken by</p>	<p>We do not agree with the proposal in relation to contracting for market operations (for example, market clearance and reconciliation), we believe Transpower is conflicted over service provider contract management. We are also unaware of any</p>

<p>MED alongside its preparation of the Energy Outlook. 28.2 Emergency management. 28.3 Operation of reserve energy (if retained). 28.4 Contracting for market operations (for example, market clearance and reconciliation) pursuant to rules set by the EMA.</p>	<p>expertise that Transpower would bring to this process.</p>
<p>Recommendation 29 Require the EMA to set up and service a Security and Reliability Council, comprising senior level persons from the electricity market, to meet periodically to help monitor and provide advice on the System Operator's performance of its functions and on security of supply issues generally.</p>	<p>Agree.</p>