



The Genesis Energy Building  
93 The Terrace  
PO Box 10568  
The Terrace  
Wellington  
New Zealand  
Genesis Power Limited  
trading as Genesis Energy  
Telephone: 04-495-6357  
Fax: 04-495-6363

28 September 2007

2013 Review  
Electricity Group  
Energy and Communications Branch  
Ministry of Economic Development  
PO Box 1473  
WELLINGTON

e-mail: [electricity@med.govt.nz](mailto:electricity@med.govt.nz)

## **Review of Section 62 of the Electricity Act 1992 'Continuance of Supply' (2013 Review)**

Genesis Power Limited, trading as Genesis Energy, welcomes the opportunity to provide comments to the Ministry of Economic Development on its consultation paper entitled 'Review of Section 62 of the Electricity Act 1992 'Continuance of Supply' (2013 Review)' dated August 2007. Genesis Energy has reviewed the consultation paper and is pleased to have the opportunity to respond to the issues raised in it.

### **Genesis Energy's Interest in this Issue**

Genesis Energy has a strong interest in this issue. This interest is underpinned by a desire to ensure that:

- a. The regulation of lines businesses is effective, and in the best interests of end-consumers; and
- b. The practical implementation of the lines company regulatory framework is, as a whole, efficient and does not impose any undue or unexpected costs on third parties.

In this particularly instance, Genesis Energy wishes to ensure that its large retail customer base is paying a fair price for the service delivered,<sup>1</sup> in the most efficient manner. Genesis Energy also seeks to ensure that its customers are provided electricity that is reliable and in an environmentally sustainable manner.

## The Implications of the Government Policy Statement

Before considering the options set out in the consultation paper and determining which is 'best', it is informative to assess the implications of the Government Policy Statement. Paragraph 99 of the Government Policy Statement, states:

"The Government expects distribution companies to keep any changes to rural lines charges in line with urban line charges. The Commission should monitor developments in rural charges."

The consultation document goes on to say that:

"Hence there is an explicit degree of cross-subsidy from other users of the network. This review is undertaken on the assumption that this government policy will continue ....."<sup>2</sup>

The Government Policy Statement clearly implies that officials do not have a free hand to consider a plausible range of options, but instead implies some important constraints, both direct and indirect. In Genesis Energy's view, these constraints are as follows:

1. Most obviously that a subsidy of some amount will continue. While in the context of the consultation paper, the subsidy concerned primarily relates to those customers who had connections prior to 1 April 1993 (an 'access' subsidy), it also relates to customers who paid for more expensive rural connections after that date (based upon the likelihood that the costs of maintaining a rural connection are more than that of an urban connection and the pegging of charges between the two);
2. That lines companies continue to be the vehicle via which the subsidy is delivered. There would be no need otherwise for the government, in the Government Policy Statement, to "*expect distribution companies*" to keep their rural and urban charges in line; and

---

<sup>1</sup> Fairness in this context relates to relative price levels between classes or types of consumers such as rural and urban customers and regarding access to infrastructure such as between those customers connected prior to, and post 1 April 1993. Importantly, Genesis Energy does not believe fairness to equate to the concept of 'affordability'. While affordability is an important public policy outcome, the aim of good public policy should be to first focus on the delivery of the lowest cost option as encapsulated in the concept of efficiency with considerations of affordability then being taken into account in ensuring the delivery of the best, lowest-cost solution.

<sup>2</sup> Ministry of Economic Development consultation paper entitled "Review of Section 62 of the Electricity Act 1992 'Continuance of Supply' (2013 Review)", dated August 2007, page 9, paragraph 23.

3. That dynamic efficiency losses are not to be addressed. That is, incorrect investment decisions by consumers (in respect of their power consuming assets) will continue to be made due to the lack of a signal of the full cost of their continuing to take supply.

## **The Implications of the Government Policy Statement for the Options**

Clearly the Government Policy Statement has important implications for the relevant set of options that can be considered as appropriate. This is particularly so in light of the Government Policy Statement obligation and the clear policy position by the Government that an explicit subsidy will continue.

However, such assumptions do not appear to have been considered in the development of the consultation paper and several of the options outlined for serious consideration essentially disregard these important 'baseline' considerations.

Consequently Genesis Energy can see no reason for active consideration by officials of options (c), (d) and (e) that allow for the obligation to supply to expire. On the presumption that lines companies would eventually quit uneconomic supply (albeit not immediately), each of these options would essentially make the Government Policy Statement requirement meaningless to the extent that on cessation of the obligation, the supply of electricity to rural consumers and its day-to-day pricing will fall to other parties such as the customers themselves and/or the providers of alternative energy technologies. No access subsidy would exist under these three options and only the possibility of some level of subsidisation continuing to exist will remain.

To the extent that lines companies do continue, by mutual agreement, to supply rural customers they would be treated the same as if they were connected after 1 April 1993 and have their day-to-day prices pegged to those of their urban counterparts.

## **The Remaining Options**

With respect to the remaining options [options (a), (b) and (f)], these all continue an indefinite obligation on lines companies to provide an access subsidy (in some form) and the ability for lines companies directly to keep rural and urban charges in line as per the Government Policy Statement. However, while these options are consistent with broad Government policy objectives, options (b) and (f) provide only weak incentives for lines companies to find the least cost means of continued supply to these remote customers.

Lines companies specialise in lines solutions and, as demonstrated at the transmission level they are unlikely to put much effort into researching less familiar local generation options, for example. On the other side, individual consumers will have no incentive to agitate for cheaper solutions since they will not save anything on lines charges as a consequence.<sup>3</sup>

Option (f) appears to offer the worst of all possible outcomes – this being the masking of the true cost of continued access across all of New Zealand and not just within a particular network area. This would be of most consequence to those networks with little or no rural customers who would not currently incur an access subsidy. Option (f) would also:

1. Effectively remove the accountability for the costs of maintaining the pre 1 April 1993 rural connections from the lines company by making the collection of a national levy another entity's responsibility;
2. Add administration costs. For example, lines companies would be required to separately account for, and have audited, that portion of their access costs that relates to pre 1 April 1993 connections. In addition, lines companies will need to adjust urban prices downwards to compensate for the fact that urban customers no longer need to subsidise rural customers to the same extent, or be required to verify the extent to which the access subsidy resulted in profit foregone. On the other hand, those entities who become responsible for the collection of a levy and payment of the access subsidy would also face new costs;<sup>4</sup> and
3. Appear to violate the requirement of the Government Policy Statement if its expectation is for lines companies to be responsible for delivery of the access subsidy as well as the day-to-day pricing subsidy.

In light of the above, which then, of options (a) or (b) is to be preferred? In reality, there is little daylight between them. The key difference relates to the fact that the Act will be amended to allow alternative forms of supply that meet the same objectives. No mandatory action on the part of lines companies and alternative means of supply will be required as lines companies would retain responsibility for making the decision on how best to supply. Such a legislative amendment will at best only have a marginal effect and that effect, in turn, relies on lines companies not already testing the options to deliver the obligation (and therefore, the access subsidy) at the lowest possible cost.

---

<sup>3</sup> The effect of a cheaper solution will be washed out in the averaging of charges across the network.

<sup>4</sup> For example, in the absence of lines companies, it is possible that retailers would be considered as a default mechanism via which the access subsidy would be delivered given their account relationship with rural customers. Such a requirement would be unlikely to be a low-cost one as it would further complicate an already complex billing process.

On balance, of the options put forward by the Ministry of Economic Development, the above analysis suggests that option (b) should be supported. This enables some increased scope for lines companies to focus more on the outcome – energy supply to rural consumers - and provides them with some small incentive to outsource the supply of energy (for which they will remain accountable) to the providers of non-lines alternative solutions. However, ultimately option (b) is clearly a second-best solution.

## **A Better, Alternative Way Forward**

Genesis Energy's analysis above effectively eliminates all of the proposed options either on the basis that they do not deliver key government policy objectives [options (c), (d) and (e)] or that they deliver inefficient policy outcomes [options (a), (b) and (f)]. Genesis Energy considers that it is no coincidence that these groups of options essentially coalesce around retaining or removing the obligation to supply after 2013.

In reality, Genesis Energy considers that the answer must lie somewhere in between the two extremes of:

1. A strict adherence to the dictates of the Government Policy Statement that would count out economically sound options (c), (d) and (e) that involve removing the obligation to supply but encourage the consideration of options (a), (b) and (f) that in general continue the obligation but deliver poor policy outcomes; and
2. The reverse which would deliver better policy outcomes but with no regard to the Government's key broader policy objectives.

Genesis Energy considers that there is a middle path and believes that at its heart there are three features, these being:

1. The importance of letting the full cost of maintaining rural connections flow through to all parties whether or not connected prior to 1 April 1993;
2. A substantial transition period over which the adjustment can occur; and
3. The development of a targeted affordability safety-net based on the needs of specific rural customers once a full price of access has been made transparent.

More specifically, Genesis Energy considers that the obligation to supply should be extended by say, a further 10 years through to 2023, but that over that timeframe, lines companies would be allowed via some carefully managed transition path to adjust up the price of continued access for all rural connections, both up-front payments and ongoing charges.

As a practical matter, Genesis Energy understands that discontinuing the obligation to supply will not have any practical effect in many networks. Many lines companies require new remote rural consumers to pay for the assets needed but do not subsequently require further lump sum payments when individual components fail. In these cases, all costs of maintenance and replacement are swept up in the uniform average network tariff. Whether or not anyone paid for the initial assets, all subsequent repairs and replacements are treated as operating costs. *This is the same as the treatment of pre-1 April 1993 connections.*

In those networks that do now require new remote consumers to pay for the initial assets and all subsequent replacements (say, after storm damage), the removal of the obligation to continue supply would simply draw earlier pre-1 April 1993 connections into this regime of intermittent ongoing contributions. If post-1 April 1993 connections are being treated in this way in some networks, there seems to be no good reason why earlier connections should continue to be favoured indefinitely.

In Genesis Energy's view, a carefully managed transition will:

1. Broadly retain the integrity of the Government's policy objectives, particularly around affordability and the desire that an on-going relationship be maintained between rural consumers and lines companies;
2. Moderate any price shocks that would otherwise potentially be associated with simply removing the obligation, and ensure that any price impacts are gradual over time;
3. Be fairer between rural and urban customers and fairer regarding access to infrastructure between those customers connected prior to, and post 1 April 1993;<sup>5</sup>
4. Facilitate over time the entry of alternative suppliers of electricity as they see the emergence of the full cost price path and encourage rural customers to investigate other supply options and in turn, become more aware of other potentially lower cost choices;
5. Provide time for new lower cost technologies to emerge and be applied in the rural setting; and

---

<sup>5</sup> It is simply a matter of fact that there are some things that are cheaper (and lower cost) in rural areas (for example, housing & farm produce) and some things that are more expensive. Given this, it is unclear why some services, such as electricity should be afforded special treatment. While Genesis Energy recognises that this treatment is not unique given the delivery of residential telephony services under the Kiwi Share Obligation, Genesis Energy notes the Commerce Commission's recent draft LLU pricing decision that has a higher rural price than urban. Policy consistency would be highly desirable across the delivery of such services.

6. Allow for a more careful consideration of who delivers the subsidy and in what form once there is price transparency and the implications of such transparency are estimated. This is standard public policy practice - it will enable any issues associated with affordability to progressively be worked through on the basis of need as the price path becomes clearer and enable considerations of affordability to be considered in the context of the actual price impact.<sup>6</sup> Lines companies are unlikely to be the best mechanism in the medium term.

Fundamentally, the choice for Government is whether or not it considers the benefits to be gained from the encouragement of investment and the better utilisation of resources from a progressive signalling of prices outweighs the possible detriments associated with affordability. Genesis Energy considers that they do, and believes that its proposal as outlined above has merit and should be actively pursued by officials.

## Summary

Despite intentions to convince otherwise, the Ministry of Economic Development's consultation paper fundamentally rests on the presumption that rural consumers who had connections prior to 1 April 1993 should be supplied electricity at 'reasonable' prices or prices that are 'affordable'.<sup>7</sup> Despite the rhetoric of efficiency, this makes the consultation paper largely about social equity, and not regulatory economics. This, in reality, makes it about how to continue the obligation to supply. Of the options presented in the consultation paper that deliver the Government's social objectives, option (b) is the best.

However, Genesis Energy fundamentally believes that to reach an outcome that is both fair *and* efficient the Government must remove the access subsidy between rural and urban consumers. Genesis Energy considers that this could be achieved in a carefully managed transition. The outcomes from such a managed transition could result in resources that would - by the end of the transition period - be allocated to their highest use, and consumers being given a choice of providers and technology while demanding reliability from either the lines company or the alternative provider. It would also provide the opportunity for alternative providers to develop a market and, over time, gain economies of scale that could eventually result in lines companies' charges being undercut thereby facilitating the opportunity for *all*

---

<sup>6</sup> For example, in the development of its carbon trading regime the Government has recently signalled that it is willing to compensate low and middle income families on the basis of their inability to afford the increases in the electricity retail prices that it has estimated will result from such a policy. Undoubtedly the details of the delivery mechanism and quantum will be carefully worked through but key to this approach is one of first revealing the price path and then understanding who will be affected and finally how to manage that effect. It is likely, given the existence of the Working for Families infrastructure and income information database that it will be used as the mechanism to deliver assistance to low and middle income families.

<sup>7</sup> These highly subjective, emotive terms are not defined in the consultation paper.

rural consumers potentially disconnecting, and placing downward pressure on lines companies' charges to remaining rural consumers. A virtuous circle.

If the progressive removal of the subsidy proves to be unaffordable for affected rural consumers, then means should be put in place to manage this. Genesis Energy's expectation is that if the transition is managed with care, there is unlikely to be any widespread rural hardship caused and little, if any risk of supply (in whatever form) being unavailable.

Genesis Energy is happy to discuss further any aspect of its submission with the Ministry of Economic Development should it wish.

Yours sincerely

A handwritten signature in black ink, appearing to read 'J Carnegie'.

John A Carnegie  
Regulatory Affairs Manager