

4 April 2008

Fuels & Crown Resources  
Energy & Communications Branch  
Ministry of Economic Development  
33 Bowen Street  
PO Box 1473  
Wellington

To Ross Milner,

Team Leader Electricity,

## **Draft Government Policy Statement on Electricity Governance**

### **Introduction**

1. Thank you for the opportunity to make a submission on the draft update of the Government Policy Statement on Electricity Governance (Electricity GPS), dated March 2008. No part of our submission is confidential and we are happy for it to be made publicly available.

### **Summary of Mighty River Power's views on the revised Electricity GPS**

- The revised GPS is clearer and more succinct than the previous version.
- The GPS would benefit from a consistent focus on objectives and outcomes. We suggest a standard format "topic heading" followed by "context" followed by "Government objectives and outcomes".
- The GPS would benefit from clarification that consistent with the Government's own standards for best practice policy development, regulation is only one of many tools available to the Commission when it seeks to give effect to the GPS. In addition, regulation is not the tool of first resort to be used without reference to any assessment of alternatives and cost and benefit analysis.
- The GPS would benefit from a tighter focus. This could be achieved by the removal of material that does not relate to the functions of the Commission. In particular we suggest merging Parts 2 and 4.
- The GPS attempts to address problems that the Commission is not empowered to solve – particularly the institutional overlaps in the energy efficiency area and the timeliness of Transpower's resource and land use planning. We agree these are important problems and support Government addressing them, but outside the GPS.
- We are concerned about the duplication of electricity efficiency functions, particularly the requirement that the Commission to use its levy funding to pay

for EECA's programmes - which have traditionally been funded out of general taxation. We see no reason why these programmes cannot continue to be funded by EECA, although we note that EECA has struggled to spend the money allocated to it for this purpose.<sup>1</sup>

- While we support the adoption of a mean winter energy margin standard for security we are concerned about how it will be implemented. We recommend that implementation be undertaken in a transparent manner with close consultation with market participants to mitigate the risk of crowding out market investment.

### **Refining the Approach in the GPS**

2. We consider that the revised Electricity GPS is an improvement on the existing version and that updating it is timely. The latest version is in some respects, shorter and clearer but there is still scope for improvement.
3. As we have argued in previous submissions on both the Electricity and Gas GPS, the general approach taken to the specification and content of the GPS is not consistently in keeping with the statutory framework set out in the Gas and Electricity Acts.
4. We consider that the Electricity GPS in some instances prescribes solutions to unspecified problems. Our view is that the Electricity GPS, like the Gas GPS we recently commented on, errs on the side of being overly prescriptive. This approach runs the risk of both limiting the discretion of the Commission, and compromising the clarity of the GPS.
5. Section 1720 of the Electricity Act 1992 sets out the principal objectives of the Commission in relation to electricity and section 172ZK(1) provides that "The Minister may set objectives and outcomes that the Government wants the Commission to give effect to in relation to the governance of the Electricity industry, and against which the Commission must report". These sections determine the appropriate content of the GPS and how the Commission should deal with the GPS.
6. These statutes provide for the Minister of Energy to set objectives and outcomes. The revised Electricity GPS, while better than the previous version is not consistently drafted in terms of "objectives and outcomes". For example, Part 5 dealing with renewable energy states the Government's objectives in paragraph 52. Paragraph 53, which addresses integration issues, jumps straight to prescribing a solution – the Commission is to "investigate the extent to which hydro and other generation sources can be integrated fully with intermittent wind generation in order to ensure that the maximum economic potential of

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<sup>1</sup> See for example EECA's latest financial review by the Commerce Select Committee.

wind generation can be achieved". An approach more consistent with the statutory framework would be to specify that the Government wants the Commission to use its powers and functions to ensure that the maximum economic potential of wind generation can be achieved, leaving it up to the Commission to decide how to do this.

7. Generally, a standard approach to organising material in the GPS would make it easier to interpret. For example, "topic heading" (renewable energy), followed by "context" (in this case paragraphs 50 and 51) if necessary, followed by a statement of government's "objectives and outcomes" (in this case paragraph 52).
8. Another example of the tendency to go beyond specifying objectives and outcomes is the requirement that the Commission should monitor compliance with the guideline on arrangements to assist low income and vulnerable consumers. The GPS goes on to state in paragraph 23 that the Commission should recommend regulations if necessary and then specifies in detail what the regulations should cover, including Government's view that bond payments should not exceed the value of one month's electricity consumption by an average household.
9. This approach goes beyond the requirement to specify objectives and outcomes. A consistent approach would involve requiring the Commission to monitor compliance with the Guideline and consider alternative options, including the costs and benefits of each option, if non compliance is an issue. This would give the Commission scope to consider whether the guidelines are being substantially complied with or whether there are acceptable reasons for non compliance, rather than giving the impression that strict compliance or regulation are the only options available.
10. Likewise, in the section covering the consumer complaints resolution system there is a requirement for electricity retailers and distributors to participate in a complaints resolution system if the Commission has approved one. Paragraph 28 provides that the Government expects any system to adequately address consumer interests. The GPS goes on to specify that a complaints system should cover electricity and gas and that if the industry is unable to set up such a scheme within a reasonable time then the Commission should recommend regulation to establish a system.
11. In contrast, paragraph 25 of the GPS which deals with arrangements in the event of retailer insolvency, is consistent with an objectives and outcomes approach.
12. The other tendency, reflected in the way the GPS is drafted, is to state a desired outcome (including detailed content prescription), and to go on

to specify that if the outcome is not achieved within a reasonable time the Commission should recommend regulation. The inference that could be drawn from this approach is that the Commission need not concern itself with a cost/benefit analysis of other solutions, or with considering whether there are good reasons for not meeting the specified content prescription. This approach is inconsistent with a) good process, b) Part 1 of the GPS<sup>2</sup> and c) the standards Government sets itself for policy development. Government policy proposals require regulatory impact analysis of alternative options including an assessment of the costs and benefits of alternatives.

13. We raise this issue both because it is important from a best practice perspective and because we are concerned that the Commission may be interpreting the GPS as giving it a licence to regulate without reference to alternatives. For example, in the context of consultation over the distribution services use of system agreement the Commission has indicated that if the agreement is not widely adopted it will regulate to make it mandatory. When challenged about this approach the Commission points to the GPS and indicates it has no choice.
14. Another example appears in paragraph 131 of the GPS which covers purchase of surplus generation by retailers and provides that “The Commission should recommend regulations or rules if voluntary arrangements are unsuccessful.”
15. If it is not the Government’s intention that the Commission proceed to regulate without reference to alternatives in the event that an outcome is not met then this should be made clear by either relying on Part 1 of the GPS to guide the Commission’s approach and deleting the frequent references to a regulatory alternative in the rest of the GPS or making it clear that regulation is only one of a range of options for consideration. If the latter approach is to be adopted then the wording in paragraph 85 could be used throughout the GPS; “As with other regulation-making powers, the Commission may only recommend regulations if it has first established that there are significant problems that are not resolvable through voluntary arrangements and co-operation” and a reference back to paragraphs 2 and 4 of the GPS. We note that this latter approach is consistent with the Government’s recent Quality Regulation Review.

### **Electricity Efficiency**

16. Parts 2 and 4 of the GPS are presumably in the GPS because they relate to electricity efficiency, the advancement of which is one of the Commission’s functions. These sections would benefit from a clear

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<sup>2</sup> Particularly paras 2 and 4 of the GPS.

statement of the objectives and outcomes Government wants the Commission to achieve as distinct from a description of how institutional arrangements are co-ordinated and descriptions of the various Government strategies that relate to electricity efficiency. This is important both for giving the GPS clarity and focus and because the Commission is only responsible for a relatively small, albeit important part of the Government's overall objectives for climate change and energy efficiency. We would expect the objectives and outcomes specified in the GPS to relate to the Commission's statutory functions contained in section 1720 and 172N of the Electricity Act.

17. We find the directive contained in paragraph 38 particularly troubling. It states that the Government expects the Commission to use EECA to help deliver its electricity efficiency work programme unless there is a good reason to contract with another party. The intention is to build up EECA's capacity so it can work as a delivery agent for more actions developed and funded by the Commission.
18. We appreciate that the problem that is being addressed here is that of funding for EECA. The Commission is effectively being used as a funding channel for EECA. However, this solution creates accountability and governance issues.
19. We consider that imposing this requirement on the Commission breaches the Auditor General's "Procurement – A Statement of Good Practice" guideline that: "Procurement from a selected supplier, without inviting competing tenders from any other suppliers, should be the exception rather than the rule, and should be justified only in certain limited circumstances"<sup>3</sup>.
20. We also note that the Auditor General offered the view that: "A public entity using sole source procurement for significant contracts – which are likely to involve public scrutiny, and possibly review by other agencies – should exceed the usual standard, not fail to meet it".<sup>4</sup>
21. We note that EECA runs competitive tender processes for delivery of programmes it administers. Despite this, we would still expect the Commission to retain the freedom to run competitive tender processes for choosing a provider to manage delivery of the electricity efficiency work programme it is responsible for funding in order to ensure it gets the best possible service at the lowest cost to electricity consumers. It is these consumers who ultimately pay for the programmes through levies. In addition any presumption in favour of using EECA is likely to crowd out development of private sector businesses developing expertise in

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<sup>3</sup> Available at [www.oag.govt.nz](http://www.oag.govt.nz)

<sup>4</sup> Paragraph 2.5 of the Auditor-General's report "The Electricity Commission: Contracting with service providers", July 2005.

electricity efficiency programme delivery, something we would expect the Government to want to foster. Fostering competition in the delivery of electricity efficiency programme delivery will not only help make electricity efficiency mainstream but also assist with the Government's wider sustainability and economic transformation agendas.

22. We are also concerned that this directive appears to be inconsistent with the requirement in paragraph 7 of the GPS that the Commission keep in mind the importance of encouraging innovation when deciding how best to deliver on its objectives. We consider that the promotion of competition where practical is an excellent way of encouraging innovation.
23. As we noted in our submission to the Commission on its Proposed Work Programme for 2008/09, if the Government wants EECA to manage delivery of particular programmes we would expect Government to fund EECA to do this out of general taxation, particularly in relation to programmes such as EnergyWise that are a) relatively successful, b) pre date the establishment of the Commission, and c) cover energy efficiency matters that go beyond electricity efficiency<sup>5</sup>.
24. We remain concerned about the proliferation of Government departments and Crown entities with overlapping and competing functions operating in the energy efficiency space. We are sceptical that the solution prescribed in the GPS - a Senior Energy Officials Group overseeing this work, coupled with a revised memorandum of understanding between EECA and the Commission will address the problem. The GPS, which binds only the Commission, is not the appropriate mechanism for dealing with this public sector management problem.
25. There is an instruction in paragraph 41 that a report prepared by EECA and the Commission should continue to underpin the development of proposed electricity efficiency activities. As well as being inconsistent with an objectives and outcome based approach reference to a detailed report that is not attached to the GPS is unhelpful. We suggest a reference be added.
26. In summary, we consider that specification of a clear, succinct set of Government objectives for electricity efficiency as they relate to the Commission's statutory functions is the appropriate approach to take. Presumably this would involve going through the NZES and NEECS and stating those objectives for which the Commission is responsible. Part 2 of the GPS provides background context much of which is not strictly

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<sup>5</sup> Even though the Commission has a role in ensuring the electricity sector contributes to achieving Government's climate change objectives by, amongst other things, promoting demand-side management and energy efficiency, amongst other pursuant to the Electricity Act section 172N(g).

relevant. This context is duplicated in Part 4. We suggest merging these two sections and adopting the “topic heading”, followed by “context”, followed by “objectives and outcomes” approach to structuring the material.

## **Security of Supply**

27. This version of the GPS introduces a new security standard – a mean winter energy margin to replace the “1 in 60” dry year standard. We agree with the introduction of a mean winter energy margin. We have this view because the method of presentation is more useful for investment purposes, and looks forward further than a year, not because we think the proposed method is more accurate or easier to understand. We suggest that the objectives, (specified in paragraph 58) be more clearly specified to reduce uncertainty. The Commission’s slides that describe its approach could be used as a basis for this.
28. As noted, we do not consider the winter energy security margin is easier to understand than the minzone concept. Both have a role to play, with the minzone being a necessary, if static, representation of the reserve margin and particularly useful for operational understanding. We support the Commission continuing to calculate minzones as well as the winter energy security margin. The same assumptions should be used in the calculations underpinning both approaches and industry should be consulted over the assumptions to help ensure they are realistic. This requirement could be added to the general direction to work with stakeholders contained in paragraph 60.
29. Our main concern with the use of a winter energy security margin are the risks around implementation. Due to timeframes for construction of new plant we would expect forward margins to decline about three years before investment takes place. We would not want the Commission to intervene every time it notices a dip in forward margins, as this would effectively crowd out investment. We support the Commission forecasting out to 5 years, rather than the 3 to 5 years mentioned in paragraph 65. This approach, if administered in a transparent fashion, will give the market the certainty it needs to make investments before the Commission exercises the option of intervening.
30. It is not clear how the requirement on the Commission in paragraph 64 fits with the forecasting and modelling work undertaken by MED.
31. Finally, on a different matter, in the absence of any move to relieve the Commission of its conflicting functions, (our preferred approach), we support the outcome of greater transparency inherent in the requirement in paragraph 63 for the Commission to publish protocols to

manage potential conflicts between its roles as a contractor for reserve energy and as a regulator.

### **Transmission**

32. Paragraph 106 conveys the expectation that Transpower and the Commission will ensure Transpower identifies and secures appropriate interests in land, designations and resource consents required for transmission corridors in advance of urgent needs. While we think this is an important issue, we do not consider the GPS the appropriate mechanism for achieving this.
33. The organisation that has control over Transpower's strategy for timely acquiring planning consents is Transpower not the Commission. The Commission is responsible for approving grid upgrade proposals in a timely fashion but not for ensuring Transpower gets the appropriate consents. If Government is concerned about the timeliness of Transpower's planning then the appropriate vehicle may be Transpower's SOI or a letter to Transpower from the Shareholding Ministers.

### **Distributed Generation**

34. Distributed generation rates a mention in paragraph 126. It is unclear what objectives and outcomes the government wants the Commission to achieve. Is the desired outcome the removal of barriers to the development of distributed generation, should this prove necessary? This should be clarified.

### **Other comments**

35. The arrangements for the benefit of low income and vulnerable domestic consumers in paragraph 23 are a little unrealistic in places. For example the second bullet point would require a time limit otherwise a consumer could potentially claim indefinitely that they were in consultation and therefore should not be disconnected. Bullet point 7 should provide that consumers should have *the opportunity to* enter into the most appropriate contract to meet their needs. It is not up to the Commission to determine the most appropriate contract for particular consumers.
36. Paragraph 48 in the section on electricity efficiency would benefit from some problem definition, for example a description of current incentives and why they are inadequate. Paragraph 49, bullet 4 refers to smart metering. Rather than facilitate the progressive introduction of smarter meters, something that is already happening, the problem definition should address the removal of any barriers to their introduction.
37. Paragraph 52 in the section on renewable energy, the third and fourth bullet points appear to be saying the same thing. The heading prior to

paragraph 53 should be “wind integration issues”. This paragraph should be rephrased in terms of objectives and outcomes. At the moment it implies that the Commission should decide when to retire Huntly which is a commercial decision for the plant’s owner.

**Concluding remarks**

38. If you have any queries regarding Mighty River Power’s submission, or would like further information, please do not hesitate to contact me.

Yours sincerely,

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**Regulatory Strategist**