DOMESTIC ENERGY USERS' NETWORK

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Age Concern NZ
Child Poverty Action Group
Grey Power Federation
Public Health Association
Rural Women NZ

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Preface

The Electricity Industry Act has the policy problem wrong. It portrays the main problem to be insufficient investment, so that electricity supply is less reliable or secure than it should be.

From the domestic consumers' viewpoint, the policy problem is that electricity prices continue to rise at in real terms a time when many incomes are static or declining in real terms. The average residential consumer price rose by 23.3% in real terms in 2010 (Energy Data File, table I.1b).

As prices rise, more consumers are unable to afford the electricity they need for a warm and healthy home. Each consumer will make their own trade-offs, some buy less food, some don't use medical services, some let their houses get cold all or some of the time, and their[i] health and welfare suffer whichever compromise they choose. Consumers who fall into arrears in their power bills incur yet more costs – we are aware of a "management fee" of $25 per month over and above the cost of electricity itself.

The Electricity Industry Act is for the long-term benefit of consumers. This is considered to mean, in summary: a reliable and efficient supply and a competitive market. But it defines "benefit" purely from the supply-side point of view.

The Electricity Industry Act 2010 puts its prime focus on investment and innovation by suppliers. Extensive "interpretation" of the Act's statutory objective seems to come down to the proposition that reliability/ security of electricity of supply will be put at risk unless suppliers can invest with confidence that investments can be commercially viable. This means that business risks will be fully priced – to consumers! And domestic consumers are disadvantaged because gentailers (the big five generator-retailers) find big users more profitable, so they will discount electricity to them, loading extra costs onto their less profitable consumers to ensure they are at least marginally profitable. The supplier is the active participant - consumers are treated as passive.

The basic error is that this fails to address the fact that consumers must also invest. The Independent Review of the Transmission Pricing Methodology consultation document observed that:

> " . . . a strong case can be made that the primary rationale for natural monopoly regulation is the protection and promotion of sunk investment – not the sunk investment of the

monopolist, but the sunk investment of its customers and consumers. . . . The total sunk investment in generation may well exceed the total sunk investment in transmission by a factor of ten. Furthermore, other large transmission customers (such as aluminium smelters) will also make a substantial sunk investment in their location. Even small customers make a substantial sunk investment in electrical wiring, electrical appliances, and customised equipment which uses electricity as a source of energy. . . . Loads will be reluctant to make an investment which locks them in to using electricity even if that is the most efficient source of energy."

Scarcity pricing one of several drivers of likely price increases

Consumers have been warned of future significant price increases, most recently by Contact Energy, supported by TrustPower and Meridian Energy on Radio NZ on 24 August. They all say that they cannot build new generation unless prices rise.

Electricity market design provides the mechanisms by which the major retailer-generators can all face similar commercial pressures. The market is being designed so the large suppliers can respond, but it creates difficulties for small and innovative suppliers.

These design features include the Customer Compensation Scheme, already implemented, which was the driver behind Meridian Energy's withholding of hydro generation last December, which drove spot prices very high. Another design feature is HVDC pricing, not yet finalised, but the majority of the Advisory Group recommends an option that could add as much as $150 million per year to power bills across the customer sector.

A further factor driving prices up will be the completion of Emissions Trading Scheme pricing, because only half of the price impact has been implemented to date.

Scarcity pricing may well be a major driver of future price increases, because although it has been moderated through two or three safeguard mechanisms, it still enables security of supply to be treated as a market opportunity rather than a requirement of companies providing an essential service in an environment of market power.

Scarcity pricing

Scarcity Pricing, as discussed in Section B.7 of the consultation document, is designed to make "last-resort oil-fired plant" commercially viable. All the calculations in the Cost-benefit analysis are built around the assumption that this plant will always earn a commercial return.

The cost-benefit analysis, at B.39, states that the main expected cost associated with scarcity pricing is in the market-clearing software which will have to be modified. The main cost to consumers will be from high spot prices during shortage events. The Analysis treats this as a wealth transfer amongst different parties, with no effect at all on the aggregate benefit to New Zealand.

DEUN has consistently submitted that higher costs and risks of scarcity events, and of the other drivers of price rises, would be passed through mainly to the least competitive consumers, the domestic sector.

Cost-benefit analysis should count the costs of health impacts

DEUN has heard many reports of people in tears opening their power bills; many people we are told are still going to bed early to keep warm. When we put this to the Scarcity Pricing Advisory Group, we were asked whether the best way to address such problems might not be through the Security Settings (or other market design considerations that may transfer wealth from consumers to the supply side of the industry). Surely, we were asked, this is a matter for WINZ or some other government agency (or perhaps charitable agencies, or family).

We replied that the economic theory behind Scarcity Pricing and the rest of the market design assumes that electricity is a competitive industry, which will work most efficiency by being regulated as little as possible. This assumption is made by no other jurisdiction internationally. The International Energy Agency, in its New Zealand Country Review earlier this year, wrote:

> Despite its size and peripheral location, New Zealand was among the first OECD member countries to reform its electricity market along competitive market-oriented lines. While the innovative nodal-pricing regime delivered benefits in the early years, progress in recent years in developing the market has been slow. Generators and retailers tend to be both vertically integrated and geographically concentrated, **while there have been indications that retail profit margins are relatively high and that margins tend to be highest in regions with less active or fewer retailers.**

One if its key recommendations was that New Zealand should:

- Recognise that **self-regulation can lead to undesirable outcomes** and intervene when necessary, for example by regulating the introduction of smart metering and standardisation of distribution third-party access conditions.

Investment should be on the demand side whenever this is cost-effective

Many consumers cannot now invest in energy efficiency to mitigate the impacts on them of price rises. An ideal response to scarcity events would be access to alternative fuels, to ensure houses are warm and comfortable in inclement weather or during blackouts. But if scarcity pricing is designed to make diesel power generators commercially viable, the necessary investment will be done on the supply side, increasing industry asset values, instead of on domestic consumer premises where it can achieve multiple benefits.

The warm homes/ clean heat schemes of both governments is a prime example of this. It should be made available to a larger number of householders, who would thereby become less vulnerable to scarcity events.