

**OFFICE OF THE MINISTER  
OF ENERGY AND RESOURCES**

The Chair  
**CABINET ECONOMIC GROWTH AND INFRASTRUCTURE COMMITTEE**

**GOVERNMENT POLICY STATEMENT ON ELECTRICITY GOVERNANCE**

**PROPOSAL**

- 1 That Cabinet approve proposed amendments to the Government Policy Statement on Electricity Governance (the GPS) to ensure that the regulatory rules governing smaller grid investment are made more efficient and to remove redundant references to the prior Government's energy strategy.

**EXECUTIVE SUMMARY**

- 2 I am concerned that the current regulatory regime, administered by the Electricity Commission, is not flexible enough to facilitate the accelerated grid upgrade work that Transpower is proposing to undertake. I have therefore amended the GPS to require a streamlined process be put in place for grid upgrade plans of less than \$20 million.
- 3 I have also removed references to the New Zealand Energy Strategy, and related matters that are no longer relevant, and brought forward, the section on security of supply, to emphasise the priority that this Government gives it.
- 4 I have consulted on the proposed amendments to the GPS, as agreed by the Cabinet Business Committee on 29 February 2009 [CBC Min (09) 4/5 refers].
- 5 A marked up copy of the GPS, showing proposed changes since the consultation version, is attached at Appendix 1.

**BACKGROUND**

- 6 The GPS is made pursuant to section 172ZK of the Electricity Act 1992. It sets the objectives and outcomes the Government wants the Electricity Commission (the Commission) to give effect to in relation to the governance of the electricity industry.
- 7 Cabinet recently agreed to commence a Ministerial review of electricity market performance. The purpose of the review will be to improve the performance of the electricity market and its institutions and governance arrangements in order to better achieve the Government's objectives for the electricity [CAB Min (09) 11/11 refers]. I also intend to review the energy strategy promulgated by the previous Government. I expect that both of these reviews may result in significant changes to the GPS.

- 8 Accordingly, the revisions I propose to make at this time are limited just to those matters that warrant more urgent attention.

## **COMMENT**

### **Proposed Regulatory process for small grid investments**

- 9 The revised GPS proposes a streamlined process for transmission investments under \$20 million in value. Under this process Transpower need only demonstrate that they have effectively consulted with interested parties. The Commission will not be required to carry out a merits review of investment decisions under \$20 million.

### **Assessing the problem**

- 10 Evidence provided by Transpower indicated that it took between 3-9 months to prepare a grid upgrade proposal to the level of detail required by the Commission, and the Commission took between 2 to 6 months to approve it.
- 11 Transpower claims that this process is inefficient for small investments as it ties up expert resources within Transpower, the Commission and industry participants, and delays the commencement of important, but low cost, grid upgrades. Transpower claim that the Commission's requirements lead to complex and costly analysis for projects which are clearly self evident and do not warrant this level of evaluation. This in turn risks delay to related maintenance or replacement and refurbishment works (including larger maintenance projects).
- 12 An alternative view is that the problem lies largely with Transpower's internal processes. The Major Energy Users Group (MEUG) notes that the last four projects approved by the Commission under \$20 million all took 55 days or less to approve, thereby implying that Commission is efficient. These timeframes are confirmed by the Commission.
- 13 The extent to which the existing rules gives rise to unnecessary costs or delays in progressing small investments is therefore unclear from the evidence to date. Nevertheless, I believe there is sufficient evidence of delay and costs, and insufficient evidence that the current level of regulatory scrutiny adds value, such that a change to the GPS for small projects is warranted.

### **Consultation Outcome**

- 14 There is a statutory requirement to consult with the Commission before issuing any GPS. In addition, as a matter of good process the revised GPS was released publicly on 2 March 2009, and 32 submissions were received: 14 from interest groups (including a mix of business and domestic consumer groups); four from large business; nine from lines companies, and five from retailer/generators. Discussions and submissions have also been received from Transpower, the Commerce Commission, and the Ministry for the Environment.

- 15 Submitters were generally supportive of streamlining of the approval process and agree that this would benefit New Zealand and the industry. Submitters raised a number of issues regarding the GPS as drafted. The most significant of these are discussed in turn below.

### **Modifications to the draft wording**

- 16 The most significant submissions received were on paragraphs 87 and 88 of the draft GPS concerning small transmission investment.
- 17 Paragraphs 87 and 88 of the GPS as released for consultation were drafted as follows:

#### **Investment in minor transmission works**

- 87 The Government's objective in relation to the investment in and maintenance of the transmission network is to put in place a more streamlined process for the approval by the Electricity Commission of grid upgrades by Transpower where the total cost of a project is less than \$20M.
- 88 For all future small projects which cost less than \$20M the Government seeks the following outcomes:
- Transpower should develop and submit upgrade plans to the Commission for approval.
  - Grid upgrade plans should demonstrate the rationale for all expenditure (operational, maintenance and capital), taking into account good industry practice for power system operation.
  - In developing grid upgrade plans Transpower should undertake the detailed planning role; it should consult with materially affected parties, and have regard to all submissions or objections received prior to submitting the grid upgrade plan to the Commission.
  - Once the Commission has received a grid upgrade plan the Commission should approve the plan without undue delay provided it is satisfied that Transpower has complied with the requirements above.
  - The Commission should not be required to assess and evaluate the merits of small investment plans of a value less than \$20 million.
  - If Transpower wants to amend an approved grid upgrade plan it should follow the same process unless the total project cost under the amended plan exceeds \$20M. In that case, the standard process, as outlined in paragraphs 78 to 86, should apply.
- 18 The Commission supports the general objective expressed in paragraph 87 of the proposed GPS. It is, however, concerned that the specific requirements set out in paragraph 88 may present it difficulties during the rule change process. The Commission submits that the proposed change to the GPS is too prescriptive and does not give the Commission sufficient latitude to assess a broad range of options to achieve the objectives defined in paragraph 87 of the GPS.
- 19 The Commission has therefore submitted that the Government should consider setting the proposed amendments in the GPS at a higher level, directed at the objective to be pursued, rather than the means by which it should be pursued.

*Use of GPS for policy directives*

- 20 Concerns were raised by Consumer Coalition on Energy (CC93), MEUG, Federated Farmers, and Rio Tinto on the use of the GPS for such specific policy directives. These parties claimed that the proposed amendments were potentially in conflict with the rules (as raised above the Commission), and also expressed concern that “tinkering” with the GPS was “a very poor regulatory approach which exacerbates concerns around the quality of governance in the sector”.

*Minor wording changes in paragraph 87 and 88*

- 21 Submissions identified wording changes that would improve the intent and flow of paragraphs 87 and 88. The majority of these were minor additions that added qualification to wording such as the insertion of the words “expected” before total costs and “upgrade” before project.

*Coordination with Commerce Commission*

- 22 The Commerce Commission noted that if the Electricity Commission reduces the level of scrutiny for those between \$1.5m<sup>1</sup> and \$20m, it may need to consider whether it needs to increase its scrutiny in this area. The Commerce Commission advised that it cannot pre-determine its views and may need to consult on the treatment of Transpower’s capital expenditure for this range of projects.

*Increase threshold*

- 23 Several parties asked for the threshold to be increased to \$50 or \$100 million. Others asked on what basis \$20m had been chosen. I consider that \$20m is an appropriate level at this time, as it balances the risk of lesser project scrutiny against the need to expedite transmission investment.

**Recommended response for improving the regulatory process for small transmission projects:**

- 24 The issues raised by submitters suggest three different options for consideration. These are:
- a Option 1: Continue with the GPS as drafted for consultation (with minor improved wording);
  - b Option 2: Describe the outcomes sought in a less prescriptive manner (as suggested by the Commission); or
  - c Option 3: Keep with the status quo.
- 25 I will discuss each of these options in turn.

---

<sup>1</sup> Under the Administrative Settlement arrangements between the Commerce Commission and Transpower, the CC reviews any grid upgrade plan which requires capital expenditure under \$1.5 million, with the Electricity Commission reviewing those over \$1.5million.

*Option 1: Retain current drafting of paragraphs 88 and 89*

- 26 The GPS as consulted on clearly sets out what the Government's expectations are for the Commission when considering smaller grid upgrade plans and should be straight forward to implement.
- 27 The Ministry of Economic Development's legal advice is that there is a risk that paragraph 88, as drafted could be legally challenged on the basis that it goes beyond the scope of section 172ZK of the Act. This is because paragraph 88 arguably (at least in part) consists of processes rather than outcomes.
- 28 The Ministry has also considered the Commission's concern that paragraph 88 is too prescriptive and would present difficulties during the process of amending rules under section 172F. The Ministry's legal advice is that, while paragraph 88 is expressed in quite specific terms, it should still be possible for the Commission to fulfil its duties in relation to rule making., Matters of detail will still need to be spelled out in the rules in order to give effect to paragraph 88 and there is scope for the Commission to consider a range of different options in relation to each such rule. The Ministry considers that the proposal is, therefore, workable.
- 29 There is a risk that the Commerce Commission may not be satisfied with this level of scrutiny and may in compensation seek to increase its own level of scrutiny in addition to the Electricity Commission's process, thereby defeating the objective of a more streamlined process. I do not believe this is a significant risk because, any additional process put in place by the Commerce Commission (for small grid upgrades) is likely to be more streamlined than the process currently required by the Electricity Commission.
- 30 Overall this option achieves the objective of a streamlined process for small grid investments.

*Option 2: Focus on the outcomes sought in paragraph 88*

- 31 A less prescriptive requirement would be to amend the GPS as follows:
- Investment in minor transmission works**
- 87 *The Government's objective in relation to investment in the transmission network is to put in place a more streamlined process for approval by the Electricity Commission of grid upgrade proposals by Transpower where the expected total cost of the upgrade is less than \$20 million.*
- 88 *The Government expects the Commission to develop and report to the Minister of Energy and Resources by 31 July 2009, on the processes that will achieve the objectives and outcomes expressed in paragraphs 87.*
- 32 This wording drafted by my officials is consistent with that suggested by the Commission in its submission. It allows the Commission to consider other options for streamlining the investment decision process.
- 33 However, I believe there is a risk with this option that any resulting changes to the rules or the Electricity Commission's processes would not sufficiently

reduce the time taken to have small grid upgrade plans developed and approved, nor would it absolutely preclude merits reviews being undertaken on small projects in future by the Commission.

*Option 3: Status Quo*

- 34 An option would be to hold off making changes to the GPS in this area until the Ministerial Review on the electricity market is completed. However, I believe that streamlining small investments is a matter that can and should be addressed quickly.
- 35 The potential hold ups being experienced, the potential savings identified by Transpower, and limited progress in improving these issues to date, highlights the need for me to send a very strong signal about the need for progress in this area.

**Conclusion:**

- 36 Each of the options above has its merits, and its own risks. On balance I believe that Option 1 is the best way to proceed, as it achieves the desired outcomes and should be straightforward to implement.

**OTHER PROPOSED AMENDMENTS TO THE GPS**

**Removal of references to New Zealand Energy Strategy (NZES) and New Zealand Energy Efficiency and Conservation Strategy (NZECS)**

- 37 Most parties were supportive of the removal of references to the NZES and NZECS.

**Removal of reference to Advisory Groups**

- 38 Several parties noted that the current direction in the GPS for the Electricity Commission to use advisory groups was at a level of detail not appropriate to GPS, but questioned whether its removal means that the Electricity Commission can no longer use advisory groups.
- 39 The removal of the advisory group paragraph does not prevent the Electricity Commission using advisory groups where it can see the benefit for all parties.

**CONSULTATION**

- 40 The Ministry of Economic Development prepared this paper in consultation with the Treasury. The Department of Prime Minister and Cabinet has been informed.
- 41 The Electricity Commission and the Commerce Commission were consulted on the proposed changes to the GPS. Submissions were received from other interested parties.

## FISCAL IMPLICATIONS

42 There are no current fiscal implications.

## HUMAN RIGHTS

43 There are no human rights implications.

## LEGISLATIVE IMPLICATIONS

44 The Electricity Commission may need to develop and recommend amendments to the Electricity Governance Rules to implement the new policy objectives set out in the GPS. Electricity Governance rules are made by the Minister of Energy and Resources following a recommendation from the Electricity Commission. The Minister of Energy and Resources may not amend those rules, except to give effect to a recommendation from the Commission.

## REGULATORY IMPACT ANALYSIS

45 A regulatory impact statement has been prepared and is submitted together with the proposed final GPS.

## PUBLICITY

46 The GPS will be published in the Gazette and placed on the Ministry of Economic Development's website, along with the submissions. The Minister of Energy and Resources will release the final GPS with a media statement.

## RECOMMENDATIONS

47 It is recommended that the Committee:

- 1 **Note** that the Government Policy Statement on Electricity Governance (GPS) sets the objectives and outcomes the Government wants the Electricity Commission to give effect to in relation to governance of the electricity industry;
- 2 **Note** that a draft GPS was released for consultation and 32 submissions were received.
- 3 **Note** that the attached Government Policy Statement on Electricity Governance has been revised and updated to:
  - 3.1 remove references to the New Zealand Energy Strategy (NZES) and New Zealand Energy Efficiency and Conservation Strategy (NZEES);
  - 3.2 emphasise the priority this Government accords to security of supply policy; and

- 3.3 express the Government's desire to facilitate small grid upgrade investments by streamlining the investment approval process under the Electricity Governance Rules.
- 4 **Approve** the attached Government Policy Statement on Electricity Governance.
- 5 **Invite** the Minister of Commerce to transmit the GPS to the Commerce Commission pursuant to section 26 of the Commerce Act 1986 as a statement of Government policy;
- 6 **Note** that the Minister of Energy and Resources intends to release this Cabinet paper and the Regulatory Impact Statement on the Ministry of Economic Development website, after it has been approved by Cabinet.

Hon Gerry Brownlee  
**Minister of Energy and Resources**

Date signed: \_\_\_\_\_

## **Regulatory Impact Statement**

### **EXECUTIVE SUMMARY**

The Government Policy Statement (GPS) on Electricity Governance is made pursuant to s172ZK of the Electricity Act 1992. It sets the objectives and outcomes the Government wants the Electricity Commission (the Commission) to give effect to in relation to the governance of the electricity industry.

The purpose of the GPS is to give greater direction to the Electricity Commission on how it should meet its objectives to implement Government policy, over and above what is provided in the general purpose statements of the Electricity Act 1992. These objectives and outcomes provide greater detail on what the Government expects from the Electricity Commission in relation to consumer protection, electricity efficiency, renewable energy, security of supply, system operation and wholesale markets, transmission, distribution, distributed generation and retail.

The proposed revisions to the GPS are intended to facilitate the accelerated grid upgrade work that Transpower is proposing to undertake, by encouraging the Electricity Commission to develop a streamlined process for the approval of smaller transmission investments.

### **ADEQUACY STATEMENT**

The Ministry of Economic Development (MED) confirms that the Code of Good Regulatory Practice and the regulatory impact analysis requirements, including the consultation RIA requirements, have been complied with. A RIS was prepared and MED considers the RIS and the RIA analysis undertaken to be adequate. A final RIS was circulated with the Cabinet paper for departmental consultation purposes.

MED notes consultation was not supported by a discussion paper covering a wide range of options to the proposal. However, submitters did identify a number of options which were analysed and assessed in the development of the final proposal. MED therefore believes that the RIA analysis requirements have been adequately fulfilled.

### **STATUS QUO AND PROBLEM**

The GPS is made pursuant to the Electricity Act 1992 and sets out the objectives and outcomes the Government wants the Electricity Commission to give effect to in relation to the governance of the electricity industry. The GPS includes the Government's objectives and expectations for investment in and maintenance of the transmission network.

At present all transmission upgrade works above \$1.5 million must be approved by the Electricity Commission under Section III, Part F of the Electricity Governance Rules (otherwise Transpower will not be entitled to recover from transmission customers the costs of the works under the Commerce Act (Transpower Thresholds) Notice 2008). The costs and content of Transpower's maintenance and replacement and refurbishment programmes (including Transmission upgrade works under \$1.5

million) are regulated by the Commerce Commission under the Commerce Act (Transpower Thresholds) Notice 2008.

Transpower reports that it currently has plans for 28 upgrade projects valued at less than \$20 million over the next 12 months, and 79 over the next 5 years. Of these 79 upgrade plans over the next 5 years, 35 are valued at less than \$5 million. These low cost projects typically relate to things such as the installation of new interconnecting transformers, new bus zone and circuit breaker protection, and thermal upgrading of existing lines. Transpower considers that many of these projects are necessary to ensure on-going risks to security of supply are minimised.

Transpower reports that it currently takes between 3-9 months for it to prepare a grid upgrade plan for even low cost upgrade proposals, with a subsequent 2-6 months for regulatory approval by the Electricity Commission. Transpower contends that it is the application of the Rules, in particular the Grid Investment Test, to minor investment works that gives rise to substantial delays in applying for and obtaining regulatory approval, and that this level of scrutiny and analysis is inappropriate for such minor works.

## **OBJECTIVES**

The objective of the GPS change is to signal to the Electricity Commission the need to accelerate prudent grid investment by putting in place a streamlined process for the approval of grid upgrade proposals by Transpower which will have an expected cost of less than \$20 million. The Government's primary objectives are to ensure security of supply by enabling grid investment to be approved more quickly, and to reduce unnecessary regulatory costs.

## **ALTERNATIVE OPTIONS**

An option is to amend the GPS through having a less prescriptive, outcome focussed description of what is required in the GPS. This would allow the Commission to consider other options, including whether a process can be established within the framework of the Grid Upgrade and Investment Review Policy (GUIRP). It would also be more consistent with the intent of the rule change process in the Act.

However, a risk with this option would be that any resulting changes to the rules or to the Commission's process would not sufficiently reduce the time taken to have projects approved.

Consideration of retaining the status quo was also considered. The Government has a longer term objective of improving the regulatory arrangements that govern the Electricity Commission, Transpower and the Commerce Commission. This objective is being pursued through a review in 2009 of the electricity market and electricity governance and institutional arrangements by a Ministerial Working Group. This review is likely to report back after August 2009 with implementation of recommendations intended in late 2009 and early 2010.

The proposed amendments to the GPS are seen as an interim step in order to ensure current transmission investment projects can progress more quickly. The smaller transmission investments that will be facilitated by this policy are intended to

provide much-needed stimulus to regional economies over the months ahead. Accordingly, more wide-ranging alterations to the regulatory approval scheme for transmission investments were not considered until the Government's intentions in this sector are known

### **PREFERRED OPTION**

The preferred option adds to the GPS the new concept of a minor transmission work. This is done by adding a new sub-part to the GPS in the transmission part (part 7). A minor transmission work is a planned investment or grid upgrade work with an expected cost of less than \$20 million.

Under this revision Transpower will continue to develop and submit grid upgrade plans for minor works. The objectives for investment in and maintenance of the network will remain the same, but the Commission approval process for minor transmission works is simplified.

The key features of the new streamlined process for minor transmission works are:

- Transpower must prepare an upgrade proposal that meets minimum reliability standards, and is supported by an appropriate level of economic analysis;
- Transpower then must consult on the proposal and consider feedback;
- The Commission will approve the proposal once Transpower has consulted with stakeholders.

### *Costs and Benefits*

One benefit of a more streamlined process for the assessment and approval of small transmission projects would be lower administrative costs for Transpower, the EC and consulted parties. Savings are expected to arise largely from reduced time to complete the streamlined process and may include:

- reduced risk of delay in proceeding necessary maintenance, replacement and refurbishment of the grid arising from delay in obtaining regulatory approval for small works; and
- improvements in Transpower's resource planning through more efficient allocation and better coordinated programmes of work, for example whereby small projects are completed earlier, allowing inter-linked larger projects to be bought forward because restricting constraints have been removed or relaxed.

Further indirect savings could arise from increased security and reliability of the grid, and from the avoidance of transmission constraints providing increased business confidence.

Such expected future savings are difficult to quantify, although Transpower has provisionally estimated that the streamlined process will save between \$3-11 million

per year (based on its current work plan). These figures though have not been verified by independent analysis.

The streamlined process reduces regulatory scrutiny of small transmission investments. There is a potential risk therefore that an unnecessary or insufficiently justified project could be undertaken that previously would have failed the regulatory test. Further there is a risk (raised by some submitters during consultation) that larger projects could be deliberately broken down into smaller sub \$20 million projects to avoid regulatory consideration.

However, the new streamlined process retains many of the existing safeguards and incentives that ensure that Transpower meets minimum grid requirements and minimises its investment costs. The risk of imprudent or unnecessarily expensive grid investments is mitigated by requiring Transpower's minor investment works to continue to meet standards of GEIP and minimum reliability standards for core grid assets.

In addition to these regulatory safeguards, the requirement to consult (which is retained in the new GPS) should reveal in a public forum any substantive issues not already identified and accounted for in Transpower's proposal.

Lastly, Transpower will continue to be subject to regulatory oversight by the Commerce Commission.

On balance, the benefits of a more streamlined process for small projects (i.e. lower cost for Transpower, the EC and other consulted parties) are expected to exceed the potential costs (i.e. of less prudent investment by Transpower attributable to the lower level of scrutiny).

#### **IMPLEMENTATION AND REVIEW**

The Electricity Commission will need to develop and recommend amendments to the Electricity Governance Rules to implement the new policy objectives set out in the revised GPS. Electricity Governance rules are made by the Minister of Energy and Resources following a recommendation from the Electricity Commission. The Minister of Energy and Resources may not amend those rules, except in response to a recommendation from the Commission

#### **CONSULTATION**

The Electricity Commission, Treasury, EECA, DPMC and the Commerce Commission were consulted on this paper.

**APPENDIX 1: DRAFT GPS****DRAFT  
GOVERNMENT POLICY  
STATEMENT ON ELECTRICITY  
GOVERNANCE****May 2009**

## Foreword

The Government established the Electricity Commission in 2003 with the principal objectives of ensuring that electricity is produced and delivered to all classes of consumers in an efficient, fair, reliable and environmentally sustainable manner and promoting and facilitating the efficient use of electricity.

The Electricity Act 1992 (s172N) sets the principal objectives for the Electricity Commission and the specific outcomes that the Commission must seek to achieve. An extract of s172N is attached as an appendix to the GPS.

This Government Policy Statement sets out the objectives and outcomes the Government wants the Commission to give effect to. It is made pursuant to s172ZK of the Electricity Act 1992 and replaces all previous Government Policy Statements on Electricity Governance.

Hon Gerry Brownlee  
**Minister of Energy and Resources**

## TABLE OF CONTENTS

<b>FOREWORD .....</b>	<b>13</b>
<b>1. COMMISSION’S POWERS AND APPROACH .....</b>	<b>17</b>
Consultation .....	17
Innovation.....	17
Information .....	17
Administration of regulations and rules .....	17
<b>2. SECURITY OF SUPPLY (PREVIOUSLY SECTION 6).....</b>	<b>19</b>
Background .....	19
Key requirements of security of supply.....	19
Security of supply objective for the Electricity Commission.....	19
Security of supply policy .....	20
Information, forecasting and monitoring.....	20
Hydro storage guidelines .....	21
Reserve energy .....	21
Emergency management.....	22
Levy .....	22
Review.....	22
<b>3. CONSUMER PROTECTION.....</b>	<b>23</b>
Domestic consumer contracts .....	23
Low fixed charges .....	23
Arrangements for the benefit of low income and vulnerable domestic consumers.....	23
Arrangements in the event of retailer insolvency.....	24
Consumer complaints resolution system.....	24
<b>4. ELECTRICITY EFFICIENCY .....</b>	<b>26</b>
Other arrangements and programmes .....	26
Generation .....	27
Conveyance .....	27
End-use.....	27
<b>5. RENEWABLE ENERGY.....</b>	<b>28</b>
<b>6. SYSTEM OPERATION AND WHOLESALE AND RELATED MARKETS.....</b>	<b>29</b>
Transmission risk management .....	29
<b>7. TRANSMISSION .....</b>	<b>30</b>
Background .....	30
Objectives for the provision of transmission services.....	30
Connection to and use of the national grid .....	31
Investment in and maintenance of the transmission network .....	31
Investment in minor transmission works.....	33
Planning ahead .....	33
Environmental effects.....	34
Transmission alternatives.....	34
Pricing for connection to and use of the national grid.....	34

Cost recovery and pricing principles .....	34
<b>8. DISTRIBUTION .....</b>	<b>36</b>
Pricing methodologies .....	36
Use of system agreements.....	36
<b>9. INTERRELATIONSHIP WITH THE COMMERCE COMMISSION.....</b>	<b>37</b>
<b>10. DISTRIBUTED GENERATION.....</b>	<b>38</b>
Access to lines .....	38
Purchase of surplus generation by retailers .....	38
<b>11. RETAIL .....</b>	<b>39</b>
The reconciliation of, and payment for, distribution line losses .....	39
<b>12. ACCOUNTABILITY REQUIREMENTS.....</b>	<b>40</b>
Status of existing Government Policy and Section 26 Statements.....	40
<b>APPENDIX 1: S172N ELECTRICITY ACT 1992.....</b>	<b>40</b>

## 48 Commission's powers and approach

---

- 1 The Commission should work with stakeholders including consumers, market participants and Government agencies to achieve its objectives.
- 2 In particular, whenever possible, the Commission should use its powers of persuasion and promotion, and provision of information, guidelines and model arrangements, to achieve its objectives rather than recommending regulations and rules. The Commission should monitor compliance with these guidelines and model arrangements and recommend regulations or rules if voluntary arrangements prove unsatisfactory.
- 3 The Government recognises that clear and effective regulations and rules are required in many key parts of the market. Accordingly, the Commission has powers under the Electricity Act 1992 to make recommendations to the Minister of Energy concerning new or amended regulations and rules. The Commission should be prepared to use these powers fully where required to achieve the Government's policy objectives.

### Consultation

- 4 Where the Commission proposes guidelines or model arrangements, new regulations or rules, or substantial changes to existing regulations or rules, it should follow good processes. This includes identification of the main options, assessment of costs and benefits, and consultation with and exposure of its analyses to affected parties. When recommending regulations or rules it is required by the Act to satisfy itself that other options (such as information, education and voluntary arrangements) are unlikely to satisfactorily achieve the Government's objectives.
- 5 The Government expects the Commission to maintain a protocol on its consultation processes.
- 6 The Commission should actively consult with the Ministry of Consumer Affairs when pursuing outcomes which directly impact on small consumers.

### Innovation

- 7 The Commission should keep in mind the importance of encouraging innovation. It should therefore consider, when deciding how best to deliver on its objectives, any trade-offs between certainty and clarity on the one hand and encouraging and allowing scope for innovation on the other.

### Information

- 8 High quality information is essential for efficient markets. The Commission should give high priority to ensuring that relevant information is made available to market participants and to the public at large on matters relating to the electricity sector.

### Administration of regulations and rules

9 The Commission has responsibility for monitoring compliance, investigating alleged breaches and if necessary, taking enforcement action in relation to regulations and rules, particularly:

- Electricity Governance Regulations 2003
- Electricity Governance Rules 2003
- Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004
- Electricity Governance (Connection of Distributed Generation) Regulations 2007

and for any subsequent amendments to these regulations and rules.

## Background

- 10 A key priority of the Government is to maintain security of electricity supply. Shortage risks and periods of high spot prices need to be well managed to ensure that businesses and the wider community have confidence in ongoing security of supply. In the Government's view, security of supply is vital to achieving its objective of sustainable economic development.

## Key requirements of security of supply

- 11 Key requirements for security of supply, and confidence in security of supply, are that:
- sufficient generation capacity is built or energy efficiency improvements made to meet ongoing demand growth
  - hydro and thermal generating capacity and fuels are appropriately managed, to deal with the risk of shortages, including extended dry hydro periods
  - the system has sufficient capacity (plant and fuel and/or demand response) to cope with extreme dry sequences, periods of low wind speed and other unexpected supply disruptions
  - quality information and forecasts of thermal fuel availability, the hydro system (including lake levels and spill), wind flows and generation capacity are available
  - the national grid and distribution lines meet specified reliability objectives. (Transmission and distribution issues are covered in separate sections)
  - opportunity exists for electricity consumers to manage exposure to high spot prices. (Hedge market transparency and liquidity are covered in separate sections.)

## Security of supply objective for the Electricity Commission

- 12 A function of the Commission under the Electricity Act 1992 (s1720) is to use reasonable endeavours to ensure security of supply, without assuming any demand reduction from emergency conservation campaigns, while minimising distortions to the normal operation of the electricity market.
- 13 To provide a measure of security of supply, to date government policy has been to assess security of energy supply against a “1 in 60 dry year” standard. Following a substantive review of the reserve energy policy in 2007, the “1 in 60 dry year” is replaced by a standard expressed in terms of “winter energy margin” (the margin between forecast capacity to supply in a mean hydro year and forecast demand).
- 14 Accordingly, to meet the security of supply objective, the Commission should use reasonable endeavours to ensure that the generation and transmission system is capable of maintaining a mean winter energy margin of 17 percent for New Zealand

overall, and 30 percent for the South Island. This new standard will provide a level of security similar to the 1 in 60 standard, but provides a measure that is clearer, and easier to calculate and understand.

- 15 The Commission should also develop and set security standards for adequacy of capacity to meet peak demand.
- 16 The Commission should work with stakeholders to identify industry contingencies, and develop strategies consistent with the operation of the electricity market to manage supply and demand during such contingencies.

## **Security of supply policy**

- 17 The Commission should have, and publish, a security of supply policy. The security of supply policy should include:
  - the information and forecasts to be made available
  - details of how the Commission will monitor energy margins during the year and whether the market will deliver adequate new capacity
  - the procurement and utilisation policies for reserve energy
  - the steps that the Commission will take at various stages during a contingent event such as an extended dry sequence, and the emergence of risks relating to peak capacity.
- 18 The objective of publishing the policy is to provide a high degree of certainty to market participants about how the Commission intends to meet its security of supply objectives.
- 19 The Commission should have, and publish, protocols to manage potential conflicts between its roles as a contractor for reserve energy and as a regulator.

## **Information, forecasting and monitoring**

- 20 The Commission should undertake and publish detailed supply and demand modelling and forecasting at least annually. The objective is to provide well-researched information on both short-term and long-term security of supply, including the likely availabilities of fuels and new generation options under various scenarios.
- 21 To establish the need for additional reserve energy (see below), the Commission should look out 3 to 5 years (given consent and construction timelines for new capacity), collect information, develop a baseline that makes assumptions about which known projects are likely to proceed, and identify any "shortfalls" year by year.
- 22 The Commission is expected to be active in monitoring resource availability to meet demand and, in particular, determining whether the market is consistently failing to deliver new capacity sufficient for an adequate energy margin and to meet peak demand.

- 23 If the Commission determines that the market is consistently failing to deliver sufficient capacity, it should use the powers available to it to make recommendations to the Minister on any arrangements or policies that it considers necessary to provide better outcomes.

## Hydro storage guidelines

- 24 To help ensure security of supply, the Commission should develop and publish a set of hydro storage guidelines providing its estimate of the hydro storage levels that reflect different levels of shortage risk. These guidelines should take into account the expected availability and use of thermal generation, transmission constraints and other factors that may impact upon security of supply.
- 25 As part of the hydro storage guidelines, the Commission should have an emergency storage guideline that would trigger a range of emergency response measures, including a conservation campaign. The emergency storage guideline should be set on the basis that there is a significant probability that emergency blackouts may be required if other emergency response measures are not put in place.

## Reserve energy

- 26 If the New Zealand or South Island mean year energy margin is unlikely to be met by market participants, the Commission should contract for, but not own, reserve energy (generation and contracted demand response) to maintain the desired energy margin. This is to be the Commission's primary means of meeting its security of supply objective.
- 27 Any reserve energy procured to ensure security of supply should also be available to help cope with other unexpected supply contingencies, such as serious grid, plant or fuel supply disruptions.
- 28 In contracting for reserve energy the Commission should seek to:
- minimise the risk that reserve energy affects the incentives for market participants to:
    - respond to higher prices
    - construct new capacity
    - enter into hedge and other contracts
    - invest in demand-side management
  - maximise static and dynamic efficiency.
- 29 Contracted demand response should form part of the Commission's portfolio of reserve energy, provided this is practicable and the Commission is confident that the reduction in demand is additional to normal demand-side responses to higher prices.
- 30 Reserve energy should be offered to the system operator for dispatch at 20c/kWh or the contracted variable payment rate, whichever is the higher.

- 31 The Commission should determine, for each contracted form of reserve energy, a storage guideline level at which it would expect reserve energy to be operating. If storage falls below a particular storage guideline level, and the relevant reserve energy is not being dispatched, the Commission may choose to offer that reserve energy for dispatch at a lower price in order to preserve hydro storage and to reduce shortage risks.
- 32 If the hydro storage guidelines are consistently breached and thermal generation is not being used appropriately to preserve hydro storage, the Commission should investigate the reasons and consider what action, if any, would be desirable.

### **Emergency management**

- 33 Although the Government wants the Commission to guide the electricity sector to ensure minimal risk of supply shortages, it recognises that there will be infrequent circumstances where there is a material risk of shortage. To manage such circumstances, the Commission should establish an emergency response plan that identifies and includes a range of measures to cover contingencies more severe than those allowed for within the mean winter energy margin. Such measures are to include conservation campaigns.
- 34 The Commission is also expected to put in place contingency arrangements to provide for the scheduling of outages, including rolling outages in the extreme event that blackouts are required to ensure a balance between supply and demand.

### **Levy**

- 35 The Commission should receive any spot price revenue arising from the dispatch of reserve energy. Net costs should be recovered by way of the levy on wholesale purchases.
- 36 Over time, the levy should recover the net costs that the Commission incurs for reserve energy (that is, operating and capital payments less any revenue received from the sale of reserve energy).

### **Review**

- 37 The Commission should undertake a review, in consultation with interested parties, of the security standards and policies set out in this section, and make recommendations to the Minister of Energy on the outcome of that review by the end of 2012.

## 50 Consumer protection

---

### Domestic consumer contracts

- 38 The Commission should ensure that the terms and conditions of contracts between domestic consumers and electricity retailers (and where applicable, contracts between domestic consumers and electricity distributors) reflect the reasonable expectations of consumers.
- 39 The Commission should ensure the following matters are addressed in contracts:
- transparency of charge components
  - frequency of billing
  - company-specific arrangements for dispute resolution
  - arrangements for informing consumers about planned outages
  - arrangements for the benefit of low-income domestic consumers as described below.
- 40 The Commission should have regard to any provision by the Commerce Commission requiring distribution businesses to engage with local communities on the trade-offs they wish to make concerning price, quality and reliability of supply.
- 41 The Commission should, in consultation with the Ministry of Consumer Affairs and other relevant interested parties, ensure that terms and conditions remain effective and up-to-date with current market issues.

### Low fixed charges

- 42 The Low Fixed Charge regulations were introduced in 2004 with the purpose of assisting low-use domestic consumers and encouraging energy efficiency. Prior to their introduction, low-use consumers in many areas faced unreasonably high fixed daily charges for their electricity usage. The introduction of the regulations provided these low-use consumers with a tariff option that was more equitable for low energy usage and compatible with the Government's energy efficiency objectives.
- 43 The Commission is charged with monitoring compliance and enforcing the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 and any subsequent amendments.

### Arrangements for the benefit of low income and vulnerable domestic consumers

- 44 The Commission should monitor compliance with the Guideline on arrangements to assist low income and vulnerable consumers<sup>2</sup> issued in July 2007, to ensure that:

---

<sup>2</sup> <http://www.electricitycommission.govt.nz/pdfs/opdev/retail/lowincome/guidelines-low-income-2Jul07.pdf>

- consumers who may have difficulty paying their bills on time are advised by retailers of the budgeting and other advice and assistance available from Government agencies and community service organisations
  - retailers are required to consult with the Ministry of Social Development about possible assistance for vulnerable consumers where, in spite of the retailer's assistance, the consumer is unable to pay, and that there is no disconnection while that consultation is occurring
  - any consumer who is dependent on electricity for critical medical support will not be disconnected for reasons of non-payment
  - clear guidelines or standards exist for disconnections following non-payment in order to avoid the costs of frequent disconnections and reconnections
  - there is regular communication with all consumers on their payment options
  - debt recovery is arranged in a time-frame that avoids an adverse credit situation for the retailer and minimises hardship for the consumer
  - consumers enter into the most appropriate contracts for their needs
  - consumers are given the opportunity to identify themselves as potentially vulnerable
  - where the consumer has not responded to any of the notices sent by the retailer, and the retailer has been unable to contact the consumer, there is a visit to a consumer's home before disconnection for non-payment takes place.
- 45 The Commission should consider options such as pre-payment meters, alternative payment options (such as advance payments, more frequent payments or smoothed payments) and bonds. The Government considers that, in principle, bonds should not exceed the value of one month's electricity consumption by an average household.

#### Arrangements in the event of retailer insolvency

- 46 The Commission should establish arrangements to ensure an orderly transition for consumers in the event that a retail company becomes insolvent.

#### Consumer complaints resolution system

- 47 Section 158G(1) of the Electricity Act requires that every electricity distributor and every electricity retailer must participate in a complaints resolution system, provided that the Commission has approved one or more complaints resolution systems under that section.
- 48 The Government expects everyone (including potential consumers and owners and occupiers of land), in their capacity as producers or consumers of electricity, to have access to an independent and cost-effective system for resolving complaints about electricity distributors (including Transpower) and electricity retailers without

charge to the user/applicant, whether or not they have a consumer contract with the retailer or distribution company.

- 49 The Commission should, in consultation with the Ministry of Consumer Affairs, ensure that any approved system adequately addresses consumers' interests.
- 50 The Government believes that consumers' best interests are more likely to be served by a single independent complaints resolution scheme that includes both electricity and gas. The reason for this is that a single dual-fuel scheme provides benefits such as ease of access, consistency of outcomes and efficiencies of scale. The size of the gas market does not justify a separate scheme and many of the same companies are involved in both sectors. Many customers buy electricity and gas from the same retailer.
- 51 The Commission should work closely with the Gas Industry Company and coordinate approaches to approval and governance of an electricity and gas consumer complaints scheme.
- 52 If the industry is unable to provide an acceptable scheme supported by membership from all retailers and all distributors (including Transpower) within a reasonable time, the Commission should recommend regulations to introduce a statutory scheme. Again, the Government expects the Commission to work closely with the Gas Industry Company in this regard.
- 53 The Government expects any approved complaints resolution system to include the following features:
  - an independent complaints resolution scheme that is consistent with international best practice in the field of consumer complaints resolution systems (for example the Australian Benchmarks for Industry based Consumer Dispute Resolution Schemes<sup>3</sup> which were developed in consultation with the New Zealand Ministry of Consumer Affairs)
  - a decision-making process and administration of the scheme that is independent of scheme members
  - membership by all distributors (including Transpower) and retailers
  - robust internal complaints-handling processes within all member companies
  - a document that sets out the minimum standards of conduct for scheme members
  - self-funding by the industry
  - compensation for consumers where appropriate
  - is practical and resolves disputes quickly and cost-effectively without unduly protracted or costly processes.

---

<sup>3</sup> The Australian benchmarks are: accessibility, independence, fairness, accountability, efficiency and effectiveness.

## 51 Electricity efficiency

---

- 54 Electricity efficiency and demand side management help reduce demand for electricity, thereby reducing pressure on prices, scarce resources and the environment. The Commission should ensure that it gives full consideration to the contribution of the demand side as well as the supply side in meeting the Government's electricity objectives.
- 55 As part of its research and information activities, the Commission, in conjunction with EECA, has undertaken a comprehensive review of the potential of electricity efficiency to contribute cost-effectively to achievement of the Government's electricity objectives, including estimating the level of investment required to realise this potential. This work should continue.
- 56 A number of Government agencies have responsibilities that support improved energy efficiency in the stationary energy demand sector. These include [EECA](#), the [Commission](#), MED, MfE, MAF, DBH and Housing New Zealand Corporation. It is the government's intention that EECA be the primary service delivery agency for energy efficiency programmes in this sector.
- 57 [EECA](#) and the [Commission](#) have a common objective: to promote the use of electricity in an efficient and environmentally sustainable manner. In undertaking its electricity efficiency activities, the Commission should work closely with EECA. It is important that the Commission's activities complement the work of EECA and that duplication of effort is avoided. Through its membership of the Senior Energy Officials Group, the Commission will work with the group to develop priority energy efficiency programmes and will reflect this in its work programme to promote the efficient use of electricity.
- 58 EECA has expertise in the management of energy efficiency programmes. The Commission should draw on this expertise in designing, administering and delivering its programmes, and good procurement practice. This will promote concentration of expertise and coordination of effort. As EECA builds its capability in a wider range of areas, EECA will work as the delivery agent for more actions developed and funded by the Commission.
- 59 All purchases by the Commission of services from EECA should be formalised in contracts which should be made available on the Commission's website.
- 60 The Government notes that the two agencies have developed a Memorandum of Understanding outlining how they will work together. The Government requests that this memorandum be reviewed to clarify the respective roles of each agency and to reflect the arrangements above.

## Other arrangements and programmes

- 61 The Commission should also put in place arrangements and programmes to promote efficiency in the following components of the electricity sector:

## Generation

- 62 Hydro, thermal and other fuels resources should be used efficiently in the generation of electricity. Disclosure of information, such as the amount of and reason for hydro spill, is expected to help avoid unnecessary waste of resources.

## Conveyance

- 63 Electricity should be conveyed efficiently on the national grid and distribution lines. Transmission and distribution companies should have incentives to manage transmission and distribution losses and constraints. The Commission should promote pricing structures that provide appropriate signals to manage those losses and constraints.

## End-use

- 64 The Commission should promote and facilitate the efficient use of electricity by end users. It should pursue this objective in multiple and mutually-reinforcing ways, including:
- by providing financial incentives for investment in electricity efficiency where it is cost-effective to do so and in response to market failures and barriers
  - by promoting cost-reflective pricing
  - by seeking innovative ways to enable residential and other consumers to respond to pricing incentives to use electricity more efficiently
  - by facilitating the progressive introduction of advanced/smarter meters for consumers, through publishing technical guidelines, and reporting on the need for regulations by December 2009
  - by encouraging and facilitating demand-side participation in the wholesale, distribution and retail markets
  - by promoting the efficient use of load management.

## 52 Renewable energy

---

- 65 Investment co-ordination can be particularly problematic for renewable generation because such generation is often remote from existing load centres and major transmission lines, and individual renewable generation plant is typically small relative to the size of the regional demand.
- 66 The Government's objectives in relation to renewable electrical energy are that:
- undue barriers to investment in renewables should be reduced or removed
  - the efficient uptake of renewable generation should be promoted
  - the national transmission grid should be planned and made available so as to facilitate the potential contribution of renewables to the electricity system
  - the specification of the grid planning processes and approval criteria should allow grid upgrade plans to facilitate the efficient and timely development of renewable generation resources, taking into account any difference in lead times for transmission and generation investment.

### 53 System operation and wholesale and related markets

---

- 67 The Commission should promote and facilitate efficient and well-functioning markets and related arrangements for:
- common quality and real-time security
  - dispatch and pool rules
  - reconciliation and settlement
  - information disclosure to improve market efficiency, including:
    - aggregate hedge and contract prices and volumes
    - offers by generators
  - minimum prudential standards
  - hedge market transparency and liquidity.

#### Transmission risk management

- 68 The Commission should oversee the development of arrangements that will enable market participants to manage financial risk in respect of transmission losses and constraints.
- 69 The product developed should include the following broad principles:
- realistic long-term risk management mechanisms should be made available to all parties that face financial risks arising from spot price effects caused by transmission losses and constraints;
  - economic efficiency, including the integrity of price signals, should be maintained or improved; and
  - solutions should be pragmatic and not overly complex to use.

## 54 Transmission

---

### Background

70 The way in which transmission services are provided and priced impacts both directly and indirectly on all parts of the electricity industry, the economy and the environment. Transmission has strong natural monopoly characteristics, which make it important that the Government sets out its policy expectations as to how transmission services should be provided and priced and how Transpower should operate.

### Objectives for the provision of transmission services

71 The Government's objectives for the provision of transmission services are that:

- the services are provided in a manner consistent with the Government's policy objectives for electricity, and in particular, that grid reliability should be maintained at a level required by residential, commercial and industrial users and by the Government's economic development objectives
- the transmission grid should be adequately resilient against the effects of low probability but high impact events having regard to the load which could be disrupted and the duration of any disruption
- where practicable, the transmission grid should provide adequate supply diversity to larger load centres, having regard to the load which could otherwise be disrupted and the duration of any disruption
- efficient competition in generation and retail is facilitated and transmission constraints are minimised
- the national transmission grid should be planned and made available so as to facilitate the potential contribution of cost-effective renewables to the electricity system, and in a manner that is consistent with the Government's climate change and renewables policies
- the efficiency of transmission services should be continuously reviewed and improved so as to produce the services that grid users and consumers want at least cost
- the services are priced in a manner that:
  - is transparent
  - fully reflects their costs including risk
  - facilitates nationally efficient supply, delivery and use of electricity
  - promotes efficient investment in transmission or transmission alternatives
  - promotes nationally efficient use of transmission services by grid users and consumers

- stakeholders and the public are kept well informed about how agreed minimum levels of grid reliability are to be maintained throughout the development and consideration of any grid upgrade plans.

#### Connection to and use of the national grid

- 72 The national grid is essential to all connected parties, and should be maintained and operated to a common set of grid reliability standards. These common standards should be embodied in rules that recognise the interconnected nature of the network.
- 73 Grid reliability standards should apply to agreements between Transpower and its customers dealing with connection to and use of the grid, investment planning (including replacement), transmission system design and construction, and transmission system maintenance.
- 74 The common standards for the grid should be determined by the Commission, following consultation with Transpower and affected parties. The Commission should, from time to time, review the standards to ensure that they promote a secure and reliable grid and that the interests of end-customers are properly taken into account.
- 75 Transpower's customers should be permitted some flexibility over standards (which could be higher or lower than the norm), so long as the integrity of the core grid is not compromised. The Commission should ensure that arrangements are in place to protect the interests of third parties when Transpower and one of its customers agree to a local variation from common standards.
- 76 All transmission customers should be required to have a transmission agreement with Transpower, and the Commission-developed benchmark agreement is the default agreement if the parties are unable to agree.

#### Investment in and maintenance of the transmission network

- 77 As part of its modeling and forecasting work, the Commission should provide for the development of statements of opportunities relating to transmission. These should:
- incorporate electricity demand and supply forecasts
  - enable identification of potential opportunities for:
    - efficient management of Transpower's transmission network including investment in system expansions, replacements and upgrades
    - transmission alternatives (notably investment in local generation, demand-side management and distribution network augmentation)
  - facilitate long-term planning for timely securing of easements and resource consents, including to facilitate the connection of renewables.
  - be prepared at least every two years.

- 78 Transpower should develop and submit grid upgrade plans to the Commission for approval.
- 79 Any grid upgrade plan submitted by Transpower should be as comprehensive as possible, ideally covering and identifying the relationships between short, medium and longer term proposals, except where urgency is required for individual projects. The rigour of analysis supporting projects should be reasonable given the size of the project. This will better enable consideration of the interrelationships between projects and the wider synergies of the grid, including facilitating renewables, least-cost provision of new generation and increased competition between generators. It will also enable consideration of investment proposals for the grid as a whole within a longer term framework (for example, over five years).
- 80 Unless otherwise agreed by the Commission, grid upgrade plans should also be consistent with the statement of opportunity forecasts and wider Government energy policy, including applicable policies on renewable generation and climate change.
- 81 Grid upgrade plans should demonstrate the rationale for all expenditure (operational, maintenance and capital), taking into account the prescribed reliability standards and good industry practice for power system operation. The plans should demonstrate that the proposed expenditure is required to meet these standards and/or deliver the greatest net benefit after taking into account transmission alternatives and Government energy policy requirements to the extent achievable.
- 82 In the development of grid upgrade plans; the Government's objective is that:
- Transpower should undertake the detailed planning role (including the assessment of both transmission and transmission alternatives); and
  - the Commission should, without undue delay, review and approve grid upgrade plans that meet the criteria set out in the Electricity Governance Rules, and reject applications that fail them.
- 83 The Commission should make available to Transpower and other stakeholders clear and specific policies and processes relating to how grid upgrade plans in general, and any particular plan specifically, will be developed, and then reviewed and approved or rejected. These criteria should be clearly explained so that the review process and linkages to other processes such as the statement of opportunities are transparent and can be understood and the analysis can be replicated by stakeholders.
- 84 The Commission should ensure that affected parties are fully consulted on grid upgrade plans.
- 85 Transpower should be able to seek a determination from the Commission on updated grid upgrade plans in response to events that significantly affect any capital investment already approved under a grid upgrade plan.
- 86 Where the Commission approves a grid upgrade plan, the full costs associated with implementing the grid upgrade plan should be recoverable by Transpower in accordance with the pricing methodology determined by the Commission.

### Investment in minor transmission works

- 87 The Government's objective in relation to the investment in ~~and maintenance~~ of the transmission network is to put in place a more streamlined process for the approval by the Electricity Commission of grid upgrades by Transpower where the expected total cost of a the project is less than \$20M.
- 88 For all future small projects with an expected cost of less than \$20M the Government seeks the following outcomes:
- Transpower should develop and submit upgrade plans to the Commission for approval.
  - Grid upgrade plans should set out demonstrate the rationale for the proposal and all expenditure, meet minimum reliability standards for the grid, be supported by economic analysis commensurate with the expected level of expenditure, (operational, maintenance and capital), and taking into account good electricity industry practice for power system operation.
  - In developing grid upgrade plans Transpower should undertake the detailed planning role; it should consult with materially affected parties, and have regard to all submissions ~~or objections~~ received prior to submitting the grid upgrade plan to the Commission.
  - Once the Commission has received a grid upgrade plan the Commission should approve the plan without undue delay provided it is satisfied that Transpower has complied with the process requirements to prepare a grid upgrade plan, and the consultation requirements above.
  - The Commission should not be required to assess and evaluate the merits (whether technical, economic or otherwise) of small investment plans with an expected cost of a value less than \$20 million.
  - If Transpower wants to amend a previously approved grid upgrade plan it should follow the same process unless the total project cost under the amended plan exceeds \$20M. In that case, the standard process, as outlined in paragraphs 78 to 86, should apply.

### Planning ahead

- 89 The Government is concerned to ensure that the necessary planning and securing of consents (or designations) and land access rights for investments in the transmission system will meet needs.
- 90 The Commission should encourage Transpower to identify and secure appropriate interests in land, designations and resource consents required for transmission corridors well in advance of urgent needs. Transpower should be able to recover the reasonable net costs of doing this work.
- 91 The risks to maintaining grid reliability resulting from uncertainties in demand forecasting and easements should be conservatively managed.

- 92 This should help the essential process of maintaining stakeholder confidence in ongoing security of electricity supply even if, at times, there is some loss of flexibility around investment choices and some additional cost for electricity consumers.

#### Environmental effects

- 93 Final environmental requirements are determined by consenting authorities under the Resource Management Act 1991 which provides the statutory framework for dealing with environmental effects.
- 94 To the extent that the Commission considers the environmental effects of new lines proposed by Transpower in a grid upgrade plan, it should also take into account any longer term benefits that larger capacity lines may provide by avoiding multiple smaller lines.

#### Transmission alternatives

- 95 As part of the consideration of transmission investments where the total cost of a project is more than \$20M, the Commission should ensure that transmission alternatives are considered to the extent practicable subject to the following conditions:
- only alternatives which have a high probability of proceeding, and where reliability can be maintained by contingency measures if the alternative is delayed or does not proceed, should be considered;
  - alternatives which are only likely to proceed if they are assisted financially by the Government or relevant body should not be considered unless the Government or relevant body has agreed to provide such assistance.
- 96 As part of its consideration of transmission pricing, the Commission should consider whether there would be net benefits in providing for a mechanism whereby investments in transmission alternatives receive payments reflecting some or all of the value of avoided transmission investment. This is a complex subject, and the Commission will need to take into account, amongst other things, practicalities, effects on incentives to invest in alternatives, and the extent of assurance that grid reliability standards will be met.

#### Pricing for connection to and use of the national grid

- 97 Transpower should determine its total revenue requirement (covering both sunk and new investments) subject to the constraints of the Commerce Act 1986. A transmission pricing methodology should determine how this total revenue is recovered from parties under the agreements for connection to and use of the grid.

#### Cost recovery and pricing principles

- 98 The Government expects transmission services to be priced as efficiently as possible and, subject to the Commerce Act 1986, Transpower's charges to recover the full economic costs of its services.

- 99 The Commission should ensure that the following principles are applied by Transpower in developing any transmission pricing methodology, and by the Commission in approving it:
- the costs of connection should as far as possible be allocated on a user-pays basis
  - the pricing of new and replacement investments in the grid should provide beneficiaries with strong incentives to identify least-cost investment options, including distributed generation, energy efficiency and demand management options, and combinations of those options.
  - pricing for new generation and load should provide clear locational signals
  - sunk costs should be allocated in a way that minimises distortions to production/consumption and investment decisions by grid users and consumers
  - the overall pricing structure should include a variable element that reflects the marginal costs of supply in order to provide an incentive to minimise grid constraints.

## 55 Distribution

---

### Pricing methodologies

- 100 The Commission should develop, in consultation with interested parties, principles or model approaches to distribution pricing and monitor their uptake. The Commission should recommend regulations if required to ensure compliance. As part of this work the Commission should investigate barriers to demand side participation.
- 101 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 Commission should consider whether standardisation and simplification of tariff schedules and contractual arrangements would facilitate market entry by retailers.
- 102 The Government expects distribution companies to keep any changes to rural line charges in line with changes to urban line charges. The Commission should monitor developments in rural charges.

### Use of system agreements

- 103 The Commission should ensure reasonable terms and conditions for use of system agreements for use of distribution lines, and ensure that they remain up-to-date with current market issues. Terms and conditions should take into account the interests of consumers, retailers and distributors and should be consistent with:
- arrangements for connecting distributed generation to distribution networks (described later)
  - obligations imposed on retailers as a result of arrangements relating to contracts between retailers and consumers
  - arrangements covering distribution pricing methodologies
  - arrangements for the use of technologies for load management (including ripple control)
  - any other regulations promulgated under the Electricity Act 1992.

## 56 Interrelationship with the Commerce Commission

---

- 104 This section sets out the Government's expectations and intentions regarding the interrelationship between the Commerce Commission and the Commission with regard to the regulation of Transpower and electricity lines businesses by the Commerce Commission under the Commerce Act 1986 and the Electricity Commission under the Electricity Act 1992.
- 105 The Government expects the Commerce Commission and the Electricity Commission to work together closely to ensure that their respective roles are well coordinated, and to minimise any scope for uncertainties regarding jurisdictional issues.
- 106 The Government notes that the two Commissions have developed and published a Memorandum of Understanding on their respective roles.
- 107 The Government's economic policy is that investment and other costs in relation to approved grid upgrade plans should be recoverable by Transpower. The Government also wishes to ensure that interested parties have certainty and clarity on how the two Commissions will operationalise the coordination of their respective roles.
- 108 Accordingly the Government requests that the Memorandum of Understanding between the Commerce Commission and the Electricity Commission continues to address the following matters in relation to transmission:
- the methodology for determining how each relevant expenditure component in relation to approved grid upgrade plans will be treated over time under the Commerce Act 1986
  - how price setting as regulated by the Commerce Commission interacts operationally with the pricing methodology approved by the Electricity Commission
  - how issues relating to valuation methodologies, pricing and pricing methodologies, quality and information disclosure will be coordinated and harmonised where possible between the two Commissions.
- 109 In addition, the Government requests that the Memorandum of Understanding between the Commerce Commission and the Electricity Commission continues to address the following matters in relation to improving incentives for electricity lines businesses in respect of:
- managing distribution losses
  - facilitating uptake of advanced metering infrastructure and more efficient distribution pricing
  - ensuring target security levels for distribution networks are met at least cost
  - facilitating investment in energy efficiency (including consumer end-use efficiency), demand side management and distributed generation.

## 57 Distributed generation

---

110 Distributed generation is expected to play an increasingly important role in meeting electricity demand as the cost of smaller-scale and new renewable technologies continues to decline. Distributed generation can improve security of supply by creating diversity of fuel types, locations and technologies, and, where appropriately sited, helps reduce the need for transmission and distribution upgrades. Accordingly, it is important that there are no unnecessary barriers to its development.

### Access to lines

111 The Commission should investigate the provision of guidelines or standards for domestic scale distributed generation to reduce regulatory compliance costs.

### Purchase of surplus generation by retailers

112 The Commission should ensure reasonable terms and conditions in contracts for purchase of small electricity surpluses by local retailers from generators with generation units capable of generating up to 40,000kWh over a year. The Commission should investigate and make recommendations:

- on whether contracts should meet specified pricing principles; and
- on how contracts should require itemised billing (showing imports and exports) by 2009.

113 The Commission should review contracts from time to time to ensure that they remain up-to-date with current market issues.

## 58 Retail

---

- 114 The Government considers that competition between electricity retailers should, over time, help ensure that retailing costs are minimised, service quality is improved and downward pressure is placed on generation costs. Most consumers, especially in larger centres, have a choice of retailers, and the processes for consumers to change suppliers have steadily improved. The Government considers, however, that retail competition is not as vigorous as it could be, and looks to the Commission to promote and facilitate retail competition.
- 115 The Commission should take primary responsibility to promote and facilitate efficient and well-functioning markets and related arrangements for:
- Terms and conditions for access to end-use electricity meters by retailers
  - Processes and procedures to ensure that consumers are able to switch retailers with a minimum of inconvenience and cost
  - Enabling retailers to effectively manage price risk e.g. through hedging.

### The reconciliation of, and payment for, distribution line losses

- 116 Current methods for calculating, reconciling and arranging payment for distribution line losses by competing retailers are often raised as a concern by retailers. The Commission should develop model approaches to improve distribution loss factor calculation and should investigate and make recommendations for the management, minimisation and allocation of distribution losses.

## 59 Accountability requirements

---

- 117 The Government expects the Commission to prioritise work on the objectives and outcomes set out in this Government Policy Statement.
- 118 In addition to the reporting requirements set out in legislation, the Commission should report at least quarterly to the Minister of Energy on progress against the Government's expectations in this Government Policy Statement.

## Status of existing Government Policy and Section 26 Statements

- 119 For the avoidance of doubt, all other previous Government Policy Statements on Electricity Governance are supplanted by this Policy Statement.
- 120 A new section 26 Statement will be issued advising the Commerce Commission that this Government Policy Statement is a statement of the Government's economic policies within the meaning of that section.

Hon Gerry Brownlee  
**Minister of Energy and Resources**

Date: \_\_\_\_\_

---

### Appendix 1: s172N Electricity Act 1992

Principal objectives and specific outcomes -

The principal objectives of the Commission in relation to electricity are -

- a. to ensure that electricity is produced and delivered to all classes of consumers in an efficient, fair, reliable, and environmentally sustainable manner; and
  - b. to promote and facilitate the efficient use of electricity.
- 121 Consistent with those principal objectives, the Commission must seek to achieve, in relation to electricity, the following specific outcomes:
- a. energy and other resources are used efficiently:
  - b. risks (including price risks) relating to security of supply are properly and efficiently managed:

- c. barriers to competition in electricity are minimised for the long-term benefit of end-users:
- d. incentives for investment in generation, transmission, lines, energy efficiency, and demand-side management are maintained or enhanced and do not discriminate between public and private investment:
- e. the full costs of producing and transporting each additional unit of electricity are signalled:
- f. delivered electricity costs and prices are subject to sustained downward pressure:
- g. the electricity sector contributes to achieving the Government's climate change objectives by minimising hydro spill, efficiently managing transmission and distribution losses and constraints, promoting demand-side management and energy efficiency, and removing barriers to investment in new generation technologies, renewables and distributed generation.