

# Chair's half-yearly report to the Electricity Authority Board

July 2011 to December 2011

12 January 2012

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## 1 Introduction

- 1.1.1 The Retail Advisory Group was established by the Electricity Authority (Authority) in May 2011 to provide independent advice to the Authority on the development of the Electricity Industry Participation Code 2010 (Code) and market facilitation measures, focusing on the relationships between the retailer/distributor/customer.
- 1.1.2 This half-yearly report outlines the Group's activities for July 2011 to December 2011. The Group's terms of reference require the Chair to report every six months to the Authority Board on the Group's progress against its work programme.

## 1.2 Role of the Group

- 1.2.1 The role of the Group is to provide independent advice to the Authority on the development of the Code and on market facilitation measures, focusing on:
- a) Development of the retail electricity market, including matters relating to the retailer/consumer interface, the retailer/distributor interface and the consumer/distributor interface, the distributor/embedded generation interface and advanced metering infrastructure;
  - b) Priorities for developing:
    - i) The Code, especially in regard to Parts 6 (Connection of distributed generation), 10 (Metering arrangements), 11 (Registry information management) and 15 (Reconciliation); and
    - ii) Market facilitation measures in regard to retail market services.

## 2 Membership of the Group

- 2.1.1 The Group met for the first time on 1 July 2011, and held four meetings between July and December 2011.<sup>1</sup> All meetings were held in Wellington, at the offices of the Authority.
- 2.1.2 Table one gives details of Group's membership, and members meeting attendance for July to December 2011.

**Table 1: Retail Advisory Group membership details**

Member	Affiliation	Appointed (term)	Meeting attendance
Peter Allport, Chair	Independent	March 2011 (two years)	4
Dene Biddlecombe	Managing Director, Pulse Utilities	May 2011 (one year)	4
<i>Dean Carroll</i>	<i>General Manager Retail, Genesis Energy</i>	<i>May 2011 (two years) resigned September 2011</i>	2
Suzanne Chetwin	Chief Executive Officer, Consumer NZ	May 2011 (two years)	3

<sup>1</sup> The Group met on 1 July, 7 September, 14 October and 16 December.

Member	Affiliation	Appointed (term)	Meeting attendance
Sarah Free	Domestic Energy Users Network	May 2011 (one year)	4
Anne Herrington	Director, Smart Power	May 2011 (two years)	3
Ross Parry	Regulatory Affairs Manager, Genesis Energy	October 2011 (two years)	2
Nathan Strong	General Manager Regulation and Pricing, Unison Networks	May 2011 (two years)	4*
<i>David Stroud</i>	<i>General Manager, Advanced Metering Services</i>	<i>May 2011 (one year) resigned November 2011</i>	3
James Munro	General Manager Retail and Corporate Affairs, Mighty River Power	May 2011 (one year)	3

\*Nathan Strong attended the 16 December 2011 meeting by teleconference.

## 2.2 Resignations and new member

2.2.1 Two members resigned from the Group to take up opportunities overseas:

- a) Dean Carroll, General Manager Retail, Genesis Energy Limited, resigned effective 7 September 2011; and
- b) David Stroud, General Manager, Advanced Metering Services, resigned effective 25 November 2011.

2.2.2 Consistent with the terms of reference for the Group, the Authority sought nominations to fill the vacancy on the Group left by the resignation of Dean Carroll in September 2011. Ross Parry, Regulatory Affairs Manager at Genesis Energy was appointed by the Authority in October 2011 for a two year term.

2.2.3 The Group considers that there is benefit in filling the vacancy left by the resignation of David Stroud to ensure the Group has an appropriate mix of skills and experience.

## 3 2011-12 work programme

3.1.1 The Group's 2011-12 work programme was developed following discussions between the Authority and the Group, including an initial discussion of possible tasks with the Chair.

3.1.2 The agreed 2011-12 work programme comprised three projects

- a) consideration of arrangements for managing retailer default situations;
- b) consideration of arrangements for the purchase of power by retailers from small-scale distributed generation; and
- c) consideration of domestic contracting arrangements.

- 3.1.3 In addition to these tasks, the Group was interested in assisting the Authority with the section 42 project on “more standardisation”, the Part 10 Review (particularly advanced metering installation (AMI) aspects) and low user fixed charge arrangements. The Authority appreciated the Group’s interest in these matters, but decided against assigning further tasks to the Group as part of its 2011-12 work programme.
- 3.1.4 The Group noted at its 16 December 2011 meeting that consideration of low user fixed charge arrangements has been included in the Authority’s proposed 2012-12 work programme, and continues to be interested in assisting the Authority in this area.
- 3.1.5 Throughout the Group’s tenure, the Group has relied on support from the secretariat, provided by the Authority. Support for the Group has included external resources, procured by the Authority, such as Sapere and Buddle Findlay for legal advice.

### **3.2 Consideration of arrangements for managing retailer default situations**

- 3.2.1 The Group is considering the implications for consumers should an electricity retailer fail to pay amounts due to the Clearing Manager or electricity distribution businesses, or otherwise default on its financial obligations to market participants. In particular, the Group is interested in identifying the potential risk that a default by a retailer may result in disruption to electricity supply, cause concern to consumers, or damage the credibility of the market, with the consequent potential for ad-hoc legislative intervention.
- 3.2.2 The Group agreed at its 16 December 2011 meeting to release a Discussion paper: retail customers in retailer default situations, to seek feedback from industry and consumers on the effectiveness of arrangements for managing retailer default situations.
- 3.2.3 This paper should be released in early February 2012, following discussions with the Authority Board, for a six week consultation period. The Group expects to provide the Authority Board with recommendations on options for managing retailer default situations by June 2012.
- 3.2.4 This has proven a conceptually challenging project, with the Group spending considerable time to properly understand and document the current situation and implications of the existing arrangements for managing retailer default situations. The Group had extensive discussions on:
- a) that a consumer is unlikely to be immediately affected by a retailer default, and the initial and more significant risks are to industry participants (including the Clearing Manager) who are creditors of the failed retailer. It was noted that retailer default scenarios included low probability, high impact events such as the failure of a major gen-tailer;
  - b) the number of consumers who might be stranded by a retailer default. The view was that most consumers are likely move to a viable retailer, either voluntarily or as part of a sale process, but that a small number of commercially unattractive consumers might be stranded;
  - c) that consumers are not generally refused supply, but credit, and that this issue can be managed using prepayment meters. Prepayment options are provided in some areas by retailers, however, (although not definitive) it is understood that prepayment meters may not be available in parts of New Zealand;
  - d) the role of metering equipment providers, and distributors’ possible actions, in a retailer default situations, such as what the metering and network companies’ positions would be, how they may react and how they could help/hinder. For example, it was observed that, at the moment, there is little risk of end users being disconnected because, in part, this requires

a physical disconnection in most instances. This situation could potentially change as more smart meters are installed;

- e) the economics of the supply chain and information flows. The feasibility of disconnection is linked to the cost of identifying and disconnecting consumers. However there is a point at which the opportunity cost of a consumer without a retailer creates an incentive to disconnect the consumer;
- f) legal advice regarding which parties could call in a liquidator in the case of a retailer not paying all their bills. Neither the Authority nor the Clearing Manager can appoint a receiver; and
- g) what has happened previously when energy retailers have faced financial difficulties.

3.2.5 The Group has spent considerable time considering the nature of the problem to be resolved (in the case of retailer default), and if so, the nature of any regulatory response. It was noted that the market may resolve the situation, but if it is not resolved quickly, the associated uncertainty may have adverse consequences for the credibility of the market, with the potential for ad-hoc legislative intervention.

3.2.6 The Group has liaised with the Wholesale Advisory Group about the influence of retailer default arrangements on that Group's settlement and prudential security review work stream. There has been extensive interaction between the Authority staff (secretariat) supporting the two Groups.

### Conclusions

3.2.7 Several important changes have been made to how settlement risk is allocated in the wholesale market since the NZEM rules were replaced with regulations. Importantly, the "right" that had existed under the NZEM rules for the Clearing Manager (subject to approval by the Market Surveillance Committee) to appoint a receiver was not carried over from the NZEM rules to the Electricity Governance Rules and Regulations (EGRs). This right was not reinstated when the EGRs were repealed by the Electricity Industry Act 2010 and replaced by the Code. Similarly, generators are not parties to any agreement with purchasers for the sale and purchase of electricity through the wholesale market that includes a right to appoint a receiver should a purchaser default on payment.

3.2.8 Current arrangements appear to risk giving rise to moral hazard in which a retailer may not fully factor in the costs of its potential failure on other participants (both generators and retailers). These incentives could in time lead retailers to adopt riskier business strategies than are economically efficient (strategies that would not be profitable but for the fact that the downside is borne in part by others).

3.2.9 Inefficient risk taking can be expected to lead to more disruption and inconvenience to consumers, with the consequential impact on the reputation of the market. It also creates uncertainty about the level of risk faced by industry participants, particularly for generators who now bear in first instance the risk of electricity used by the defaulting retailer's customers.

3.2.10 The Group is seeking feedback on three options for managing retailer default situations:

- a) one option would be to make no changes. This option assumes that participants who bear the financial costs of a failed retailer face incentives to reach an agreement to curtail the loss. Making no change would have the advantage of avoiding the costs of amending existing regulatory arrangements or administering any alternative mechanism. The disadvantage is

that the apparent incentives for inefficient risk taking would remain and there would be little or no certainty as to the outcomes or the timeline of events following non-payment by a retailer;

- b) option two is to re-establish a mechanism whereby the Clearing Manager, or the Authority, could appoint a receiver if a retailer in default did not pay any outstanding liabilities and restore its required collateral within the period provided under existing prudential requirements; and
- c) option three is to implement a modified version of the Draft Code Change that provides the Authority with the means to transfer customers from a retailer. This option would presumably change the preferential order of claims on the retailer's assets, as the customer base (and associated cash flows) transferred to another retailer would no longer be available to settle preferential claims and secured creditors.

### **3.3 Distributed generation**

- 3.3.1 The Group is considering the arrangements for purchase of power by retailers from small scale distributed generation to identify whether there is potential to reduce transaction costs and ensure that electricity market regulatory arrangements do not deter investment or deployment of small-scale DG (including new innovations).
- 3.3.2 The Group agreed at its 16 December 2011 meeting to release a Discussion paper: investigating barriers facing small-scale distributed generation, to seek feedback from industry and consumers on arrangements for purchase of power by retailers from small-scale distributed generation.
- 3.3.3 This paper should be released in early February 2012, following discussions with the Authority Board, for a six week consultation period. The Group expects to provide the Authority Board with recommendations on options for managing retailer default situations by June 2012.
- 3.3.4 The Group has found this an interesting topic, and has engaged in wide-ranging discussion on the future prospects for small-scale distributed generation, and the implications of new technologies and practices for the electricity network and system.

#### **Conclusions**

- 3.3.5 The October 2010 letter of expectations from the Minister of Energy and Resources requested the Authority to investigate the case for developing mandatory terms and conditions for the purchase by retailers of power from small-scale DG to reduce transaction costs for individual investors. The Group considers that at the heart of this expectation is a perception that consumers wishing to invest in small-scale DG are somehow at a disadvantage, and something should be done to change the arrangements by which retailers purchase power from these suppliers. To test this perception the Group is asking for feedback on:
  - a) Are there barriers that small-scale DG face entering the market?
  - b) Are there likely to be significant social benefits (externalities) associated with the entry of small-scale DG to the market that are not being captured?
- 3.3.6 The Group has identified three markets that a DG owner could enter:
  - a) the wholesale electricity market;
  - b) the electricity distribution services market; and

c) the delivered electricity market.

- 3.3.7 As small-scale DG currently tends to be for the purpose of offsetting the owner's retail supply the investment decision is likely to include a comparison between the retail price of electricity and the price of electricity from the DG unit plus any fixed charges that the user pays for their network connection. Investment on this basis tends to belong in the market for delivered energy. However, the possibility of some export from this style of DG means that most of the issues are common to both the market for delivered energy and the wholesale electricity market.
- 3.3.8 The analysis presented in this paper suggests that the cost of photovoltaics (PV) has converged toward the delivered electricity price, but may still be more costly than grid sourced electricity, at least on average. There may be areas in New Zealand where the solar output is sufficiently high and the retail tariff sufficiently high for solar DG that offsets domestic consumption to be commercially viable. As the relative cost of PV is expected, by some commentators, to fall further, removing any barriers to entry will become increasingly important to ensuring a market conducive to DG investment.
- 3.3.9 The Group's initial assessment suggests that the only condition that may constitute a barrier to entry relevant to the Authority's mandate is liability. The liability provisions in the publicly available contracts are wide in scope and unlimited in scale. This contrasts with the liability clauses in the regulated terms of connection which are limited to direct losses not caused by force majeure, and capped at \$1000 per kW of installed capacity. The distributor also has the ability to temporarily disconnect the DG under certain circumstances to protect property or people.
- 3.3.10 The Group has noted that the price offered for excess generation is a contentious matter for those interested in promoting renewable energy. The Group's analysis suggests that in a workably competitive market a DG owner would not expect to receive from the retailer more than the wholesale generation price (adjusted for risk management costs) for surplus output.
- 3.4.1 The Group is considering the existing suite of domestic contracting arrangements, involving:
- a) reviewing whether the voluntary good practice contracting principles and minimum terms and conditions for domestic contracts for delivered energy (interposed) are consistent with the Authority's statutory objective;
  - b) developing voluntary good practice contracting principles and minimum terms and conditions to apply where consumers are on networks that adopt a conveyance model contractual arrangement.<sup>2</sup> The Group considered that the incomplete coverage of the voluntary good practice contracting principles and minimum terms and conditions could reduce the effectiveness of the domestic contracting arrangements; and
  - c) considering the level of duplication between the voluntary principles and minimum terms (both interposed and conveyance) and arrangements to assist vulnerable consumers and medically dependent consumers.

<sup>2</sup> The conveyance model involves a triangular contractual relationship between the consumer, the retailer and the distributor. The interposed model involves a linear relationship where the consumer has a contractual relationship with the retailer only.



**Progress**

- 3.4.2 The Group expects to consider a paper on domestic contracting arrangements at its February 2012 meeting, and to release a discussion paper in March 2012. The Group expects to make recommendations to the Authority Board by June 2012.
- 3.4.3 Authority staff met with the Ministry of Economic Development in December 2012 to obtain input on the aspects of the project related to vulnerable and medically dependent consumers.