

4 April 2008

Electricity Group
Energy & Communications Branch
Ministry of Economic Development
33 Bowen Street
PO Box 1473
Wellington

By email: electricity@med.govt.nz

**SUBMISSION ON THE GOVERNMENT POLICY STATEMENT ON ELECTRICITY
FEBRUARY 2008**

- 1 Orion New Zealand Limited welcomes the opportunity to respond to MED on the draft version of the Government Policy Statement on Electricity Governance (the *GPS*).
- 2 We detail our comments below.

Section 3 – consumer protection

- 3 Paragraphs 16 to 20 of the GPS indicate a move to a higher level of regulation, with the Electricity Commission (the *Commission*) actively monitoring domestic consumer contracts to ensure that those contracts comprehensively implement the objectives of paragraphs 16 and 17 of the GPS.
- 4 However paragraph 20 indicates that the Commission, in consultation with the Ministry of Consumer Affairs and other relevant interested parties, will review the model contracts from time to time to ensure that they remain effective and up-to-date with current market issues.
- 5 We question whether there is any need for the Commission to carry out both a monitoring role and ongoing development of model contracts.

Recommendation

- 6 We therefore recommend that the requirement for the Commission to continue to develop model domestic consumer contracts be removed.
- 7 Consequently, to ensure that the consumer contracts remain current, paragraph 20 should be modified to read:

The Commission should, in consultation with the Ministry of Consumer Affairs and other relevant interested parties, review paragraphs 16 and 17 of the GPS from time to time to ensure that they remain effective and up-to-date with current market issues.

Section 6 – security of supply

- 8 Orion is encouraged by the Government's continued focus on security of supply, and in particular, its new focus on monitoring peak capacity. For many years we have focused on control of peak loading and security of supply. We have successfully limited peak growth in our network area through:
 - 8.1 peak pricing products;
 - 8.2 encouraging the use of distributed generation at peak times; and
 - 8.3 maintaining and improving our load management systems.
- 9 We consider that the Government should require the Commission to consider the benefits of these types of measures in conjunction with its role in monitoring peak capacity.
- 10 Additionally when contracting for reserve energy the Commission should consider the additional benefits that this reserve generation could provide in respect of:
 - 10.1 assisting in reducing peak capacity constraints; and
 - 10.2 delaying, where economically appropriate, network and grid upgrades.
- 11 For example, we have considered the use of small scale (30 MW) diesel generators as a source of reserve energy and as a method of reducing peak constraints. This type of solution may be uneconomic to meet any

one of the above uses individually, but could prove economic when applied for all three uses, that is:

- 11.1 reserve energy;
- 11.2 reducing peak constraints; and
- 11.3 delaying network and grid upgrades.

Recommendation

12 We recommend that paragraph 73 be modified to require the Commission to consider the additional benefits that this generation could provide in respect of:

- 12.1 helping to reduce peak capacity constraints; and
- 12.2 delaying, where economically appropriate, network and grid upgrades

when contracting for reserve energy.

Investment incentives

- 13 Paragraph 55 states that a key requirement for security of supply and confidence in security of supply is that "*The national grid and distribution lines meet specified reliability objectives*". Paragraph 55 then states that transmission and distribution issues are covered in separate areas.
- 14 Orion welcomes the acknowledgement that the electricity distribution and transmission sectors are a key component of security and reliability of supply. However, to meet the need for strong and reliable distribution and transmission, it is essential that incentives to invest for growth and security of supply are enhanced rather than reduced.
- 15 We note that it would be counter-productive for the Government to create generation resources for security of supply purposes, only to find in years to come that this generation could not be delivered reliably due to lack of investment in delivery systems caused by regulatory constraints.
- 16 We also note that while the GPS covers the need for investment in the transmission system, it fails to address this issue in regard to the distribution sector.

Recommendation

- 17 We recommend that a new sentence be added at the end of paragraph 54 as follows:

The Government acknowledges that security of supply cannot be delivered to a modern, growing economy by investment in electricity generation alone and incentives on electricity distribution and transmission companies to invest and innovate must continue.

Disaggregation of load management

- 18 A key issue in maintaining security of supply in the event of grid or network emergencies is the ability to control certain loads that have minimal customer impact.
- 19 Orion has recently initiated a requirement that suitable loads connected to our network must be available for control, by Orion, in the event of a grid or network emergency. We introduced this measure due to our concern that disaggregation of load management systems could potentially lead to major impacts on customers. This could result in unnecessary power cuts in the event of grid emergencies, rather than a coordinated load management process which controls suitable loads with minimal customer impact.

Recommendation

- 20 We recommend that consideration is given to requiring the Commission to consider in respect to load management, the potential adverse impact that disaggregation of centralised load management control may have on system security.

Section 9 – distribution

- 21 Orion notes that the Commerce Amendment Bill 2008 was recently introduced. This Bill proposes substantial changes to the current regulatory regime under Part 4A of the Commerce Act. For example:
- 21.1 the current threshold regime is to be replaced by default price-quality paths;
 - 21.2 the Commerce Commission will be required to set input methodologies; and

- 21.3 each distributor will be entitled to submit customised proposals in response to the Commerce Commission's assessment of its default price-quality path.
- 22 This Bill has yet to be considered by the Select Committee. Therefore for the moment there is uncertainty as to:
- 22.1 the final content of this proposed legislation; and
- 22.2 the time at which it may come into force.
- 23 Section 9 of the GPS makes no allowance for this proposed change to the regulatory regime under the Commerce Act. For example, paragraph 116 of the GPS requires the Commission to develop "*principles or model approaches to distribution pricing*". We note that the Bill (Section 52S(1)(v)) requires the Commerce Commission to develop pricing principles as one of the input methodologies.
- 24 We would not wish to anticipate at this stage how the Bill may impact on the GPS. However, we suggest that some amendments could be made to section 9 of the GPS to recognise that by necessity, the Bill reflects Government policy and therefore will impact on the GPS and the Memorandum of Understanding between the two Commissions.

Recommendation

- 25 In this context we recommend that matters relating to "*principles or model approaches to distribution pricing*" as set out in paragraph 116 and 118 should be moved from section 9 and addressed in section 10 of the GPS and explicitly considered under the Memorandum of Understanding.

Standard contracts

- 26 Paragraph 117 of the GPS states:

"The diversity and complexity of the terms and conditions offered by different lines companies for use of their lines is often cited as a significant barrier to expansion of retail competition. The Government considers that greater standardisation and simplification of tariff schedules and contractual arrangements will facilitate market entry by retailers."

- 27 We addressed this issue in our response to the September 2003 draft GPS. In that submission we pointed out in relation to the equivalent clause that:

“...it is important that a balanced approach be taken on this issue. The prime stakeholders are the consumers not large electricity retailers.

The industry has spent considerable time developing models of distribution agreements through the use of a working group process, which comprised representatives of the retail, line and consumer sectors with an independent chair. Orion advises that the government should take a cautious approach when considering standardisation and simplification of tariff schedules and contractual arrangements. The likely outcome is that innovative solutions will be stifled and more economically efficient/cost reflective improvements would be hindered. Rather than enabling and encouraging competition, standardisation may actually increase barriers to new entrants.

Orion considers any drive to standardisation of lines tariffs will undermine demand side management and be to the detriment of normal economic incentives for load management, dual fuel responses and distributed generation”

- 28 We also provided a recent example of an innovative solution that was not standard to the industry yet provided consumers with real benefits.

Recommendation

- 29 We recommend that paragraph 117 be deleted, given the developments to the industry since 2003.

Section 10 – interrelationship with the Commerce Commission

- 30 As mentioned above, the recently introduced Commerce Amendment Bill 2008 proposes substantial changes to the current regulatory regime under Part 4A of the Commerce Act. Again, while not wishing to anticipate at this stage how the Bill may impact on the GPS, we suggest that some amendments could be made to section 10 of the GPS to recognise that, by necessity, the Bill reflects Government policy and therefore will impact on the GPS and the Memorandum of Understanding between the two Commissions.

Recommendation

- 31 In this context we recommend three possible changes are as follows:

- 31.1 the words “under Part 4A threshold” could be deleted or replaced with the words “under the Commerce Act 1986” in bullet point 1 of paragraph 124;

- 31.2 the words “under a threshold as regulated” could be deleted from bullet point 2 of paragraph 124; and
- 31.3 in a new paragraph 126 the Government could “request the two Commissions to review their Memorandum of Understanding, in the event that the Bill is enacted, so as to make such amendments to this Memorandum as may be appropriate to accommodate the new regime.”

Section 11 – distributed generation

- 32 The first bullet point of paragraph 129 requires the Commission to investigate and make recommendations on whether model contracts should specify pricing principles related to the purchase of small amounts of excess generation from small generators.¹
- 33 As discussed in paragraphs 3 to 5 above, paragraph 19 of the draft GPS requires the Commission to monitor domestic consumer contracts and recommend regulation if the objectives of paragraphs 16 and 17 of the GPS are not comprehensively implemented.
- 34 In view of this monitoring role we have questioned whether there is any need for the Commission to develop or maintain **model** domestic consumer contracts.
- 35 Adding a further bullet point to paragraph 17 of the GPS dealing with the purchase of small electricity surpluses by local retailers would allow the Commission to monitor customer contracts to ensure this issue is being addressed.

Recommendation

- 36 We recommend that a requirement in relation to the purchase of small amounts of excess generation be added to the list of issues in paragraph 17 of the GPS that the Commission is required to ensure is included in contracts. Paragraphs 129 to 133 could then be deleted.

Section 12 – retail

- 37 We note in relation to paragraph 134 that the Commission has radically changed the allocation methodology for distribution losses between

¹ Generation units capable of generating up to 40,000kWh over a year.

retailers that commences on 1 May 2008, which should allay any retailer concerns in this area.

- 38 In relation to the other two requirements on the Commission to investigate and make recommendations in relation to the management and minimisation of losses, we note that the issue of the management of losses and incentives has been added to paragraph 125 of section 10 as a matter for consideration between the Commerce and Electricity Commissions.
- 39 We also submit that line companies in general, through their contractual arrangements for distribution services, have an incentive to use good industry practice. This requires line businesses to consider the economic trade-off between the cost of losses and the cost of capital.
- 40 Consequently, line businesses apply these principles when purchasing transformers and building overhead lines. Therefore incentives on line companies are already in place to manage physical losses.²
- 41 We also consider that the term “minimise” in this paragraph is inappropriate as it implies an absolute priority whereas it is more appropriate when considering physical losses to “optimise with regard to capital expenditure” as this correctly states the trade-off required.

Recommendation

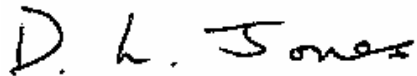
- 42 We recommend that paragraph 134 be deleted. The issue of management of losses should be left as an issue between the two Commissions as provided for in paragraph 125 of section 10.

² We consider the term “physical losses” should be used rather than “losses” to distinguish this from losses related to retailer metering and data errors.

Concluding remarks

- 43 Thank you for the opportunity to make this submission. If you have any questions relating to the submission, please contact Dennis Jones (Industry Developments Manager) DDI 03 363 9526 email dennis.jones@oriongroup.co.nz.

Yours faithfully

A handwritten signature in black ink that reads "D. L. Jones". The letters are cursive and slightly slanted to the right.

Dennis Jones
Industry Developments Manager