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Electricity Group
Energy and Communications Branch
Ministry of Economic Development

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Submission on revised Government Policy Statement on Electricity Governance

1. Vector welcomes the opportunity to provide this submission on the revised Government Policy Statement on Electricity Governance (GPS). In this submission we will comment on the proposed amendments to the GPS, recommend some further quick changes which could be made and raise other issues that should be considered in any more detailed review of the GPS and electricity governance.

2. Vector considers that for any regulatory body to succeed it must have clear and complementary objectives. Vector does not believe that a 30 page document with a mix of specific targets and general goals across a range of issues is likely to promote effective outcomes, particularly as the objectives are sometimes conflicting and contradictory. We have some sympathy with the position the EC finds itself in, attempting to reconcile and resource the various objectives that the current GPS places upon it. The amendments that have been proposed for the GPS are welcome but a more fundamental review is clearly needed; and this review would ideally produce a much shorter, clearer and less prescriptive document. In our view, the GPS would be more effective and credible if it focused on the objectives and outcomes that were sought rather than prescribing the means.

Proposed amendments to the GPS

3. Vector supports moves to shift the focus of the GPS to security of supply. Security of supply is critical to New Zealand's economic performance and should be the primary aim of any electricity governance regime. The spate of dry years and recent transmission interruptions suggest that the current governance arrangements have not succeeded in providing for security of supply. However,

Vector notes that the only actual change proposed for the Security of Supply section is to move it from section 6 to section 2. Vector is not convinced this will have a noticeable effect on EC decisions and priorities. Vector discusses below some other improvements which could be made to the Security of Supply section.

4. Vector is strongly in favour of simplified and streamlined processes for transmission investments. Vector considers that the existing process has unduly delayed and hindered transmission investments, and too often fails to produce a better outcome than the initial proposal. In that regard, Vector considers that the proposed amendment regarding transmission investment proposals with a cost of less than \$20 million is an improvement. However, the proposal still requires Transpower to go through a reasonably lengthy process, including the development of a Grid Upgrade Plan. Vector recommends that further consideration be given to how the process could be streamlined further. Vector considers that projects costing less than \$20 million (a reasonably small amount in transmission investment terms) could conceivably proceed without needing EC approval at all.

5. However, this will not resolve the problems facing transmission projects costing more than \$20 million. Vector believes that the entire transmission investment process is flawed and creates substantial delays and costs for little if any benefit. Vector believes that responsibility for grid planning should be clearly assigned to Transpower and it should be able to carry out its role without the Electricity Commission reproducing much of its work. Vector accepts that there should be some oversight of the process, particularly on major investments, but we believe the process would be more efficient if the EC had a checking role and was limited in its ability to second guess and duplicate Transpower's work by developing its own alternatives. Transpower's longer term vision of a process where a single regulator is responsible for approving a multi-year programme of investment, rather than the current project-by-project approach, should also be considered.

6. Overall, Vector believes the New Zealand transmission grid is in need of a period of substantial investment to ensure it can continue to meet the needs of consumers. This needs to be recognised by the regulatory agencies involved.

7. In the context of improving clarity of objectives for the EC, removing market distortions, and focusing on security of supply, Vector supports the removal of references to the New Zealand Energy Strategy (NZES) and the New Zealand Energy Efficiency and Conservation Strategy (NZECS).

8. Vector believes the paragraph relating to the integration of wind generation could be improved but should not be deleted altogether. Vector believes that the

objective of achieving “the maximum economic potential of wind generation” should be removed. It amounts to picking winners in the generation sector and is unnecessary as the introduction of an emissions trading scheme should ensure wind generation is priced at a level which reflects its low level of carbon emissions, relative to other generation sources. However, the intermittent nature of wind generation (and also tidal and some hydro generation) does create issues for system operation that need to be resolved and we would be concerned if this disappeared from the EC’s workstream.

9. The proposed amendments to the GPS include removal of the requirement that the EC make extensive use of advisory groups to provide industry input into the development of rules and regulations. It is not clear to Vector why this change is being made. The EC recently consulted on proposed improvements to the structure of its advisory groups. Vector supported the EC’s proposals, notably those to increase consumer involvement, have independent chairpersons and to shift the focus of the advisory groups towards more strategic issues.

10. Vector considers that it is important for the EC to engage extensively with industry when developing rules and regulations and that engagement should go beyond formal consultation. Advisory groups where industry and the EC can discuss issues and options are a useful tool for achieving a high level of engagement. A positive change that could be made to the advisory group structure is to require that each group makes its advice publicly available and require the EC Board to explain its reasons where it chooses not to follow advisory group advice. Overall, in Vector’s view, there needs to be more collaboration with the industry on improvements in the rules and regulations, not less.

Other recommended amendments to the GPS

11. Vector considers that the following changes could also be made relatively quickly to the GPS:

- The section on distribution pricing methodologies requires the EC to develop model approaches to distribution pricing and to consider standardisation of distribution tariffs. In our view these requirements are unworkable and conflict with other objectives. Standardised pricing should be a last resort and pursued only if retailers and distributors are unable to resolve workable arrangements between themselves. Standardised pricing would impede the ability of lines companies to develop innovative pricing, notably with regard to demand-side participation and smart metering. Distribution pricing methodology also needs to be flexible to ensure each network is priced at an efficient level (e.g. the needs of dense urban networks will differ

substantially from dispersed rural networks and this will be reflected in the tariffs). Vector recommends that paragraphs 100 and 101 be deleted from the GPS. Additionally, the Commerce Commission is carrying out work on distribution pricing methodologies for both electricity and gas. The GPS needs to ensure there are clear boundaries between the roles of the EC and the Commerce Commission in this area, to avoid confusion and duplication of effort.

- The chapter on electricity efficiency contains a discussion of the joint work between the EC and EECA to “promote the use of electricity in an efficient and environmentally sustainable manner”. This duplication of roles is confusing and, in Vector’s view, distracts the EC from its core functions. The promotion of energy efficiency is important but should be the clear responsibility of EECA. Vector does not consider that there is any need to retain paragraphs 54 to 60 of the GPS.
- Paragraphs 13 and 14 contain prescriptive instructions as to how the EC should undertake its security of supply obligations (e.g. must apply a mean energy margin of 17% for New Zealand and 30% for the South Island). Vector suggests that these instructions are unnecessary and the general objectives set out in paragraphs 12 and 15 are sufficient.

Other issues for consideration

12. Vector believes there are a number of other aspects of the electricity governance arrangements and the GPS that would benefit from reform. However, these are generally complex, interrelated policy issues where quick changes without detailed consultation would not be appropriate. Vector would therefore recommend that the following issues be fully addressed in any forthcoming review of electricity governance arrangements:

- *Low-User Fixed Charge regulations.* The aim of the policy behind these regulations is to support low-income households and provide them with lower bills. However it is mis-directed as low income consumers do not necessarily use less electricity than high income consumers. The effect of the regulations is to create a non-transparent subsidy within the market from high electricity users to low electricity users, irrespective of the customers’ need for electricity or their ability to pay. The regulations also create distortions that compromise the overall effectiveness of the market, particularly when combined with the Distributed Generation Regulations. For example, they reduce the incentives for lines companies to invest in demand-side alternatives to grid-delivered electricity. This policy is

ineffective and Vector recommends the GPS be reframed to give the EC a clear mandate to develop an alternative policy (in conjunction with other agencies) that would better meet the objectives of managing electricity costs for low-income consumers.

- *Transmission pricing methodology.* There are currently no effective price signals to incentivise efficient locating of generation investments. As a result, new generation can be placed anywhere without considering the transmission costs involved in taking the electricity to load centres. This creates inefficiencies in the market. In order for the market's performance to improve, the transmission pricing methodology should be amended to incentivise better locational investment decisions. Vector understands that the EC has recently begun a wide ranging review of the allocation methodology for transmission costs. Vector believes this review is timely and necessary and supports its continuation.
- *Reserve energy policy.* This policy is under review following the independent review of the capacity shortage events of winter 2008. Vector supports the recommendations of the review, particularly that the reserve energy scheme be discontinued and that market rules be changed to ensure decision-makers face the cost to consumers of any forced demand curtailment. Changes to the GPS in this area should follow the recommendations of the independent review.
- *Retail competition.* In Vector's view, the current GPS is relatively weak on promoting retail or wholesale competition and could be strengthened. The retail market appears to tend towards regionalised monopolies rather than workably competitive outcomes and profit margins appear to have risen significantly with little apparent improvement in capacity or service. The forthcoming review from the Commerce Commission on market competition should provide more information in this regard. Vector considers that some fundamental changes, such as ending the vertical integration of generation and retail, need to be considered.

13. Vector believes that security of supply is not only a question of transmission and generation. The distribution networks are equally critical but investment in these networks is often hampered by regulatory interventions. Vector believes that any review of electricity governance must ensure all regulatory agencies recognise that prudent investment in distribution assets should be promoted.

Contact details

14. Vector is happy to discuss this submission in more detail. If you have any queries please contact me on 04 803 9039 or at nathan.strong@vector.co.nz.

Yours sincerely,

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