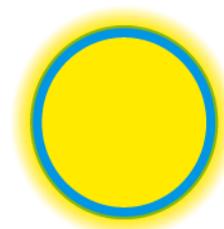


23 April 2013

Submissions
Electricity Authority
PO Box 10041
WELLINGTON 6143



Dear Sir/Madam

Re: Strategic directions for market development

This is Powerco Limited's submission on the Electricity Authority's consultation paper *Strategic directions for market development*.

The Authority has identified the following strategic directions for the electricity sector:

- reducing barriers to entry, exit and expansion;
- facilitating consumer participation;
- providing efficient price signals; and
- flexibility and resilience of the market and of market systems.

These are appropriate objectives as far as they go, but Powerco believes that the Authority should also include the following in its list of strategic directions:

- taking full account of the perceived investment risks created by frequent regulatory changes and ongoing regulatory uncertainty (e.g. repeated lengthy reviews of the transmission pricing methodology);
- actively considering the commercial burden caused by increasing regulatory complexity;
- improving the robustness of the Authority's cost-benefit analyses;
- limiting large policy changes to instances where the long-term benefits to consumers can be shown to be reasonably certain and substantial;
- identifying clearly how the strategic directions will be applied to produce a cohesive work programme.

Appendix B of the consultation paper correctly identifies that the electricity sector faces uncertainty, but fails to acknowledge that some of this uncertainty is due to the Authority's own actions (and those of its predecessor the Electricity Commission). The repeated reviews of transmission pricing that have occurred since 2004 are an obvious case in point. The amounts of money that may potentially be redistributed by changes to the transmission pricing methodology are large but, after a decade of reviews, it is still not settled. Potential investors that may be affected by regulatory changes of this sort are bound to add an additional risk premium to their evaluations of possible investments when they observe what appears to be a high degree of regulatory uncertainty.

The Authority's regulatory strategy principles, recorded at the end of Appendix B, include the following:

- "(f) strive to achieve regulatory predictability because this is particularly important when regulating high capital industries such as electricity."

In our view, the Authority should accord this principle a higher priority in the future than it has done to date.

As an important part of its strategic directions, the Authority should aim to make its cost-benefit analyses more credible and robust. At present, too many of the cost-benefit analyses are driven either by qualitative assessments or high level "top down" assumptions such as the assumed 3 per cent improvement in the efficiency of grid investment approval decisions that was central to the analysis applied to the transmission pricing methodology proposal. It is wrong to push on with massive policy changes when the net benefit calculation is not adequately developed or the net benefit value estimated is relatively small and questionable.

The complexity of the Electricity Industry Participation Code has progressively increased without any review of the need for that degree of complexity or how some existing provisions might be simplified. The current level of complexity creates real additional commercial costs for industry participants. The Authority should actively review the Code with the objective of reducing the commercial burden created by its current complex form and content.

Finally, in our view, the Authority should take one further step and explain specifically how it intends to apply its strategic directions to develop a cohesive work programme that will be able to be readily understood by the industry and implemented without undue disruption to existing market arrangements. We think it essential that the industry understand the process used to develop the Authority's work programme and "buy in" to major reforms, if new arrangements are ultimately to function effectively.

Yours sincerely

A handwritten signature in black ink, appearing to read "Richard Fletcher". The signature is fluid and cursive, with a large initial "R" and a long horizontal stroke at the end.

Richard Fletcher
General Manager Regulation and Government Relations

Appendix: Consultation questions

Question	Powerco Response
<p>1. What are your views on the proposed purpose of the strategic directions?</p>	<p>The proposed purpose of the strategic directions is satisfactory as far as it goes, but the Authority should take the additional step of explaining specifically how it intends to apply the strategic directions to achieve a cohesive work programme that will achieve industry “buy in”.</p>
<p>2. How else might the Authority indicate how the work programme will evolve in response to emerging circumstances? Please describe your proposal.</p>	<p>In our view, the Authority should take one further step and explain specifically how it intends to apply the strategic directions to develop a cohesive work programme that will be able to be readily understood by the industry and implemented without undue disruption to existing market arrangements. We think it essential that the industry understand the process used to develop the Authority’s work programme and “buy in” to major reforms, if new arrangements are ultimately to function effectively.</p>
<p>3. Do you agree or disagree with the Authority’s assessment of the challenges facing the electricity sector in the coming 10 years or so? Please provide your reasons.</p>	<p>The challenges identified by Appendix B are real. However, while uncertainty is correctly identified as a challenge faced by the electricity sector, Appendix B fails to acknowledge that some of this uncertainty is due to the Authority’s own actions (and those of its predecessor the Electricity Commission). The repeated reviews of transmission pricing that have occurred since 2004 are an obvious case in point. The amounts of money that may potentially be redistributed by changes to the transmission pricing methodology are large but, after a decade of reviews, it is still not settled. Potential investors that may be affected by regulatory changes of this sort are bound to add an additional risk premium to their evaluations of possible investments when they observe what appears to be a high degree of regulatory uncertainty.</p> <p>The Authority’s regulatory strategy principles, recorded at the end of Appendix B, include the following:</p> <p>“(f) strive to achieve regulatory predictability because this is particularly important when regulating high capital industries such as electricity.”</p> <p>In our view, the Authority should accord this principle a higher priority in the future than it has done to date.</p>

Question	Powerco Response
<p>4. Do you agree or disagree with the proposed strategic directions? Please provide your reasons.</p> <p>5. Do you consider there to be other strategic directions for market development? Please provide your reasons.</p>	<p>Powerco believes that the Authority should include the following in its list of strategic directions:</p> <ul style="list-style-type: none"> • taking full account of the perceived investment risks created by frequent regulatory changes and ongoing regulatory uncertainty (e.g. repeated lengthy reviews of the transmission pricing methodology); • actively considering the commercial burden caused by increasing regulatory complexity; • improving the robustness of the Authority's cost-benefit analyses; • limiting large policy changes to instances where the long-term benefits to consumers can be shown to be reasonably certain and substantial; • identifying clearly how the strategic directions will be applied to produce a cohesive work programme. <p>The Authority has been adding to perceived investment risks by leaving some significant issues, such as transmission pricing, unresolved and uncertain for long periods of time. As noted in response to question 4, the Authority should give a greater weighting than it currently does to item (f) of its regulatory strategy principles.</p> <p>The complexity of the Electricity Industry Participation Code has progressively increased without any review of the need for that degree of complexity or how some existing provisions might be simplified. The current degree of complexity creates real additional commercial costs for industry participants. The Authority should actively review the Code with the objective of reducing the commercial burden created by its current complex form and content.</p> <p>The Authority should aim to make its cost-benefit analyses more credible and robust. At present, too many of the cost-benefit analyses are driven either by qualitative assessments or high level "top down" assumptions such as the assumed 3 per cent improvement in the efficiency of grid investment approval decisions that was central to the analysis applied to the transmission pricing methodology proposal. It is wrong to push on with massive policy changes when the net benefit calculation is dubious or the net benefit value estimated is relatively small and questionable.</p> <p>The Authority needs to be able to demonstrate, with a high degree of certainty, that any substantial changes to the regulatory framework will deliver improvements to reliability, competition and efficiency that are in the long-term interests of consumers. In our view, the Authority's current approach to cost-benefit analysis is not credible and robust enough to achieve this goal.</p>