

1.1 The Commission's proposal

1.1.1 The Commission's proposal is to:

- (a) Amend rule 7.2.1 of part H of the Rules to bring forward the time by which participants are required to pay the Clearing Manager on settlement day from 4pm to 2pm; and
- (b) Amend rule 8.3 of part H of the Rules to require the Clearing Manager to pay payees in cleared funds by 4.30pm on settlement day.

1.1.2 The Commission's proposed rule changes are set out in Appendix 3.

1.2 Commission's objectives

1.2.1 Section 172X of the Act requires the Commission, in formulating recommendations for electricity governance rules, to outline how the proposal will give effect to its principal objectives and specific outcomes as set out in section 172N of the Act and to its GPS objectives and outcomes.

1.2.2 Appendix 1 contains a table that lists the objectives and outcomes as specified in section 172N of the Act and the GPS and outlines how the proposal may help achieve the relevant objectives and outcomes.

1.3 Objective of Commission's proposal

1.3.1 The objective of the proposed rule change is to facilitate competition in the market through reducing financial barriers to participants.

1.3.2 Section 172F(1)(c) of the Act also requires the Commission to consider whether the objective of the proposed rule change could be satisfactorily achieved by any other reasonably practicable means, other than making a rule change, for example, by education, information, or voluntary compliance. Voluntary compliance is considered as a reasonably practicable option, as below.

1.4 Other reasonably practicable options

1.4.1 Section 172F of the Act provides that before making a recommendation to the Minister on a rule, the Commission must seek to identify all reasonably practicable options, assess those options, ensure that the objective of the rule is unlikely to be satisfactorily achieved by any reasonably practicable means other than making the rule, and prepare a statement of the proposal.

1.4.2 In this instance, there are two other reasonable practicable options to the proposed changes to the Rules, as described below.

1.5 Reasonably Practicable Options

- 1.5.1 The first reasonably practicable option is the status quo, under which payers pay by 4pm and there is no obligation on the Clearing Manager to arrange to pay payees in cleared funds. Under the status quo, it can take several days for payment to a payee to clear and become available to the payee. For the purpose of this analysis, we conservatively assume that payment is delayed by one day each month, on average, or 12 days per year.
- 1.5.2 The second reasonably practicable option is to request payers voluntarily to pay by 2pm. The Clearing Manager would undertake voluntarily to pay payees in cleared funds on settlement day. The voluntary nature of the arrangement would mean that the Clearing Manager may or may not pay payees in cleared funds on settlement day. For the purpose of this analysis, we assume that 50% of the time those payments are cleared on settlement day, while 50% of the time the payments clear the following day. In other words, payment will be delayed six days per year.

1.6 Benefits and costs

- 1.6.1 The benefits associated with the proposed rule changes are the avoided costs associated with financing. These costs are a function of:
- The average monthly amounts paid by the Clearing Manager to the payees of \$405,708,842¹;
 - The cost of capital of 9.3%²;
 - The number of days annually that financing costs are incurred – assumed to be zero under the proposed rule changes, six under the voluntary arrangement and 12 under the status quo; and
 - A further assumption that only 3% of payees (by payment dollar volume) would be unable to draw on uncleared payments and would therefore incur the additional financing costs.³
- 1.6.2 Using these figures above, the estimated benefits (avoided costs) can be calculated from the three reasonably practicable options available, as below in 3.6.
- 1.6.3 The additional costs for payers to pay by 2pm are assumed to be \$100 per month in administrative costs for each of 10 payers (\$12,000 per annum).

¹ Average monthly amount paid by the Clearing Manager in the year ended May 2009. Sourced from: <http://www.electricitycommission.govt.nz/opdev/servproinfo/marketops/index.html>

² Assumed to be the energy sector rate as per: <http://www.pwc.com/nz/CostofCapital/CostofCapitalmar09.pdf>

³ The figure comes from the percentage of electricity retail customers that are not customers of the big five energy retailers in New Zealand. See: http://www.med.govt.nz/upload/68617/A1_EDF2009_Electricity.pdf

1.7 Assessment against the objective

- 1.7.1 The proposed changes to the Rules are the most effective of the three reasonably practicable options at facilitating competition in the market. Specifically, the Rule changes would limit the adverse impact on participants' working capital through working capital not being tied up for as long and hence the financial cost of covering payments would be minimised. The voluntary option would potentially improve competition in the market relative to the status quo, but would be unlikely to be as effective as the proposed rule changes in this respect.

1.8 Statement of reasons for proposal

- 1.8.1 The proposed rule changes aim to reduce financial barriers to participants and ultimately promote competition in the market.

1.9 Assessment of all options

- 1.9.1 The proposed rule changes would avoid financing costs of approximately \$37,000 per annum, relative to the status quo. This compares with an estimated \$18,500 being saved per year under the voluntary arrangements, relative to the status quo. Subtracting \$12,000 in costs gives approximately \$25,000 and \$6,500 per annum respectively as net benefits.