

24 November 2008

Electricity Commission  
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**SUBMISSION ON RESPONSIBILITY FOR RETAILERS' WHOLESALE MARKET OBLIGATIONS DISCUSSION PAPER**

- 1 Orion New Zealand Limited (**Orion**) welcomes the opportunity to comment on the responsibility for retailers' wholesale market obligations discussion paper (the **paper**) released by the Electricity Commission (the **Commission**) in November 2008.
- 2 Orion is concerned about the proposed changes in relation to the responsibility for retailers' wholesale market obligations. We consider that smaller retailers may have some justified issues with the complexity of their obligations relating to the wholesale market. However we do not think the Commission's preferred option – '*Option C: Enable a "responsible participant" to assume a registry retailer's wholesale market obligations for operations, trading and settlement*' is appropriate.
- 3 Orion **recommends** that the Commission:
  - 3.1 considers this issue in greater detail with an aim of simplifying the Electricity Governance Rules (EGRs) rather than adding a further level of complication to an already complex set of rules;
  - 3.2 adopts an arrangement that provides for transparency of information to distributor participants of the electricity sales by individual retailers at the GXP level; and
  - 3.3 maintains the status quo (option A) in the interim.

4 The Commission's paper and the preferred option (Option C) appear to further complicate an already confused set of rules. It de-facto introduces a new (but undefined) class of participant a - "registry retailer" - to the already complex definitions of: "retailer, purchaser, payer, payee, reconciliation participant, responsible party".

5 Orion raised the problem of conflicts with the definitions of retailers and purchasers in our April 2005 submission on the "*Report of the Electricity Commission reconciliation project team and proposed electricity governance rules*". In that submission we stated that:

The relationship between *purchasers* and *retailers* is unclear in the proposed rules. Specifically, it is unclear whether a retailer must also be a purchaser.

*Purchaser* is defined in Part A of the proposed rules as *a person who buys electricity from the clearing manager*.

*Retailer* is defined as *a person who supplies electricity to a consumer or to another retailer*.

On the reading of these definitions alone, it appears that a retailer who buys electricity from another retailer is not a *purchaser* as the electricity is not purchased from the clearing manager.

The above definitions are further complicated by rule 6 of Part H which requires:

*that electricity must be sold and purchased via the clearing manager*.

Orion is also unclear about whether an operative rule exists allowing retailers to purchase from another retailer, or whether this concept is solely mentioned in the definition of retailer.

6 The lack to clarify around these fundamental arrangements still remains, and we believe it leads indirectly to the problems that the paper is trying to resolve.

### Impact of retailer/purchaser relationship on reconciliation

- 7 In our 2005 submission we were also concerned that the lack of clarity around the relationship between a retailer and purchaser had potential issues in relation to reconciliation. We considered that:

If a retailer is always a purchaser then reconciliation can be carried out in two simple steps, as illustrated below in Diagram 1:

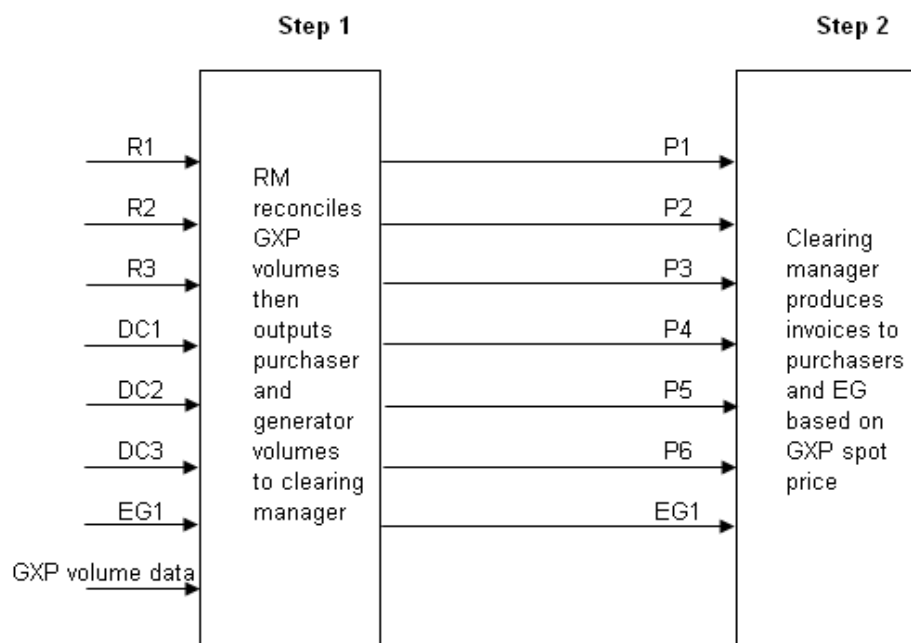
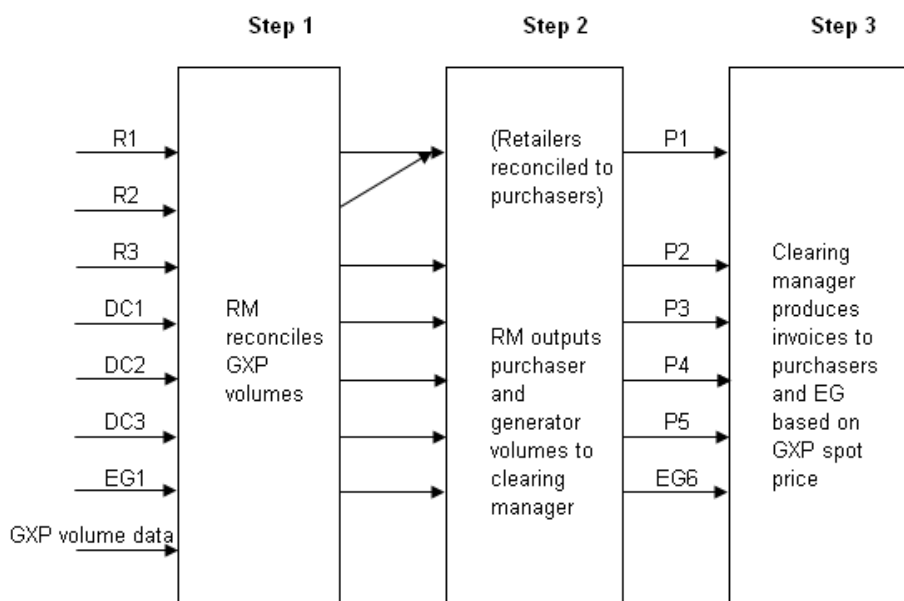


Diagram 1

However, if a retailer can exist independently of being a purchaser (that is, there is no one-to-one relationship between retailers and purchasers) then the reconciliation process becomes more complicated. The reconciliation manager would be required to carry out an additional step to correlate and reconcile the retailer electricity volumes to a purchaser where the purchaser has purchased electricity from the clearing manager on behalf of one or more retailers.

This process is illustrated below in Diagram 2:



**Diagram 2**

**Key to abbreviations**

- RM = Reconciliation Manager
- R = Retailer
- DC = Direct customer
- EG = Embedded Generator selling direct to the Clearing manager
- GXP Volume Data = Transpower's Grid Exit point metered data

- 8 We consider that the Commission's preferred option (Option C) attempts to provide the outcome shown in diagram 2 in terms of the prudential requirements and provision of data to the clearing manager, without actually providing the transparency through the reconciliation process provided by the two step reconciliation process shown.
- 9 We consider that whatever arrangement the Commission ultimately adopts must provide for transparency of information to distributor participants of the electricity sales by individual retailers at the GXP level and that the sale and purchase of electricity must be fully transparent by retailer and purchaser at an aggregated level.

**Policy problems**

- 10 The Commission has raised two policy problems:
  - *The rules may unnecessarily restrict the ways in which the risk of registry retailer default can be managed and may make it relatively more expensive for smaller retailers to provide prudential security, and*

- *A registry retailer is not able to insulate themselves from dealings with the clearing manager or dealings with the Electricity Commission and Rulings Panel in respect of wholesale market arrangements.*

11 In relation to the first of these problems we agree with the Commission's statements<sup>1</sup> that :

*It is important that prudential standards are maintained in order to ensure confidence in the market. The Commission would not expect to proceed with a rule change proposal that reduced prudential standards below the level currently envisaged in the rules.*

*Subject to that principle, the rules should generally allow participants to choose convenient and cost effective means of providing sufficient prudential security.*

12 In this respect we consider that the cost of providing the required credit support – say, a letter of credit - even for a small retailer/purchaser is small, and given that a small retailer will have a small volume of purchases, their financial exposure will be relatively small even when spot prices are high. We note that distributors (even small distributors) have to provide the same type of prudential security for their small purchases of auxiliary supplies via the clearing manager.

13 We are also concerned that under the Commission's preferred option (option C), the participant requested by a "registry retailer" to be the responsible party for the retailer's wholesale market obligations would also be the registry retailer's competitor in the retail market.

14 In relation to the second of the issues identified above, we question whether the Commission's concerns about the difficulties for small scale retailers are consistent with earlier statements made by the Commission. We note the Commission's response<sup>2</sup> in relation to a concern raised by Orion in our 2005 submission:

*... in terms of the difficulty for small participants, a barrier to entry is to be distinguished from the cost of entry. For instance, the fact that it costs more to enter into electricity generation than say, meter reading, does not, in itself, suggest higher barriers in electricity generation. A cost of entry only becomes a barrier to entry if the potential new entrant is at some*

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<sup>1</sup> Paragraphs 67 and 68 of the paper.

<sup>2</sup> <http://www.electricitycommission.govt.nz/pdfs/submissions/pdfsretail/pdfsreconrule62/Feb06-recon/sub-summary.pdf>

*disadvantage vis-à-vis incumbent firms with respect to those costs or conditions (e.g. when the new entrant has to incur costs that the incumbent did not have to incur when it entered the market).*

- 15 While we agree that there are difficulties and complexities in being a market participant that may make it too difficult or costly for a small participant, we do not consider that these can be considered a barrier to entry under the Commission's criteria above.
- 16 In general we consider that the Commission should consider whether the proposals meet the fundamentals that underpin the current market, that is:
  - 16.1 the clearing manager as the buyer and seller of all energy in the market; and
  - 16.2 a single market.
- 17 These fundamentals of the current market are expressed in rule H6.5 – “Mandatory purchase for off take through a point of connection with the grid” and differentiate the EGRs from the past trading arrangements such as MARIA which had non transparent bi-lateral arrangements.

### **Concluding remarks**

- 18 Thank you for the opportunity to make this submission. Orion does not consider that any part of this submission is confidential. If you have any questions please contact Dennis Jones (Industry Developments Manager), DDI 03 363 9526, email [dennis.jones@oriongroup.co.nz](mailto:dennis.jones@oriongroup.co.nz).

Yours sincerely



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