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Dear Mervyn

Transmission Pricing Review: Stage 2 Options

Business New Zealand is pleased to have the opportunity to provide a submission to the Electricity Commission on its consultation paper entitled 'Transmission Pricing Review: Stage 2 Options' dated July 2010.[1]

Introduction

BusinessNZ welcomes the effort evident in the consultation paper released by the Electricity Commission. It is clear that the Electricity Commission has endeavoured to progress its work in a thorough and thoughtful manner. However, as signalled in its previous submission to the Electricity Commission on this matter, BusinessNZ has a number of on-going reservations about this element of the Electricity Commission's market design programme.

But before getting into the detail of the issues, BusinessNZ wishes to comment on the issue of market confidence, as it is particularly relevant to this element of the Electricity Commission's market design programme. Over the past few years, BusinessNZ has detected a noticeable drop in the level of business sector confidence in the operation of the electricity market and its ability to deliver what they need in terms of reliability and least-cost, efficient prices. Many of our members have reacted to this lack of confidence by expressing a preference for significant changes to how the market is structured and operated.

[1] Background information on Business New Zealand is attached in Appendix One.

It is BusinessNZ's preference for the market to be given a chance to reach a new equilibrium as the changes foreshadowed in the Electricity Industry Act are implemented. However, the Electricity Commission, and its successor organisation the Electricity Authority, need to be particularly mindful of this as it is easy to get caught up in the drive to improve the market, all the while losing or having already lost the interest or support of the supposed beneficiaries of them.

Specific Comments

In its previous submission on this issue, Business New Zealand did not consider that a clear pathway forward had been revealed. BusinessNZ is pleased to acknowledge that a pathway has begun to emerge, but unsurprisingly, some questions still remain. Therefore BusinessNZ wishes to comment on a number of specific matters. These are (in no particular order):

1. the Electricity Commission should be applauded for the modelling work that it has undertaken. While BusinessNZ cannot always see the point of some of it, or reach the same conclusions that are being drawn from it, BusinessNZ considers the modelling has on balance been a net-positive addition to the decision-making landscape. However, while GEM undoubtedly provides useful information for comparing general trends such as those in the Statement of Opportunities, it appears to be of more limited use when there is uncertainty in the input parameters. These and other issues were raised in a report by Charles River Associates prepared for Transpower in 2007.[2] It is, therefore, important that the results of the modelling is not seen as determinative;

2. BusinessNZ considers it important that the Electricity Commission not under-rate the significance of the change in the new Electricity Authority's objective statement. BusinessNZ believes the change to be material for the following reasons:

    a. the mere fact that it has changed signifies the measure of policy maker's expectations of the new Electricity Authority's change in focus. If policy makers had not expected the focus of the Electricity Authority to change then they would not have altered its objective statement; and

    b. the substance of the change. The test is an efficiency one concerning the maximisation of consumer and supplier surplus. How the new Electricity Authority interprets its new objective statement could have significant implications for all elements of the market design programme. The Electricity Authority will need to provide certainty regarding its interpretation in fairly quick order in order and satisfy stakeholders that the options being pursued are consistent with it. BusinessNZ does not consider this to be a trivial exercise;

[2] This report can be found at https://gemmodel.pbworks.com/f/A+high+level+review+of+GEM+by+CRA.pdf

3. the sequencing that can be implied from the linkages to other elements of the market design programme. In its previous submission, BusinessNZ stated that it was important that the Electricity Commission:

   > " …….understand whether the removal of locational price risk will make an appreciable difference to retail competition (this presumably being the primary objective for the management of locational price risk). If its removal does make an appreciable difference to retail competition (and it is our contention that this will be the case), it will then be possible to assess what refinements are feasible while still preserving intense widespread retail competition. If necessary, use the transmission pricing review to replace locational investment signals if deemed sufficiently valuable. "[3]

   While the consultation paper models a perfectly co-optimised investment and a counterfactual assuming no locational transmission signal, this modelling seems slightly disconnected from the broader question being addressed in the other elements of the market design programme of how to enhance retail market competition and whether the impact on nodal prices of other solutions being considered would also remove incentives that need to be corrected in the context of transmission pricing;

4. an early statement is needed from the Electricity Authority as to the extent to which it considers this element of the market development programme one of its priorities. BusinessNZ notes that of the priorities outlined in section 45(2)(a) – (f) of the Electricity Industry Act that the Electricity Authority is expected to address in the next year, transmission pricing isn't one of them. The priorities set out in the Act imply a substantial work programme. BusinessNZ's views set out in point 3 above tends it towards a lower priority, but it recognises that there are some practical aspects of the inter-relationship between the various elements of the market development programme, such as the treatment of HVDC rentals, that drive others to pursue it as a higher priority;

5. in light of the forthcoming changes in governance arrangements, specifically the transfer of the responsibility for the approval of grid investments to the Commerce Commission, BusinessNZ is unclear about the importance of the distinction between economic and reliability investments for the purpose of the transmission pricing. While BusinessNZ appreciates that the Commerce Commission must effectively operate under the current framework for the next year, there is sufficient doubt as to whether that distinction is going to remain appropriate on a longer-term basis. The Electricity Commission (or the Electricity Authority) needs to assure itself that its analysis it is undertaking now is immune to any future changes in approach by the

[3] BusinessNZ submission to the Electricity Commission entitled 'Dual Submission: Managing Locational Price Risk: Options & Transmission Pricing Review: High Level Options', dated 7 December, 2009.

Commerce Commission. At an absolute minimum, the Commerce Commission will eventually develop a new GIT that will need to be consistent with the purpose of Part 4 of the Commerce Act. Only transmission investments that are in the long-term benefits of consumers will be approved. This makes progressing within the dual framework as proposed somewhat speculative.

Consideration of how to improve the transmission alternatives framework is a corollary to this point. BusinessNZ generally considers that the discussion about transmission alternatives misses the point – particularly the discussion about some other entity having decision-making responsibility. BusinessNZ's view on this matter is clear – there is only one grid owner, that being Transpower, and it is accountable for the development of its plans. BusinessNZ cannot see how the answer to the question of "how do we make Transpower perform better with regard to transmission alternatives" is to essentially take accountability for transmission alternatives away from it. The right answer must be, to the extent that there is a problem, to better incentivise Transpower to appropriately incorporate consideration of transmission alternatives into its analysis. This issue can be worked through by the Commerce Commission; and

6. unsurpringly (and somewhat inevitably), if the Electricity Commission's broader view on locational signalling is followed through, this piece of work essentially boils down to a review of the HVDC. This makes the following statement in the Electricity Commission's consultation paper made at the time of establishing the review particularly ironic:

> "The Commission noted that any future review should be "holistic, focusing on locational pricing", rather than merely focussing on allocating the costs of the HVDC link."[4]

BusinessNZ appreciates the complexity of the arguments and the strength of the different views that have been, and will undoubtedly continue to be, expressed, particularly given the magnitude of the costs involved. However, given the views expressed above about the objective statement, BusinessNZ considers that ***all*** of the options relating to the HVDC should remain on the table with the incremental costs and benefits against the status quo, of all options being assessed. This conclusion is reinforced by the following statement in the consultation paper that:

> "The paper does not however include consideration of whether on-balance the requirements of other regulatory settings would also support changes to the HVDC charge. This further analysis will form part of stage 3 of the review." [5]

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[4] Electricity Commission consultation paper entitled 'Transmission Pricing Review: Stage 2 Options' dated July 2010, paragraph 2.1.11.

[5] Op cit, Page C.

The requirements of the "other regulatory settings" should be applied in an even-handed way across all options.

Finally, the issue of the HVDC is most demonstrative of the issue of business confidence in the electricity market. Confidence is best garnered by stability. In this context, BusinessNZ stated the following in its previous submission:

> "Business New Zealand also questions the extent to which the Electricity Commission considers such a review will 'settle' the issue of transmission pricing. Business New Zealand considers this unlikely, and announcing the review so quickly after its final decisions on the transmission pricing methodology did not, in Business New Zealand's view, signal good regulatory practice."

Summary

It is clear that a substantial amount of work has been undertaken but much more remains to be done before this workstream can be completed. But some critical pieces of the puzzle are yet to be resolved, particularly around the interpretation of the new Electricity Authority's objective statement, and the priority which this element of the market development programme will be afforded. BusinessNZ looks to the new Electricity Authority to clarify these matters, and in doing so, grow the confidence of its stakeholders in the operation of the market and provide the market with greater stability.

Yours sincerely

John A Carnegie
Manager, Energy, Environment and Infrastructure
Business New Zealand

APPENDIX ONE: ABOUT BUSINESS NEW ZEALAND

Encompassing four regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' & Manufacturers' Association (Central), Canterbury Employers' Chamber of Commerce, and the Otago-Southland Employers' Association), Business New Zealand is New Zealand's largest business advocacy body. Together with its 58 strong Major Companies Group, and the 70-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, Business New Zealand is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

In addition to advocacy on behalf of enterprise, Business New Zealand contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.

Business New Zealand's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services). It is widely acknowledged that consistent, sustainable growth well in excess of 4% per capita per year would be required to achieve this goal in the medium term.