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SUBMISSION FROM ENERGY TRUSTS OF NEW ZEALAND INC

MARKET DESIGN REVIEW – ISSUES PAPER

Role of Energy Trusts of New Zealand (ETNZ)

ETNZ is the nationwide organisation for 20 energy trusts, the majority of whom own most or all of the shares in 23 of the 28 lines companies throughout the country.

Member trusts have investments of more than \$5 billion in these lines companies and about 62%, or 1.2 million of all New Zealand's consumers (1.9 million), are represented by these trusts. Our member trusts represent the interests of 1.4 million consumers, or in excess of 3 million New Zealanders.

This submission is on behalf of those trusts.

Support for the Review

ETNZ supports the Commission's initiative to explore opportunities for improvement in the current electricity market framework. Our comments and observations are set out below.

Chapter 1 Introduction

There is a fundamental point we wish to raise from the outset. The wording in paragraph (3) of the "Introduction" states that *"The Review seeks to examine the detail of the current design, and identify the areas that are performing satisfactorily and those where improvements can be made"*.

We believe it is too restrictive to limit this review only to those areas which are performing satisfactorily and/or to those where improvements may be made. The Commission is allocating considerable time and financial resources for this review and it should also identify **the areas that are not** performing satisfactorily (and which can materially influence the key goals of the review), so that any changes will be able to take account of issues that restrict sensible structures and performance.

In *Scope of Review*, paragraphs 10 & 11 state the wholesale and retail sectors of the industry can be considered in isolation from the fuel, transmission and distribution sectors of the market. This is questionable, given that electricity is an homogenous product and the delivery mechanisms are fundamental to the product. Furthermore, from a customer perspective the energy price has not been separated from the delivery price.

For any market to function properly there must be open, unbiased information, and competition. Issues we regard as important in improving information quality and accessibility, are:

- The clear separation of charges on all electricity accounts – of the transmission, distribution and energy components.
- The Commission should be independent of Government and political influence. This is essential in that the bulk of the generator/retail sector is Government owned. The Government is the main participant in the sectors being reviewed and there is a perception and a perspective that there is favouritism against consumers as a result.

We also make the point that despite many promises and assurances from successive Ministers of Energy over the past 5 years, the separation of billing in electricity accounts remains an issue still requiring action on retailers.

If we are to have a successful and effective electricity industry, governance aspects should be transparent and unbiased.

Chapter 2 Retail Market Issues

a) Para 50 Reliability of Supply - Point 1: The observation in Paragraph 50 that the average reliability of supply has been fairly stable during the 1995-2005 period should be qualified by making the point that weather patterns have to be taken into account. The period 1995-2003 had low storm levels and thus high reliability. Also, since 2003, reliability in distribution networks has been declining.

Points 2 & 3: The Electricity Commission has been diligent in addressing supply issues and has delivered very good results, but distribution and transmission issues have not been adequately addressed. The key is to get common governance. As long as there are split responsibilities between the Commerce Commission and the Electricity Commission the issues of long term duration will not be resolved to meet the needs of the market.

b) Para 51 Other service quality indicators - End user reliability and clear information are given as two of six important or “valued” service measures to the customer. End user reliability issues are very important and should be accorded high priority in the next stage. Distribution networks have the same high demand for heavy capital investment and re-investment as does Transpower over the foreseeable future. If those investments are not made reliability will deteriorate quickly. In our view jurisdiction for all participants in the sector should come under the Electricity Commission, so that a uniform approach can be adopted.

As for the points made about “clear information” and easy communication with the supplier, we repeat our earlier plea for transparency of billing by retailers to the mass market of consumers. This would also offer accountability.

c) Para 63 Summary of other service quality indicators - Point 3: We do not agree with the statement that survey data on customer satisfaction suggests a significant improvement. While the Consumers’ Institute Surveys are generally sound, it depends on the questions asked. Public opinion says electricity reforms have been disastrous and to the detriment of consumers. One only has to meet with groups such as Grey Power and experience life as a trustee of a trust owned lines company and be closely

involved with, and often represent the concerns of, consumers in our communities, to hear this dissatisfaction.

If service quality is to be properly measured from a customer perspective, surveys should be independent and undertaken by the Commission or an approved body – not by the suppliers of services or retailers.

We acknowledge there is a complaints body in existence, but this is a voluntary organisation which seeks to resolve issues and not arbitrate. We believe that recent problems with disconnecting consumers clearly show that service quality issues will not be adequately addressed under present arrangements.

d) Para 81 End user pricing - To be of any real value in assessing price movements, the energy component has to be separated from distribution and transmission. This exposes the actual increase in the energy component. This is vital to understand the intrigues and reality within the market as transmission and distribution components have been flat compared with retail pricing over the period in question. As transmission and distribution account for only about 40% of the input, increases obtained by the generators/retailers can be clearly seen to be excessive.

We are of the opinion that price issues cannot be properly addressed due to the non-independence of the Commission and ongoing Government ownership of the majority of generator/retailer activities in the sector.

e) Para 116 Summary observations on retail margins - We do not agree with the observations in paragraph 116, as retail margins cannot accurately be considered without looking at the generator margins as well. Generator margins are exorbitantly high. All generators have been able to obtain the long term marginal cost of supply; the market in the UK was altered to overcome this in about 2000 by installing a contract market and this concept should be considered for New Zealand.

Point 2: The main issue affecting the margins is the cost of building the next generator. We also make the point that retail margins in New Zealand have not, and will not, be a factor in fostering competition.

Point 3: This observation is not relevant. Point 4: Competitors offering service at lower prices is a matter of low priority.

f) Para 133 Retail competition indicators - The retail market is extremely concentrated to the extent that competition is only present for the installation of new plant.

Other issues to be considered are the common ownership of three of the major generator/retailers, the strung out nature of the electricity system, and the limited fuel source. We believe the problems are compounded because major investment decisions of the state owned generators have to be referred to The Treasury for ratification.

Adequate competition cannot be effectively addressed under Commission work programmes as the issues are structural.

g) Para 156 Capacity margin through time - We agree with the observations. Other important issues for analysing the margins: The first is the loss of efficiency in managing and operating the power system which occurred in the shift from a centrally controlled to a market arrangement in 1996, or thereabouts. This equated to approximately 7%.

A second is the Government ownership and control of a majority of the energy supply side of the industry. The reality is that politicians tend to be risk averse and insufficient regard is given to the overall financial and economic impact of a particular course of action. For these reasons, security of supply issues have traditionally been treated conservatively.

h) Para 167 Possible future capacity margin - The future capacity margins will be addressed under any scenario with the present ownership arrangements in the industry for the reasons stated above. More detailed work, on a system which has already been well developed by the Electricity Commission, is not necessary.

i) Para 264 Comparison of L.R.M.C. to wholesale electricity prices - The observations are correct but only tell half the story. The relationship between domestic prices and L.R.M.C., allowing for constant line charging, at or near CPI, clearly shows that generator/retailers are exploiting the weak competitive position of domestic consumers. The reason for high domestic prices must be investigated. It costs the same, or less, to supply domestic customers with energy as commercial or industrial. Distribution charges vary significantly but not energy charges. This should be treated as a high priority.

j) Para 272 Generation competition indicators - Generation competition will not occur unless structural changes are made to the industry. This is outside the scope or jurisdiction of the Electricity Commission.

k) Para 338 Demand side participation - We believe that electricity intensity has been declining as industry leaves New Zealand for more attractive locations. The reasons for this, arguably, are accentuated by the Electricity reforms of the 1990's. Economic signaling to distribution companies has ceased under the regulations now in force and this has led to the need for higher capital expenditure in both transmission and distribution networks. This emphasises the need for a single regulator of the total industry setting key policy, taking account of economic drivers. The Commerce Commission does not have adequate industry knowledge to carry out this function effectively. A very high priority should be given to this work.

On behalf of Energy Trusts of New Zealand Inc

Ken Gilligan
Chairman

17 July 2007

