

Annual Report

2003/2004

Electricity
Te Komihana Hiko

Commission



The Electricity Commission is a Crown entity set up under the Electricity Act to oversee New Zealand's electricity industry and markets. It began operating in September 2003.

The Commission regulates the operation of the electricity industry and markets (wholesale and retail) in accordance with the Electricity Act and government energy policy.

The Commission's principal objective, as set out in the Electricity Act, as amended, is to ensure that electricity is produced and delivered to all classes of consumers in an efficient, fair, reliable and environmentally sustainable manner. The Commission is also required to promote and facilitate the efficient use of electricity.

The Commission has extensive powers to regulate to achieve its aims. However, before introducing new regulations, the Commission will consult widely with stakeholders and use influence to seek mutual solutions.

Report of the Electricity Commission

for the year ended 30 June 2004

Presented to the House of Representatives
pursuant to section 172ZN of the
Electricity Amendment Act 2004

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Members

The Electricity Commission is governed by an executive chair and five other members appointed by the Minister of Energy. The Commission Board members have been appointed on the basis of their extensive knowledge of, or experience in, the electricity industry, electricity markets, regulatory processes and public policy. Members hold office for a term not exceeding three years and may be reappointed. They normally meet twice a month but can meet at short notice if required. Their fees, listed on page 34, are funded by a levy on the electricity industry which also funds the Commission's day-to-day operations.



Roy Hemmingway, Chair
BA JD

Before coming to New Zealand, Roy Hemmingway had an extensive background in electricity issues in government and the private sector in the United States. His most recent position was chair of the Public Utility Commission in the state of Oregon, the agency which regulates the electricity sector. He also served as a policy adviser to three Oregon governors and was a key figure in establishing the Northwest Power Planning Council, a four-state electricity planning body. Mr Hemmingway lives in Wellington.



David Close
MA(Hons) MA (Essex)

David Close is a former Christchurch city councillor and, until recently, was a director of the national grid company, Transpower. He has a sound knowledge of the electricity industry and extensive experience as a local body politician and as a board member of commercial, voluntary, Māori and charitable organisations. Living in Christchurch, Mr Close remains deputy chairman of Canterbury Community Trust.



Doug Dell
BE(Hons) DPA

Doug Dell trained as an engineer and has worked in the electricity industry throughout his career. His experience includes pricing, infrastructural development, marketing and operational management in the public and private sectors. He was previously assistant general manager of the former electricity division of the Ministry of Energy, and since 1990 has been an energy consultant. He was formerly a director of the electricity lines company Vector. Mr Dell lives in Auckland.



Peter Harris
BCom(Hons)

Peter Harris is a former academic and trade union economist with an extensive background in research, analysis and advocacy. He has been a member of a number of government advisory boards, and has been involved in national and international industry and economic development projects. His most recent appointment was as economic adviser to the Finance Minister, the Hon. Dr Michael Cullen. He is also a director of PSIS Ltd and chair of the Savings Product Working Group. Mr Harris lives in Wellington.



Graham Pinnell
BE(Hons)

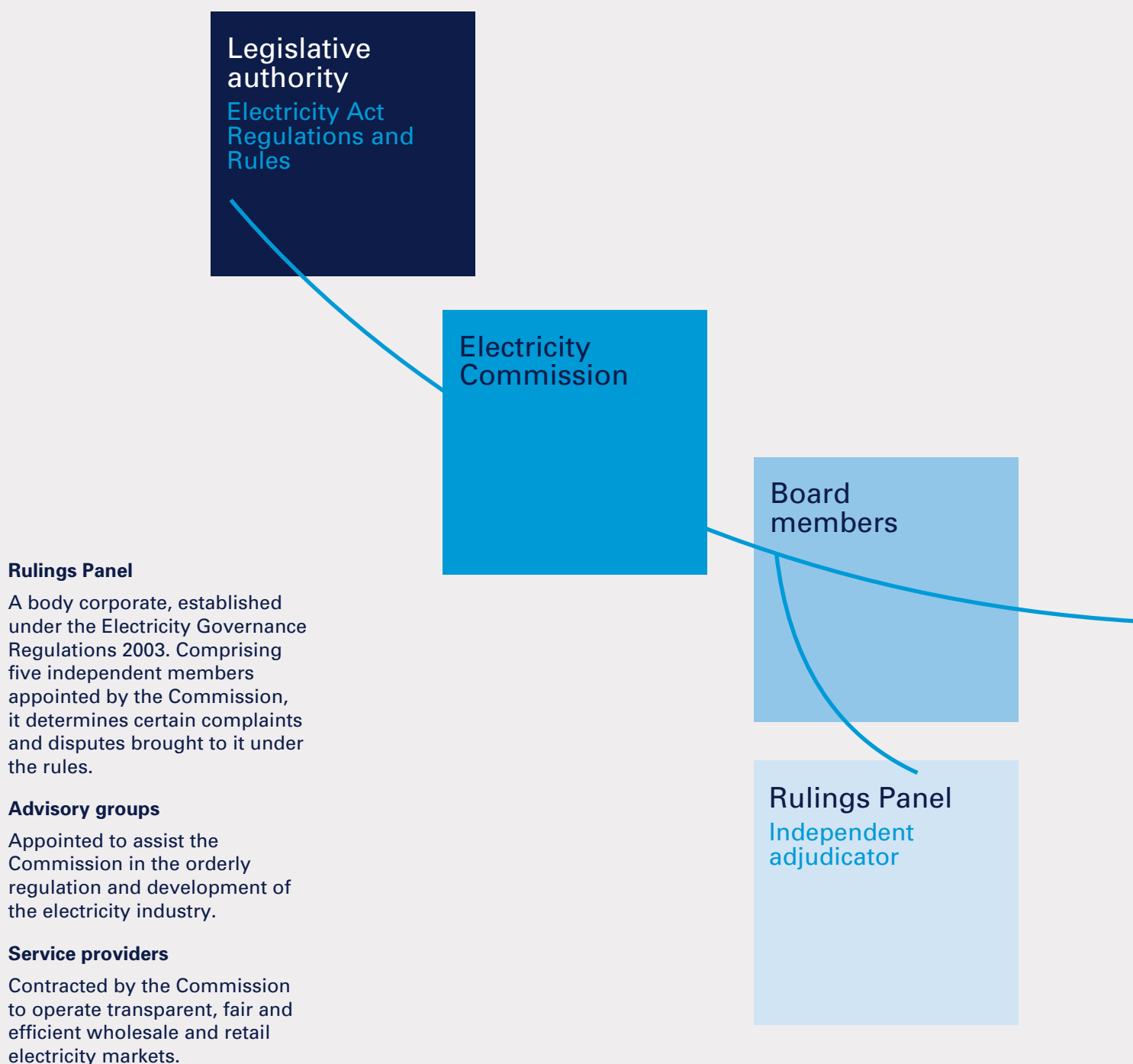
Graham Pinnell is a sheep and cattle farmer and former professional engineer. He has a strong understanding of electricity industry governance, having been a consumer nominee for a number of electricity industry bodies. He has been a national board member of Federated Farmers of New Zealand, and has been involved in a number of agribusiness and public policy issues. Mr Pinnell lives in Cambridge, Waikato.



Christine Southey
BA(Hons) LLB

Christine Southey was previously a director and partner in a consulting firm specialising in the energy sector. She has a comprehensive knowledge of the regulatory and contractual arrangements governing the electricity sector, acquired through her involvement in a number of industry projects. Before her consulting role, Ms Southey was a partner in a national law firm, where she specialised in the energy sector and competition law. She has been a director of Solid Energy New Zealand Ltd since 1999. Ms Southey lives in Wellington.

Governance and operational structure



**Supported by industry
advisory groups**

- common quality
- hedge market
- retail market
- security
- transmission
- transmission pricing
- wholesale market

**Contract agreements
with service providers**

- clearing manager
- information system
- market administrator
- pricing manager
- reconciliation manager
- registry
- system operator



Commission
operations
and staff

Stakeholders

Government

Industry

Consumers

To encourage new entry and investment in the retail and wholesale electricity markets, the Government Policy Statement on electricity governance identifies the need to improve hedge market transparency and liquidity. The Commission has recently established a Hedge Market Development Steering Group that meets monthly to provide advice on means to improve the hedge market.

The Commission chair, Roy Hemmingway, standing left, is with the group for its first meeting in September 2004. Also standing, from left are: Carl Daucher, New Zealand Exchange Ltd; Carl Hansen, advisory group support, M-co; Ralph Matthes, Major Electricity Users' Group; Paul McIver, TrustPower Ltd. Seated, from left are: Russell Longuet, independent consultant; Steve Barrett, Contact Energy; Tim Street, the Commission's senior adviser wholesale; Tony Baldwin, independent chair; Darren Gilchrist, M-co.



Chair's report

The Electricity Commission was created in September 2003 with an announcement by the Minister of Energy of the appointment of the Commission Board members. This first annual report covers the period from September 2003 until 30 June 2004.

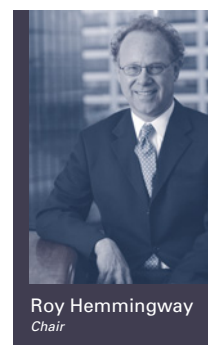
The Commission came into being in response to government concerns over the management of the electricity industry and the security of supply in dry years. Its brief, in what are complex wholesale and retail electricity markets, is to implement the intentions of the Electricity Act which recognises, among other things, the mixed public and private ownership of the industry.

The Commission is governed by an executive chair and five part-time members.

The key features of the reporting period were the transfer of operation of the electricity system, the market and the rules, and establishing, awarding and monitoring contracts for the provision of services vital for the efficient delivery of electricity to end consumers.

The many practical start-up and strategic tasks undertaken by the Board during this reporting period include the establishment of the Commission itself,

overseeing the transfer to the Electricity Governance Rules and Regulations (EGRs) 2003, appointing members of the Rulings Panel, setting up offices, determining an initial work programme, and recruiting staff. Throughout most of 2003/04 the Commission Board met fortnightly.



The Commission's obligations are set out in the Electricity Act 1992, as amended, principally by the Electricity Amendment Act 2001, and the Electricity Amendment Act 2004 (EAA), as well as from the Government Policy Statement (GPS) on electricity governance. It also receives additional powers and responsibilities under the EAA.

The Commission is funded by a levy on electricity industry participants, which ultimately flows through to electricity customers. This levy for policy, regulatory management and market service providers is in addition to the levies for reserve energy. The bulk of the levy is directed to making certain that electricity is generated and distributed in a reliable way, that a market for buying and selling electricity is administered efficiently, and that disputes arising are managed effectively.

What the Commission does

- *Proposes and administers Electricity Governance Regulations and Rules*
- *Grants exemptions from rules*
- *Investigates, determines, declares and seeks remedies to undesirable trading situations*
- *Appoints investigators to examine alleged rule breaches*
- *Appoints a Rulings Panel to decide disputes between market participants*
- *Assesses the need for reserve energy and arranges for reserve energy if required*
- *Approves grid-pricing methodology*
- *Determines contracting parties for Transpower*
- *Assesses and approves (or not) Transpower's grid upgrade plans*
- *Develops a model retail contract*
- *Promotes hedge markets*
- *Promotes wholesale and retail competition*
- *Promotes electricity efficiency*
- *Provides information to industry and consumers*
- *Oversees security of electricity supply*

What the Commission does not do

- *Set retail or wholesale prices*
- *Provide baseload generation*
- *Approve new generation projects*
- *Decide whether gas, coal, wind or energy efficiency will meet new demand*
- *Regulate lines companies*
- *Adjudicate on retail disputes*

The shift from self-regulation, where previously the industry set its own rules, to Crown-agency regulation is new to New Zealand, although such electricity regulation is firmly established in other developed countries. Regulation in the New Zealand electricity sector is not intended to impose a heavy hand of state control on an industry that now is operating largely in response to market forces. Instead, the Commission provides oversight of the electricity markets to ensure that they run fairly and efficiently. The Commission has been charged by the government to address a number of problems that challenge the electricity sector.

With reforms starting more than a decade ago, New Zealand has created wholesale and retail markets for electricity. Instead of being able to buy electricity from one state-owned monopoly only, customers now have a choice of power suppliers. As well, electricity retailers now buy their electricity in a competitive wholesale market, which has achieved a world-wide reputation as an efficient dispatch and pricing tool. These markets are expected to deliver to the electricity sector the benefits that competitive forces bring to the rest of the economy: downward pressure on costs and prices, emphasis on customer choice and service, and technological innovation.

No market can function without rules, and a primary purpose of the Commission is to recommend market rules to the Minister of Energy and to enforce those rules. The Commission's new EGRs, which largely came into effect on 1 March 2004, ensure that the nation's electricity system meets high standards of reliability and that the buying and selling of electricity is done fairly and efficiently (*see page 15*). Electricity is a unique commodity that must be produced at the exact moment and in the precise quantities that consumers demand it. The EGRs are designed to ensure the balance between supply and demand is maintained with the reliability and power quality that a modern society requires.

However, the Commission consults extensively with stakeholders and uses its influence to seek mutual solutions before proposing regulation. Good communication with stakeholders, at the consultation stage and when regulations are promulgated, is an essential part of the process and is embraced by the Board. It is Commission and government policy that the Commission remains open to hearing a range of stakeholder views.

Overseeing the market is not the only challenge facing the Commission. New Zealand relies on hydroelectric power for about 60 per cent of its electricity supply. Since hydro inflows are variable, the country faces unpredictable shortages of hydroelectric power that must be addressed. The government has indicated that it expects the Commission to deal with this problem and to ensure there is sufficient electricity in a one-in-60 dry-year event. The government took initial action in 2003 by commissioning the reserve generation plant at Whirinaki. The Commission has started work to assess whether additional reserve generation is needed. It is also assessing the challenge of how dry periods can be met with least cost and least risk of shortage.

Transmission is another area where the government has asked the Commission to find solutions. Little significant investment in the transmission grid has been made in the past two decades, due, at least in part, to uncertainties about how the investment costs would be recovered from electricity customers. If action is not taken, this lack of investment will create problems of electricity shortage during peak periods in many parts of the country. The government has asked the Commission to address these issues by approving a grid-pricing methodology for national grid company Transpower, assessing plans for Transpower to upgrade the grid in critical places, approving investment where it meets the requirements, and sorting out the contractual relationships between Transpower and the companies that receive services from the national grid.

Transmission brings electricity from remote generation sites to distant customers, provides greater system reliability by making multiple generators available over diverse locations, and allows the market to operate efficiently through dispatch of least-cost generation.

However, these benefits can also be achieved to some extent by demand reduction or correct location and configuration of new generation. A challenge for the Commission is to determine the optimum investment in new transmission for the country without resorting to central planning and undue interference in the market.

The Commission does not build new power plants or make decisions about what kind of new generation should be built. But the Commission is concerned that electricity markets operate to send the appropriate signals so that new investment in generation is made by market participants in time to meet the national need. New investment in generation is inhibited by uncertainties surrounding the long-term availability of natural gas and the level at which the government will enact a 'carbon charge' to try to limit gases that contribute to climate change. These issues are outside the Commission's jurisdiction but they raise complications that make it difficult to assess whether the market alone is able to send appropriate investment signals.

At the time of writing, the country's medium-term electricity supplies appear adequate. Because New Zealand is a small, island country, it will never be absolutely secure from the failure of a major



Consultation with stakeholders in the electricity industry is a core function of the Commission. Here, some of the members of the Transmission Advisory Group consider key work to be undertaken in electricity transmission. From left: Malcolm Alexander, Genesis Energy; Dick Whitelaw, New Zealand Steel Ltd; John Gleadow, the Commission's senior adviser transmission; Denis Clifford, independent chair; Tas Scott, Orion New Zealand Ltd.

What makes a good regulator?

A good regulator:

- Seeks best information and sound analysis
- Consults broadly and recognises limits of acceptability
- Respects evidence
- Operates openly, transparently, and comprehensively in its decision-making
- Shares information with stakeholders
- Responds quickly to events
- Focuses on long-term public benefit
- Limits intervention to only when necessary for preservation or enhancement of market functioning
- Is consistent in decisions so that participants know the rules and what to expect
- Maintains ethics and the highest standards without favour to any interest in the electricity sector

Achievements in brief

As a new entity, the Commission spent most of its efforts in the nine months to June 2004 laying the foundations and building for the work ahead. Highlights include:

- Developing a comprehensive work programme
- Recruiting a range of highly qualified staff
- Developing compliance rules
- Forming and developing the function of the Electricity Governance Rules Committee
- Appointing the Rulings Panel
- Appointing standing advisory groups
- Appointing service providers
- Appointing various ad hoc committees
- Building industry relationships
- Deciding its first claim of an 'undesirable trading situation'
- Facilitating solution-finding for the upper South Island winter capacity problem
- Initiating its first market rule enhancements
- Initiating a range of policy development tasks
- Making its first decisions regarding future need for reserve energy

system component, a dry period without historical precedent, or other contingencies. However, the Commission will be assessing how much 'insurance' it is prudent to provide in terms of additional reserve energy to meet these possibilities.

There is also the need to encourage electricity efficiency and the Commission is investigating where there might be significant savings. Yet to be exploited widely in New Zealand is wind energy. The Commission has a role in ensuring that renewable resources, such as wind, can become part of the electricity market but its powers do not extend to subsidising alternative electricity sources.

There is an unqualified potential for economic investment in electricity efficiency. Such investment would benefit all customers by providing greater assurance of adequate supplies while keeping the need for high-cost new generation to a minimum. The Commission has the power to promote and facilitate electricity efficiency and a small budget for that purpose has been passed for 2004/05, funded by the levy on the electricity sector.

The Commission will work closely with other agencies, such as the Energy Efficiency and Conservation

Authority (EECA), to review the potential for electricity efficiency to contribute cost-effectively to the government's electricity objectives, including estimating the level of investment required to achieve that potential.

The Commission plans to put in



Energy efficiency and conservation is crucial to New Zealand maintaining secure and sustainable electricity supply. To this end, the Commission plans to spend \$21 million during the next three years to improve electricity efficiency, to reduce the need for expensive new investment in generation and transmission. It works closely with the Energy Efficiency and Conservation Authority to achieve this aim. Pictured here EECA's Robert Tromop, right, is with the Commission's adviser projects, Andrew Jefferies.

place arrangements and programmes that promote efficiency in the markets, and among electricity consumers.

The Commission's primary obligation is to meet the objectives and priorities of section 172N of the Electricity Amendment Act 2001, the Electricity Amendment Act 2004, and the government's objectives and outcomes, as approved in the GPS.

As a new entity, the Commission spent most of its efforts in 2003/04 building capability for the work ahead. Important achievements included developing a work programme to advance its functions, instigating policy development, recruiting staff, developing compliance rules, forming the EGR Committee and other committees, setting budgets, appointing the Rulings Panel to adjudicate on complaints and disputes, appointing industry, consumer and independent representatives to its standing advisory groups, and building industry relationships.

During the year, the Commission decided its first claim of an 'undesirable trading situation' (UTS) in the wholesale market. It also helped find a solution for the upper South Island winter capacity problem (*see page 17*), produced its first market rules, and made its first decisions on the future need for reserve energy.

The task ahead is a challenge for the Commission but attainable. The work to date has created a solid platform for the Commission to make a valuable long-term contribution to the development of an orderly electricity industry and an electricity reserve to give New Zealanders power security.

In the coming year the results of the Commission's work will become obvious. Its profile will also be raised as projects initiated in 2003/04 come to fruition. The levy-funded electricity-efficiency projects will start saving kilowatt hours. Major decisions on transmission, forecasting, market development, retail competition, and reserve energy will be made after industry and public consultation.

In its first nine months the Commission has laid the foundations for further work to improve the electricity industry. It has been a busy period for the Board, staff and advisers. I would like to thank them for their expertise, diligence and

enthusiasm during the transition phase. I would also like to note the substantial contribution from Board members, especially in establishing and completing the rulebook which represented a major piece of work.

Special thanks are due, too, to the many industry players the Commission has worked with during the period including participants, advisory groups and service providers. With the continued assistance of the industry and other stakeholders, the Commission will be able to find solutions that will deliver a reliable, efficient, fair, and environmentally sustainable electricity system to the people of New Zealand.

The Commission will maintain the highest ethical standards. It is committed to being an open, consistent and transparent regulator. It will limit intervention to those occasions when it is necessary to preserve or enhance the wholesale and retail markets' ability to serve consumers.



Good working relations with major energy users are key to the Commission establishing sound governance and oversight of the electricity industry. Here, the Commission's senior adviser reserve energy, Gari Bickers, right, discusses a draft discussion paper on tender design for procuring reserve energy options with Ralph Matthes of the Major Electricity Users' Group.

Roy Hemmingway
Chair



Electricity Governance Rules Committee

The Commission inherited a set of rules from the electricity industry's self-governing arrangements which existed prior to its establishment. The Commission has been charged with developing those rules to ensure the best conditions exist for workable and effective competition and to ensure that the government's other objectives for the electricity sector are met.

The creation of effective electricity regulations and rules is a core function of the Commission. This led to the establishment of the Commission's first committee, the Electricity Governance Rules (EGR) Committee.

The committee is responsible for:

- initial fact-finding on rule breaches;
- formal investigations into rule breaches;
- oversight of the informal settlement process;
- recommending to the Commission that alleged rule breaches be referred to the Rulings Panel;
- granting of exemptions; and
- advancing minor rule changes.

During the committee's first few months it has taken a pragmatic approach to compliance, issuing warning letters to market participants over minor breaches rather than instigating formal investigations for matters with minimal or no market impact. The committee considered this approach appropriate during the transition from contract-based rules to a new mandatory regime. The committee also took a pragmatic approach to a number of requests for short-term exemptions to help market participants adjust to the new rules.

Members of the EGR Committee are Commission members Christine Southey (chair) and Roy Hemmingway.

Electricity governance rulebook

The electricity governance rulebook replaced a number of industry arrangements which previously governed the wholesale market and aspects of the retail market, and provided for the establishment and delivery of grid security in real time.

The rules set out various market-participant responsibilities, the Commission's duties and responsibilities as well as processes for a number of decisions relating to Transpower and the transmission grid. Parts A, C, D, E, G, H and I, relating to interpretation, common quality, ancillary services,



metering arrangements, registry information and customer switching, reconciliation, transport, trading, pricing, dispatch, clearing and settlement, and transition, were approved by the Minister of Energy on 18 December 2003 and took effect on 1 March 2004. Part F, dealing with transmission issues only, came into force in May 2004.

The Commission maintains the rulebook, which supports the operation of the electricity market. Administration of the rules is a significant part of its day-to-day workload. The Commission is responsible for ensuring market participants comply with regulations and rules, such as real-time co-ordination of the grid and guidelines on connecting generators. The Commission now has the ability to grant exemptions, consider applications under the rules and make rule changes to enhance the workability of market arrangements as necessary. The Commission and participants will work to improve the rulebook to reduce compliance and transition costs and to improve market systems.

Electricity Governance Rules 2003

Part A – interpretation of the rules and regulations.

Part B – reserved for future use.

Part C – common quality, in particular, concerning the principal performance obligations of the system

operator, the performance obligations of asset owners, arrangements concerning ancillary services and technical codes.

Part D – obligations of market participants in relation to metering standards including the handling of meter readings. The accuracy of meters and the integrity of the data obtained from meters underpin the market transactions.

Part E – management of the processes and the information required to enable consumers to switch between competing retailers.

Part F – governing the establishment of transmission agreements between Transpower and its customers, the framework for assessing and appointing (or not) transmission investment, the processes for developing and approving a transmission pricing methodology and provision for the development of Financial Transmission Rights (FTRs).

Part G – trading, dispatch, and setting of wholesale prices and reconciliation.

Part H – maintain adequate levels of security and the settlement of the sale and purchase of electricity and ancillary services.

Section I – interim dispensations, existing quality agreements, existing ancillary service arrangements and the process for transition from MARIA and NZEM.

The Electricity Commission is committed to working with national grid operator Transpower, lines companies, electricity retailers and high-load customers to minimise the prospect of power shortages during periods of high demand. This has already worked effectively in the upper South Island earlier this year. The Commission's statutory duty is to ensure that electricity is produced and delivered to all classes of consumers in an efficient, fair, reliable and environmentally sustainable manner.



Bringing certainty to the upper South Island – a case study in collaboration

When it became apparent earlier this year that winter power cuts were possible in the upper South Island, the Commission and Transpower worked closely with lines companies, electricity retailers and high-load customers to minimise the prospect of power shortages in the region.

The result was the creation of a plan to maintain system security in light of a potential shortage of transmission capacity during peak winter loads in the region.

The Commission's function in the electricity industry is one of governance, not operation, and in these circumstances it acted as facilitator. Its involvement was in keeping with its statutory duty to ensure that electricity is produced and delivered to all classes of consumers in an efficient, fair, reliable and environmentally sustainable manner.

The plan to ease the load was based on measures that could be taken in times of peak load, typically between 5pm and 7pm, weekdays.

These included:

- full ripple control of water-heating by lines companies;
- additional use of customer-owned generation;
- maximising output of existing generators;
- switching Timaru to service from other transmission lines so that it did not add to the upper South Island load;
- adding capacitors to at least one local network;
- inducing some high-load customers to reduce demand; and
- adding 'intertrip' devices to allow lines to carry power above capacity with greater certainty of supply.

While the transmission capacity was sufficient to deal with normal peak demands, it could have been tested in a severe weather event. Achieving a good outcome in this situation required input from many parties including Transpower, local distribution companies, retailers and high-load customers. The Commission was pleased with the co-ordination that was achieved and the substantial contribution made by all parties working together.

The operation of an efficient and transparent retail market is vital to maintaining public and participant confidence in the electricity sector. The Commission considered the creation of the Retail Market Advisory Group essential to meet that need. Among its many functions, this group considers and develops rule changes relating to the reconciliation of retail market meter readings, the obligations of market participants in relation to metering standards and the system for customer switching.

Pictured here, the Commission's senior adviser retail, Robert Reilly, seated, second from right, discusses issues with members of the advisory group. Also seated, from left are: Bill Heaps, independent chair; John Pask, Federated Farmers of New Zealand; Peter Rutledge, Grey Power; Bridget Wall, M-co; John van Brink, Vector Ltd; Jacinda Papps, M-co; Vince Hawksworth, Genesis Energy. Standing, from left are: Anne Herrington, Smart Power Ltd; Paul Doocey, Consumers' Institute; Phil Hawkey, NGC Holdings Ltd.



Review of operations

The Commission faced many challenges in its first nine months of operation (from September 2003 to 30 June 2004). It had to establish a competent team of staff, develop work processes, communicate effectively with industry stakeholders and the newly formed advisory groups appointed to assist in the development of market arrangements, and advise on changes to rules and regulations.

An establishment unit was set up by the Ministry of Economic Development in early 2003 to instigate the Commission. Its work, which continued through to early 2004, included the process for appointing the chair and the members of the Board, playing a key leadership role in finalising the EGRs that came into effect on 1 March 2004, and negotiating service provider agreements.

The Commission itself was established on 15 September 2003 and most of its initial staff commenced work in January and February 2004. Its approach has been to develop a small, strong core team of high-quality generalists and to use specialist contractors as required.

There has been a high demand on staff during the establishment phase. They have responded well to the

challenges of the new organisation and the urgent need to undertake key policy development tasks and to support the Board's decision-making.

Progress has been substantial though much has still to be done. The completion of the new rulebook with the Ministry of Economic Development was a substantial task, occurring at the same time that staff were being recruited and established. The significant joint effort by participants, contractors, the establishment unit, staff and service providers led to a successful changeover to the new EGRs on 1 March 2004.

The early development of a workplan was another important step in establishing the Commission's functions and building a framework for its immediate and future work. This plan sets out the Commission's intentions to address a range of key policy areas including:

- efficient use of energy and other resources;
- reliability, quality and security of electricity supply to meet the needs of all classes of electricity consumers and the needs of the economy;



Core workstreams

Wholesale market

Oversees efficient price discovery, market design (hedging, gross pod), trading arrangements, effective generation competition, downward pressure on costs and prices, secure settlement

Retail market

Effective retail competition, downward pressure on costs and prices, fair outcomes to consumers

Transmission

Efficient and equitable transmission pricing and investment and efficient generation investment

Distribution

Efficient and equitable supply and pricing, efficient distribution investment, efficient distributed generation investment

System operation

Market well co-ordinated in real time, quality of supply meets market needs, ancillary services' costs efficiently allocated

Security of supply

Market responds appropriately to dry periods, reserve generation is available to meet one-in-60 dry year, timely investment in generation

Environment

Key externalities identified and catered for, renewable supply options are encouraged, efficient consumption signalling

- reducing barriers to competition in each part of the system;
- investments required to meet consumer and economic demand need to take place in a timely and cost-effective way;
- price signals are efficient, and impacting appropriately on the behaviour of electricity participants and consumers in the short and longer term;
- maintaining downward pressure on costs and prices, within current demand and opportunities for electricity production and distribution; and
- environmentally sustainable electricity production and consumption promoted.

The priority areas for the Commission to meet government objectives and outcomes are to manage security of supply and implement reserve generation policy, work with Transpower and grid users to facilitate priority investment in the grid, improve hedge-market arrangements and demand-side participation, and promote and facilitate efficient use of electricity.

The Commission identified core workstream components of sector operations to meet its objectives and priorities. Each workstream is led by a senior staff adviser, assisted by senior staff for 'environment', 'modelling' and 'market governance'. The workstreams are wholesale market, retail market, distribution, transmission, system operation, security of supply, and environment.

Although the work programme has been structured into distinct workstreams, many of the issues facing



The Commission's brief includes fostering efficient electricity markets. Here the Commission's senior adviser wholesale, Tim Street, discusses operational issues with Shelley Nixon of M-co, which provides clearing manager services.

the Commission overlap. The inter-relationships include connections between:

- enforcement and exemptions and rule changes to improve market compliance;
- competition and generation investment and pricing predictability; and
- electricity efficiency and new investment in transmission or generation infrastructure.

The Commission is responsible for the management of service providers. It has contracted a number of organisations to provide the necessary services to run the electricity market on a day-to-day basis (*see Appendix 1*). The cost of these contracts is a substantial part of the Commission's budget.

The Commission has also appointed a number of industry, consumer and independent representatives to its advisory groups, who provide a wide range of input to many of the Commission's activities. These groups meet regularly with the Commission's senior managers on matters of wholesale and retail markets, common quality, transmission, transmission pricing, security of supply, and hedge-market development (*see Appendix 2*).

The speed with which the advisory groups have been able to assist the Commission is most welcome. The Board and staff have found the strong contributions from these groups useful in completing analyses and formulating recommendations. The advisory groups also have adapted quickly to presenting a broad range of comment and making recommendations on rule-change matters.

Looking forward, the Commission's workplan contains several milestones that can only be regarded as 'stretch goals'. This is particularly the case in the transmission workstream. There are major potential investments to be considered and careful attention to due process is equally important in achieving the deadlines for a grid upgrade plan and associated tasks.



The Common Quality Advisory Group provides advice to the Commission on power quality standards (frequency and voltage) for electricity supply, and standards and policy for the minute-by-minute operation of the power system. Advisory group members need to draw on detailed technical knowledge of the power industry so the legislation and regulations governing the Commission's activities meet the government's objectives and participants' needs.

Pictured here, Darryl Renner, the Commission's senior adviser common quality, seated, extreme right, considers points raised by members of the group. Also seated, from left: Bronwyn Ward, market administrator, M-co; John Clarke, system operator, Transpower; Tracey Bywater, market administrator, M-co; Adam Fletcher, Mighty River Power Ltd; Chris Ewers, Meridian Energy Ltd. Standing, from left: Toby Stevenson, independent chair; Terrence Currie, independent consultant; Mike Collis, Commission adviser.

The smooth start of market and system operations on 1 March 2004 was a reflection of the professionalism and dedication of the Board, staff, contractors, advisory groups, service providers and many others during the establishment phase. The current year, 2004/05, will be no less demanding.

Handwritten signature of Mervyn English.

Mervyn English
General Manager

Statement of service performance

This section reports on actual achievement against performance targets contained in the 2003–2006 Statement of Intent.

a) Commission establishment

Quantity, quality and timeliness

<i>Performance measures</i>	<i>Target</i>	<i>Performance achieved</i>
Development of a Commission work programme by 31 January 2004.	Meet target.	<ul style="list-style-type: none"> • Target met.
Memoranda of understanding with the Energy Efficiency and Conservation Authority (EECA) and Commerce Commission initiated.		<ul style="list-style-type: none"> • Core document with EECA is largely complete. • Commerce Commission document is work in progress.

b) Recommendations on electricity governance rules

Quantity

<i>Performance measures</i>	<i>Target</i>	<i>Performance achieved</i>
Rule changes are processed in response to issues raised by participants.	Five rule changes processed.	<ul style="list-style-type: none"> • Initial rule change process effective. • Four rule changes completed. • 23 exemptions considered. • 12 exemptions granted.

Quality

<i>Performance measures</i>	<i>Target</i>	<i>Performance achieved</i>
Rule-change process complies with requirements in legislation and Government Policy Statement on electricity governance.	In all cases.	<ul style="list-style-type: none"> • Rule-change procedures are robust and meet legislative and policy requirements. • Requirements of the Electricity and Gas Industries Act, which came into law in October 2004, are ready to be incorporated. • Procedures will be constantly reviewed.

Timeliness

<i>Performance measures</i>	<i>Target</i>	<i>Performance achieved</i>
Rule changes are processed within timetables set to reflect the relative importance and urgency of the issue.	In all cases.	<ul style="list-style-type: none"> • Rule-change timing is driven by the requirements of the Electricity Act, as amended, and regulations, including the requirement for consultation on all but urgent issues. • Regular reporting to the Electricity Governance Rules Committee ensures that the Commission remains confident all rule-change processes are progressing according to internally agreed priorities.

c) Monitoring and enforcement

Quantity, quality and timeliness

<i>Performance measures</i>	<i>Target</i>	<i>Performance achieved</i>
Alleged breaches reviewed and decisions made as to whether or not they should be investigated in accordance with agreed standards and timeframes.	In all cases.	<ul style="list-style-type: none"> • The Commission has been notified of 123 alleged breaches. • The EGR Committee has referred nine of these breaches for further investigation. • Of the remaining, 82 have been resolved (the majority by written warning).

d) Monitoring and enforcement – Rulings Panel

Quantity, quality and timeliness

Performance measures

Rulings Panel established by 30 April 2004 in accordance with requirements in regulations.

Target

Meet target.

Performance achieved

- Target met.
- The Rulings Panel has not yet been requested to consider a formal complaint.

e) Market operations

Quantity

Performance measures

Service provider contracts required under the EGRs are in place by 31 December 2003.

Market begins operating under the EGRs on 1 March 2004.

Target

Meet target.

Performance achieved

- Target met.

Quality

Performance measures

Service providers meet quality requirements that are set out in their agreements.

Target

Meet quality requirements in all cases.

Performance achieved

- System operations – the system operator is meeting the quality targets of the principal performance obligations.
- Retail operations – the registry and the reconciliation manager are meeting the quality requirements.
- Wholesale operations – the performance standards for the clearing manager, the pricing manager and the information system were not set for the reporting period to 30 June 2004. However, their performance has been satisfactory.
- Market administration – the performance standards for the market administrator were not set for the reporting period to 30 June 2004. However, their performance in supporting advisory groups has been good. They have been flexible in addressing ad hoc requirements and satisfactory in support of the EGR Committee as well as the rule-breach process.

Timeliness

Performance measures

Service providers meet timeframe requirements that are set out in their agreements.

Target

Meet timeframe in all cases.

Performance achieved

- The system operator has met the timeframe requirements.
- The registry and switching manager and the reconciliation manager have met the timeframe requirements.
- The clearing manager, the pricing manager and the information system have met the timeframe requirements.
- The market administrator has met the timeframe requirements.

Total cost of output – \$18,858,781 (budget – \$29,850,000) GST inclusive.





Financial report

Statement of responsibility

We acknowledge responsibility for the preparation of these financial statements and for the judgements used in them.

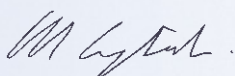
We acknowledge responsibility for establishing and maintaining a system of internal control designed to provide reasonable assurance as to the integrity and reliability of the Commission's financial reporting.

In our opinion these financial statements reflect fairly the financial position and operations of the Commission for the period ended 30 June 2004.



Roy Hemmingway
Chair

28 October 2004



Mervyn English
General Manager

28 October 2004

Statement of funding

As a Crown entity, the Electricity Commission is funded by an appropriation from Parliament, recovered by way of a levy on the electricity industry. The Commission is responsible for the allocation of that money. It sets and reviews its priorities carefully to ensure the money is used to best advantage in terms of its commitments under the Electricity Act 1992, as amended.

The timetable for setting up the Commission necessitated that the draft budget be determined on the basis of estimates by the Ministry of Economic Development before the Commission was established, before its roles were fully defined, and before it was known when the Commission would assume full responsibility for oversight of the electricity market. For these reasons, there are understandable variances between the original budget and the actual revenue and expenditure.

Most of the Commission's budget (about 70 per cent) is spent on service provider agreements. These agreements are with Transpower (the system operator) which is contracted to manage the electricity system in real time, and with a number of other companies which administer the electricity market. This expenditure by the Commission, and other spending concerned with the management of the market, replicates that which was previously recovered from industry participants through voluntary arrangements or through Transpower's connection agreements. The Commission was pleased it was able to negotiate new service provider contracts that were within the estimated budget. It has also brought in a number of changes that will result in further economies in the coming year.

The Commission's spending on external advice was initially higher than anticipated. This was because, during the time its staff were being recruited, the Commission judged it prudent to use external contractors to help meet the challenging targets set in the interim Government Policy Statement.

Electricity Commission levy

The cost of the Commission carrying out its functions and duties will be recovered from industry participants by way of a levy.

The Commission's costs are allocated to four activity groups (system operations, market operations, registry and switching, and other activities) and these are allocated across three participant classes (generators, purchasers and line owners). The mechanism for doing this is set out in the Electricity (Levy of Industry Participants) Regulations 2004 (regulations).

The volumes of electricity generated, purchased and conveyed and/or the number of consumer connections (installation control points (ICPs)) are then used to allocate each cost pool to individual participants.

The Commission is required to estimate its costs, the electricity volumes and the number of consumer connections at the start of each financial year. From this it calculates estimated levy rates which are gazetted and posted onto its website.

Each month, industry participants are invoiced for their share of the levy. This is based on the gazetted rates and the actual volumes and the number of consumer connections for that month.

The regulations contain provisions to allow the Commission to amend rates to recognise significant changes in actual costs, volumes or number of consumer connections, compared with its estimates. In addition, there is a mechanism to allow a final reconciliation using audited accounts and actual volumes and number of consumer connections. Special provisions were included for the current financial period of the Commission's activities, ending 30 June 2004.

Financial statements

Statement of financial performance

for the period ended 30 June 2004

	Note reference	Actual 2003/04 \$	Budget 2003/04 \$	Variance 2003/04 \$
Revenue				
Crown		18,533,333	26,533,333	(8,000,000)
Third-party		71,671	–	71,671
Total revenue		18,605,004	26,533,333	(7,928,329)
Costs				
Personnel (including training)		1,235,612	1,510,281	274,669
External advice		2,595,716	1,330,000	(1,265,716)
Service provider contracts		11,808,582	22,249,000	10,440,418
Occupancy		137,372	186,303	48,931
Travel		75,128	246,235	171,107
Commissioners' fees	10	621,000	600,000	(21,000)
Rulings Panel		11,375	90,000	78,625
Audit fees		24,200	–	(24,200)
Other operating costs		193,240	202,129	8,889
Depreciation		61,136	99,818	38,682
Total expenses		16,763,361	26,513,766	9,750,405
Capital charge		–	19,567	19,567
Surplus/(Deficit)		1,841,643	–	1,841,643

Statement of movements in equity

for the period ended 30 June 2004

Opening balance	–	–
Surplus/(Deficit)	1,841,643	–
Total recognised revenues and expenses for the period	1,841,643	–
Plus capital contribution		
– fixed assets	449,000	449,000
Plus capital contribution		
– working capital	420,000	420,000
Payable to Crown	(1,841,643)	–
Closing balance	869,000	869,000

The accompanying notes and accounting policies form an integral part of the financial statements.

Statement of financial position

as at 30 June 2004

	Note reference	Actual at 30 June 2004 \$	Budget at 30 June 2004 \$
Taxpayers' funds		869,000	869,000
Represented by:			
<i>Current assets</i>			
Bank		6,861,456	50,000
Short-term investments		–	4,386,000
Debtors/Prepayments	4	92,927	14,000
Debtor – Crown		–	4,843,000
		6,954,383	9,293,000
<i>Fixed assets</i>	1		
Cost			
– leased assets		33,253	–
– other assets		369,907	449,000
Less depreciation			
– leased assets		2,956	–
– other assets		58,180	99,818
		342,024	349,182
Total assets		7,296,407	9,642,182
<i>Current liabilities</i>			
Payables	2	240,570	3,799,000
GST payable	2	612,419	–
Employee entitlements	3	33,419	–
Accruals	2	3,668,518	131,182
Creditor – Crown		1,841,643	4,843,000
Leased-asset liability		10,290	–
		6,406,859	8,773,182
<i>Term liabilities</i>			
Leased-asset liability		20,548	–
		20,548	–
Total liabilities		6,427,407	8,773,182
Net assets employed		869,000	869,000

The accompanying notes and accounting policies form an integral part of the financial statements.

Statement of cash flows

for the period ended 30 June 2004

	Actual 2003/04 \$	Budget 2003/04 \$
Cash flows from operating activities		
<i>Cash provided from supply of outputs to:</i>		
Crown funding	18,533,333	26,533,333
Third-party income	71,671	–
	18,605,004	26,533,333
<i>Cash dispersed to cost of producing outputs:</i>		
Payments to employees	(1,202,193)	(1,510,281)
Payments to suppliers	(11,637,125)	(20,707,052)
Net GST	612,420	(300,000)
	(12,226,898)	(22,517,333)
Net cash flows from operating activities	6,378,106	4,016,000
Cash flows from investing activities		
<i>Cash dispersed to:</i>		
Purchase of physical assets	(372,322)	(449,000)
Net cash flows from investing activities	(372,322)	(449,000)
Cash flows from financing activities		
<i>Cash provided from:</i>		
Capital contributions	869,000	869,000
<i>Cash dispersed to:</i>		
Rental bond	(13,328)	–
Net cash flows from financing activities	855,672	869,000
Net increase/(decrease) in cash held	6,861,456	4,436,000
Opening total cash balances at 15 September	–	–
Closing total cash balances at 30 June	6,861,456	4,436,000

The accompanying notes and accounting policies form an integral part of the financial statements.

Statement of contingent liabilities

as at 30 June 2004

The Commission has no known contingent liabilities or assets and no known guarantees given under section 59 of the Public Finance Act 1989.

Statement of commitments

as at 30 June 2004

The Commission has a lease on office premises in Wellington. The period of the lease is from 22 October 2003 to 21 November 2005.

	30 June 2004 \$
Operating lease commitments	
Not later than one year	172,583
Later than one year but not later than two years	73,959
Total lease commitments	246,542
Service provider contract commitments	
Not later than one year	33,747,250
Later than one year but not later than two years	27,863,333
Later than two years but not later than five years	64,104,000
Total service provider commitments	125,714,583

Notes to the financial statements

1. Fixed assets

	Cost 30 June 2004	Current year depreciation 30 June 2004	Accumulated depreciation 30 June 2004	Net book value 30 June 2004
	\$	\$	\$	\$
Leasehold improvements	123,087	37,461	37,461	85,626
Furniture and fittings	98,959	6,470	6,470	92,489
Office equipment	26,842	2,028	2,028	24,814
Computer hardware	111,718	11,659	11,659	100,059
Computer software	9,301	562	562	8,739
Leased assets	33,253	2,956	2,956	30,297
Total fixed assets	403,160	61,136	61,136	342,024

2. Accounts payable

	30 June 2004
	\$
Service providers	2,883,901
Other trade creditors and accruals	1,025,187
GST	612,419
Total accounts payable	4,521,507

3. Employee entitlements

	30 June 2004
	\$
Annual leave	33,419
Total employee entitlements	33,419

4. Debtors and prepayments

	30 June 2004
	\$
Debtors	14,462
Prepayments	77,321
PAYE and withholding tax	1,144
Total debtors and prepayments	92,927

5. Short-term deposits

As at balance date the Commission held no short-term deposits.

6. Remuneration

No employees received remuneration and other benefits of \$100,000 or more in the current financial period. The Commission was established on 15 September 2003 and most of its initial staff commenced in January and February 2004. On an annualised basis the following numbers of employees would receive remuneration and other benefits of \$100,000 or more.

Salary band	Employees
100,000 – 109,999	2
120,000 – 129,999	1
130,000 – 139,999	3
150,000 – 159,999	2
190,000 – 199,999	1
220,000 – 229,999	1
	<hr/>
	10

The general manager's annual remuneration and benefits are in the \$190,000 to \$199,999 band. The general manager's remuneration for the reporting period was less than \$100,000.

7. Related-party transactions

The Commission is a wholly owned entity of the Crown. The government transparently sets the policy requirements to guide the Commission's roles as well as being a major source of revenue.

The Commission enters into transactions with government departments, crown agencies and state-owned enterprises. These transactions are not considered to be related-party transactions.

8. Financial instruments

The Commission is party to financial-instrument arrangements as part of its everyday operations. These financial instruments include bank accounts, accounts receivable and accounts payable.

Credit risk

Credit risk is the risk that a third party will default on its obligations to the Commission, causing the Commission to incur a loss.

In the normal course of business, the Commission incurs credit risk from financial institutions.

The Commission does not require collateral or other security to support financial instruments with credit risk, as the Commission deals with financial institutions that have high credit ratings. The Commission does not have significant concentrations of credit risk.

Fair value

The fair value of all financial instruments is equivalent to the carrying amount disclosed in the statement of financial position.

Currency and interest-rate risk

Currency risk is the risk that debtors and creditors due in foreign currency will fluctuate because of changes in foreign exchange rates. The Commission has no significant exposure to currency risk on its financial instruments. Interest-rate risk is the risk that the Commission's return on any funds it has invested and the cost of borrowed funds will fluctuate due to changes in market interest rates. Under section 46 of the Public Finance Act, the Commission cannot raise a loan without ministerial approval and all such loans have ministerial approval. (Accordingly, there is no interest-rate exposure on funds borrowed.)

9. Post-balance date events

The Electricity and Gas Industries Bill passed into law on 17 October 2004. The Bill amended the Electricity Act by adding to and clarifying the Commission's responsibilities and authorities. There were no other significant events that occurred between 30 June 2004 and the date of signing the financial statements, which could materially affect the financial statements.

10. Fees

The following fees were paid to and earned by Commission members.

	30 June 2004
	\$
L. H. Hemmingway (annual fee is \$300,000)	240,000
D. C. Close	52,000
D. G. Dell	60,500
P. S. Harris	54,000
G. C. Pinnell	90,000
C. B. Southey	124,500
Total fees paid	621,000

Note: varying fees reflect, in part, differing responsibilities among Commission members.

11. Reconciliation of the net operating surplus to net cash flows

	Actual 2003/04
	\$
Net operating surplus	1,841,643
<i>Add non-cash items:</i>	
Depreciation	61,136
Total non-cash items	61,136
<i>Add/(Less) movements in working capital items:</i>	
(Increase)/Decrease in debtors and prepayments	(79,599)
Increase/(Decrease) in accounts payable and accruals	4,521,507
Increase/(Decrease) in employee entitlements	33,419
	4,475,327
Net cash flow from operating activities	6,378,106

Statement of accounting policies

Reporting entity

The Commission is a Crown entity as listed in the fourth schedule of the Public Finance Act 1989.

These financial statements have been prepared in accordance with section 41 of the Public Finance Act 1989.

Accounting period

These financial statements record the financial performance of the Commission for the period from the date of establishment on 15 September 2003 to 30 June 2004. As these are the first statements for the Commission there are no comparative figures.

Measurement system

These financial statements have been prepared on an historical cost basis.

Particular accounting policies

The following particular accounting policies, which materially affect the measurement of financial performance and financial position, have been applied consistently.

a) Budget figures

The same policies are used for budgets as for the actual amounts in these financial statements.

b) Receivables

Receivables are recorded at estimated realisable value, after providing for doubtful debts.

c) Fixed assets

All fixed assets costing \$1,000 (excluding GST) or more are capitalised and recorded at historical cost.

d) Depreciation

Depreciation of fixed assets is provided on a straight-line basis, so as to allocate the depreciable amount of assets over their useful lives. The depreciable amount is the historical cost or revalued amount, less the residual value. The estimated useful lives are:

Computer equipment and software	3 years
Furniture and fittings	5 years
Office equipment	5 years
Leasehold improvements	Fully depreciated by November 2005

All assets are assumed to have no residual value.

The cost of leasehold improvements is capitalised and depreciated over the unexpired period of the lease.

Capital work in progress is recognised as costs are incurred. Depreciation is not recorded until the asset is fully operational.

e) Gains/Losses on fixed assets

Realised gains and losses arising from the disposal or sale of physical assets are recognised in the statement of financial performance in the period in which the transaction occurs.

f) Provision for employee entitlements

Provision is made in respect of the Commission's liability for annual leave. Annual leave is recognised as it accrues to employees at current rates of pay.

g) Taxation

The Commission, as an institution of the Crown, is not required to pay income tax. The Commission is subject to fringe benefit tax (FBT), goods and services tax (GST) and pay-as-you-earn tax (PAYE).

h) Revenue recognition

Revenue is derived through the provision of outputs to the Crown, from services to third parties and from interest on deposits. Such revenue is recognised when earned and is reported in the financial period to which it relates.

i) Goods and Services Tax (GST)

The statement of financial position is exclusive of GST, except for payables and receivables which are GST inclusive. All other statements are GST exclusive.

The amount of GST owing to or from the Inland Revenue Department at balance date, being the difference between output GST and input GST, is included in payables or receivables (as appropriate).

j) Leases

Where the lessor retains all the risks and rewards incident to ownership, these leases are classified as operating leases. Operating-lease costs are recognised on a systematic basis over the period of the lease.

Finance leases are where the risks and rewards incident to ownership are substantially transferred to the lessee. Finance leases are accounted for in accordance with the Institute of Chartered Accountants of New Zealand's Statement of Standard Accounting Practice No. 18 (SSAP18).

k) Financial instruments

The Commission is party to financial instruments as part of its normal operations. These financial instruments include bank accounts, short-term deposits, receivables and payables.

Except for those items covered by a separate accounting policy all financial instruments are shown at their estimated fair value.

l) Statement of cash flows

The following are definitions of the terms used in the statement of cash flows:

- cash means coins, notes, current accounts and short-term deposits;
- investing activities are those activities relating to the acquisition and disposal of non-current assets;
- financing activities comprise changes in the capital structure; and
- operating activities include all transactions and other events that are not investing or financing activities.

m) Cost allocation

For the 2003/04 financial period all Commission costs relate to one output class, thus no allocation is required.

Direct costs are those attributable to outputs on the basis of resource consumption. Costs which bear no direct relationship to outputs are classified as indirect. For the Commission these indirect costs are confined to corporate overheads.

n) Taxpayers' funds

This is the Crown's net investment in the Crown entity.

Changes in accounting policies

These accounting policies for the 2003/04 financial period are the first set of policies prepared by the Commission.

Audit report to the readers of the Electricity Commission's financial statements

for the period ended 30 June 2004

The Auditor-General is the auditor of the Electricity Commission. The Auditor-General has appointed me, John O'Connell, using the staff and resources of Audit New Zealand, to carry out the audit of the financial statements of the Electricity Commission, on his behalf, for the period ended 30 June 2004.

Unqualified opinion

In our opinion the financial statements of the Electricity Commission on pages 22 to 37:

- comply with generally accepted accounting practice in New Zealand; and
- fairly reflect:
 - the Electricity Commission's financial position as at 30 June 2004;
 - the results of its operations and cash flows for the period ended on that date; and
 - its service-performance achievements measured against the performance targets adopted for the period ended on that date.

The audit was completed on 28 October 2004, and is the date at which our opinion is expressed.

The basis of the opinion is explained below. In addition, we outline the responsibilities of the Board and the Auditor, and explain our independence.

Basis of opinion

We carried out the audit in accordance with the Auditor-General's Auditing Standards, which incorporate the New Zealand Auditing Standards.

We planned and performed our audit to obtain all the information and explanations we considered necessary in order to obtain reasonable assurance that the financial statements did not have material misstatements, whether caused by fraud or error.

Material misstatements are differences or omissions of amounts and disclosures that would affect a reader's overall understanding of the financial statements. If we had found material misstatements that were not corrected, we would have referred to them in the opinion.

Our audit involved performing procedures to test the information presented in the financial statements. We assessed the results of those procedures in forming our opinion.

Audit procedures generally include:

- determining whether significant financial and management controls are working and can be relied on to produce complete and accurate data;
- verifying samples of transactions and account balances;
- performing analyses to identify anomalies in the reported data;
- reviewing significant estimates and judgements made by the Board;
- confirming year-end balances;
- determining whether accounting policies are appropriate and consistently applied; and
- determining whether all financial statement disclosures are adequate.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements.

We evaluated the overall adequacy of the presentation of information in the financial statements.

We obtained all the information and explanations we required to support the opinion above.

Responsibilities of the Board and the Auditor

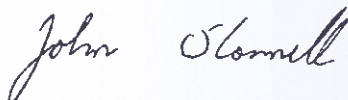
The Board is responsible for preparing financial statements in accordance with generally accepted accounting practice in New Zealand. Those financial statements must fairly reflect the financial position of the Electricity Commission as at 30 June 2004. They must also reflect fairly the results of its operations and cash flows and service-performance achievements for the period ended on that date. The Board's responsibilities arise from the Public Finance Act 1989, the Electricity Amendment Act 2001 and the Electricity Amendment Act 2004.

We are responsible for expressing an independent opinion on the financial statements and reporting that opinion to you. This responsibility arises from section 15 of the Public Audit Act 2001 and section 43(1) of the Public Finance Act 1989.

Independence

When carrying out the audit we followed the independence requirements of the Auditor-General, which incorporate the independence requirements of the Institute of Chartered Accountants of New Zealand.

Other than the audit we have no relationship with or interests in the Electricity Commission.



John O'Connell
Audit New Zealand

On behalf of the Auditor-General
Wellington, New Zealand

Matters relating to the electronic presentation of the audited financial statements

This audit report relates to the financial statements of the Electricity Commission for the period ended 30 June 2004 included on the Electricity Commission's website. The Commission is responsible for the maintenance and integrity of the Electricity Commission's website. We have not been engaged to report on the integrity of the Electricity Commission's website. We accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

We have not been engaged to report on any other electronic versions of the Electricity Commission's financial statements, and accept no responsibility for any changes that may have occurred to electronic versions of the financial statements published on other websites and/or published by other electronic means.

The audit report refers only to the financial statements named above. It does not provide an opinion on any other information which may have been hyperlinked to/from these financial statements. If readers of this report are concerned with the inherent risks arising from electronic data communication they should refer to the published hard copy of the audited financial statements and related audit report dated 28 October 2004 to confirm the information included in the audited financial statements presented on this website.

Legislation in New Zealand governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Compliance with good-employer obligations

The Commission is aware of its obligations to:

- operate a personnel policy that complies with the principle of being a good employer; and
- report on its compliance with the policy (including its equal employment opportunities programme in its annual report, and its obligations to recognise the aims, aspirations, employment requirements and the need for involvement of Māori as employees).

The Commission was established in September 2003 and is in the process of developing its personnel policy including its obligations to establish an equal employment opportunities programme and to meet its obligations to Māori as employees. Accordingly, it is unable to report on compliance with that programme in this annual report. However, the Commission is confident that its personnel administration over this initial period has complied with good practice.

Appendix 1

Service providers

The Commission has contracted a number of service providers, which operate under individual agreements as agreed with the Commission, to enable the supervision and integrity of New Zealand's electricity markets. Most agreements have a term that is reviewed and in some cases put up for tender at the end of the term.

The service providers' roles are:

- Clearing manager – responsible for monitoring prudential security requirements, and invoicing and settling electricity and ancillary service payments.
- Information system – the software system required by the rules to transfer information between participants, especially the uploading of bids and offers.
- Market administrator – provides services to the Commission including operational administration under the rules, rule-change administration and analysis, education and advisory services, and enforcement (the way these services are delivered will change after 1 December 2004).
- Pricing manager – calculates and publishes final prices.
- Reconciliation manager – facilitates the monthly reconciliation process and is responsible for reconciling metering data against a register of contracts.

- Registry – manages the database that identifies every point of electricity connection enabling energy flows between retailers to be reconciled. The registry also informs retailers when a customer switches supplier.
- System operator – responsible for scheduling and dispatching electricity in a manner that avoids cascade failure of the power system.

Further information about service providers is on the Commission website: www.electricitycommission.govt.nz/operations/providers/index.html

Appendix 2

Advisory groups

The Commission has appointed a number of industry, consumer and independent representatives, in accordance with its charter, to its standing advisory groups to advise and assist with its tasks in the operation of the Electricity Governance Regulations and Rules and other policy matters. These groups provide advice and report the extent to which their respective advice meets or is consistent with the:

- Electricity Act;
- Government Policy Statement on electricity governance;
- Commission's principal objectives; and
- objectives of specific tasks.

The advisory groups and their terms of reference are:

Common Quality (CQAG)

- Considers and advises, as requested, on any common quality standards developments (amendments to part C of the rulebook or related arrangements) under consideration by the Commission.
- Provides technical advice and industry expertise as requested in the preparation of the system operator policy statement and procurement plan, interfacing with the system operator as required.
- Provides input to a longer-term review of common quality direction to be undertaken.
- Provides advice as requested regarding any general issues arising from the Commission's oversight of the common quality arrangements and system operation.
- Chair and six Commission-appointed members from participant nominees, and the Commission's senior adviser system operations and common quality.

Hedge Market Development

- Provides advice to the Commission on the development and implementation of a transparent and liquid electricity hedge market.
- Provides comment as necessary to advisory groups whose work impacts on the operation of the electricity hedge market.
- Chair and six Commission-appointed members from participant nominees and the Commission's senior adviser wholesale.

Retail Market (RMAG)

- Considers and develops rule change proposals affecting parts B, D, E and section VI and schedules G7 and G8 of part G of the rulebook as determined by the workplan.
- Provides comment as necessary to advisory groups whose work impacts on the operation of the retail market.
- Chair and nine Commission-appointed members from participant nominees, and the Commission's senior adviser retail.

Security (SAG)

- Provides advice on how the Commission may use reasonable endeavours to ensure security of supply in a one-in-60 dry year (without assuming any demand reduction from emergency campaigns) while minimising distortions to the normal operation of the electricity market.
- Provides comment as necessary to advisory groups whose work impacts on the operation of the security policy.
- Chair and eight Commission-appointed members and the Commission's senior adviser reserve energy.

Transmission (TAG)

- Provides comment and advice on key policy development areas of part F of the rulebook, as determined by the workplan, including input to the grid investment test, grid reliability standards, grid planning assumptions, Statements of Opportunities, transmission alternatives and the transmission pricing methodology.
- Provides comment to advisory groups whose work impacts on transmission.
- Chair and nine Commission-appointed members from participant nominees, and the Commission's senior adviser transmission.

Transmission Pricing (TPAG)

- Provides advice on transmission pricing methodology proposed by Transpower.
- Provides comment as necessary to advisory groups whose work impacts on transmission pricing issues.
- Chair and six Commission-appointed members and the Commission's senior adviser transmission.

Wholesale Market (WMAG)

- Considers and develops rule change proposals affecting part G (excluding sections VI and schedules G7 and G8 of part G) and part H of the rulebook.
- Provides comment as necessary to advisory groups whose work impacts on the operation of the wholesale market.
- Chair and six Commission-appointed members and the Commission's senior adviser wholesale.

Further information about each advisory group can be found on the Commission website: www.electricitycommission.govt.nz/advisory/index.html

Glossary

Act

Electricity Act 1992, as amended from time to time. The 2001 and 2004 amendments of the Electricity Act (Electricity Amendment Act 2001 and Electricity Amendment Act 2004) directly relate to the Commission and the EGRs.

Advisory group

The six advisory groups appointed by the Commission to assist in the development of market arrangements, and to advise on changes to the regulations and rules. The advisory groups are wholesale market, retail market, common quality, transmission, transmission pricing, and security. In addition, a Hedge Market Development Steering Group has been formed.

Ancillary service

The system operator has contracts with generators, customers, retailers and distributors to provide ancillary services, which comprise black start, over-frequency reserve, frequency-keeping reserve (also known as frequency-regulating service), instantaneous reserve and voltage support. The system operator obtains instantaneous reserve on a half-hourly basis through the market.

Appropriation

Money voted by Parliament to fund the operations of a government department or agency.

Audit New Zealand

The state auditor which audits the Electricity Commission's accounts.

Board

The Electricity Commission Board established under subpart 1 of part 15 of the Electricity Act. It is composed of six Commissioners, being an executive chair, and five members, who have been appointed by the Minister of Energy to oversee the governance, operation and development of New Zealand's electricity industry.

Carbon charge

A low-level government tax aimed at reducing greenhouse gas emissions to meet New Zealand's international climate-change obligations.

Clearing manager

The service provider responsible for monitoring prudential security requirements, and invoicing and settling electricity and ancillary service payments.

Common Quality Advisory Group (CQAG)

The advisory group that provides to the Commission:

- advice on any common quality standards development;
- technical advice and expertise regarding the system operator's policy statement and procurement plan;
- input to the review of common quality direction; and
- advice as requested on issues arising from the Commission's oversight of the common quality arrangements and system operation.

Consumer

An electricity user.

Crown entity

A government-owned organisation directly accountable to the government of the day.

Demand-side initiative

An initiative that encourages or facilitates electricity consumers to modify their usage in a way that reduces consumption in a specific time period or shifts consumption from one time period to another.

Distributor

A company that owns or operates the lines which transport electricity on local low-voltage networks (also called a lines company). Distributor also refers to the lines that distribute electricity to or from the grid.

Electricity Act 1992 (Act)

The Act, as amended by later Acts, that regulates the New Zealand electricity industry, and under which the Commission operates.

Electricity Amendment Act 2004 (EAA)

Enacted in October 2004, it added to and clarified the Commission's responsibilities and authorities. The changes were part of a package of government policy announcements made at the time the Commission was formed.

Electricity Commission

The Electricity Commission established under subpart 1 of part 15 of the Electricity Act; also known as the Commission.

Electricity Complaints Commission

The Electricity Complaints Commission is a separate organisation from the Electricity Commission. It provides consumers with a free and independent dispute resolution service for complaints about their electricity lines or retail company.

Contact the Electricity Complaints Commission on:
phone 0800 22 33 40
fax 0800 22 33 47
email info@electricitycomplaints.co.nz

Or visit their website at:
www.electricitycomplaints.co.nz.

Electricity Governance Regulations and Rules (EGRs)

The Electricity Governance Regulations 2003 and the Electricity Governance Rules 2003 under which the electricity markets have operated since 1 March 2004.

- The **Regulations** include provisions relating to service provider agreements, undesirable trading situations, rules breaches and exemptions, the proceedings of the Rulings Panel, and appeals from decisions by the Commission or the Rulings Panel.
- The **Rules** set out various authorities and responsibilities of the Commission to carry out market and system governance functions, as well as to make a number of decisions on Transpower and the transmission grid (part F of the EGRs). These rules (parts A, B, C, D, E, G, H and I) were approved by the Minister of Energy on 18 December 2003, and took effect on 1 March 2004. Part F, dealing with transmission issues only, came into force on 28 May 2004.

Electricity Networks Association (ENA)

The organisation that represents the interests of the electricity lines companies (also referred to as distributors).

Energy Efficiency and Conservation Authority (EECA)

The organisation established under section 20 of the Energy Efficiency Conservation Act 2000. It promotes energy efficiency, energy conservation and renewable energy.

Financial Transmission Rights (FTRs)

A financial risk management product that protects against price risks arising from transmission losses and constraints.

Generator

A company that generates electricity connected to the grid or a local network.

Government energy policy

The government's objectives and outcomes for the energy sector, spelled out in the case of the Commission in the Government Policy Statement (GPS) on electricity governance.

Government Policy Statement (GPS) on electricity governance

A document that specifies the Minister of Energy's set objectives and outcomes the government wants the Commission to give effect to on the governance of the electricity industry, and against which the Commission must report and be examined accordingly.

Grid

The high-voltage electricity transmission network, which transmits electricity throughout New Zealand over more than 12,000km of transmission lines, from generators to distributors and major industrial users. It is also referred to as the national grid and is owned by state-owned enterprise, Transpower.

Grid upgrade plan

Plan for expansions, replacements and upgrades to the high-voltage transmission network, or national grid, that transmits electricity throughout the country.

Hedge Contract

A financial risk management product that protects against price risks associated with the spot price of electricity.

Hedge Market Development Steering Group (HMDSG)

The advisory group that:

- provides advice to the Commission on the development and implementation of a transparent and liquid electricity hedge market; and
- provides comment as necessary to advisory groups whose work impacts on the operation of the electricity hedge market.

Information system

The software system required by the rules to transfer information between participants, especially the uploading of bids and offers.

Installation control point (ICP)

A point of connection on a local network or an embedded network which the distributor nominates as the point at which a retailer will be deemed to supply electricity to a consumer.

Intermittent generation

Generation for which the source is intermittent and not easily predicted, e.g., wind or wave generation.

Levy

A charge on an industry or consumers to fund a specific service or set of services. The Commission is funded by levies on the electricity industry.

Lines company

A company that owns the lines which transport electricity on local low-voltage networks (also called distribution companies or distributors).

Major Electricity Users' Group (MEUG)

The professional lobby group that represents major electricity users.

Market administrator

The service provider that provides a number of services to the Commission, including operational administration under the rules, rule-change administration and analysis, education and advisory services, and enforcement. The way these services are delivered is to change after 1 December 2004.

Metering and Reconciliation Information Agreement (MARIA)

The agreement that, until 1 March 2004, governed all aspects of the metering and reconciliation process under bilateral trading arrangements.

National grid

The transmission network that transports high-voltage electricity from the major power stations to the local distribution networks operated by lines companies. It is also known as the grid and is owned by state-owned enterprise, Transpower.

New Zealand Electricity Market (NZEM)

The multi-party trading arrangement under which, until 1 March 2004, the majority of New Zealand's wholesale electricity was bought and sold.

One-in-60 dry year

A year in which there is a hydro drought of the severity that can be expected to occur every 60 years. The duration and timing of such an event will determine whether it has implications for security of supply.

Participant

Participants as defined under the Regulations, who engage with the Commission, include the following groups:

- electricity retailers;
- electricity distributors;
- electricity generators;
- line owners;
- electricity consumers connected directly to the grid;
- people who purchase electricity from the clearing manager;
- service providers;
- metering equipment owners;
- ancillary service agents;
- data administrators; and
- payee generators, ancillary service agents, and the system operator in relation to payment for ancillary service administrative costs.

Pricing manager

The service provider responsible for calculating and publishing final prices.

Principal objective

The principal objective of the Electricity Act 1992, as amended, is to ensure that electricity is generated, produced and delivered to all classes of consumers in an efficient, fair, reliable and environmentally sustainable manner. The Commission is committed to this objective and is also required to promote and facilitate the efficient use of electricity.

Reconciliation

The process of matching the electricity supplied to customers by individual retailers with actual demand at a grid exit point.

Reconciliation manager

The service provider that facilitates the monthly reconciliation process and is responsible for reconciling metering data against a register of contracts and passing the data to participants.

Registry

The database that identifies every point of electricity connection using an installation control point (ICP) reference, enabling energy flows between retailers to be reconciled. The registry also informs retailers and other participants when a customer switches supplier.

Regulations

The Electricity Governance Regulations 2003 as amended from time to time in accordance with the Electricity Act 1992.

Regulator

Government-appointed body or individual that sets rules and conditions for the orderly running of an industry or service. The Commission is the regulator of the electricity industry.

Reserve energy

Back-up energy supplies that can be produced to maintain frequency in the event of a generation or transmission line outage, dry year or a civil emergency.

Retail Market Advisory Group (RMAG)

The advisory group that:

- considers and develops rule change proposals affecting parts B, D and E of the rulebook; and
- provides comment as necessary to advisory groups whose work impacts on the operation of the retail market.

Retailer

A company that sells electricity to customers.

Rule breach

A rule breach occurs when a participant fails to meet its obligations under the Electricity Governance Regulations and Rules.

Rules

Electricity Governance Rules 2003 as amended from time to time in accordance with the Electricity Act 1992 (including codes of practice and technical codes).

Rulings Panel

The Rulings Panel deals with formal complaints or alleged breaches of the Electricity Governance Rules by participants in the market that are referred to it by the Commission. If it upholds a complaint, it has a number of options available including imposing penalties

against participants, awarding costs or compensation, issuing suspension or termination orders, and recommending rule changes. It also determines certain disputes between participants and can hear appeals on specific decisions made by the system operator.

Security Advisory Group (SAG)

The advisory group that provides advice to the Commission about how it may use reasonable endeavours to ensure security of supply in a one-in-60 dry year, without assuming a demand reduction from emergency campaigns while minimising distortions to the normal operation of the electricity market.

Service provider

The Commission contracts a number of service providers who operate under individual agreements with the Commission. Service providers currently contracted are:

- system operator;
- reconciliation manager;
- market administrator;
- information system provider;
- clearing manager;
- pricing manager; and
- registry.

Spot market

The buying and selling of wholesale electricity is done via a 'pool', where electricity generators offer electricity to the market and retailers bid to buy the electricity. This market is called the spot or physical wholesale market.

Statement of Intent (SOI)

The guiding document for a public sector body outlining its objectives, performance targets and means of delivery against government policy.

Statement of Opportunities (SOO)

The Commission is required to publish Statement of Opportunities (SOO) to enable the identification of potential opportunities for efficient management of the grid, including investment in upgrades and transmission alternatives.

System operator

The service provider responsible for scheduling and dispatching electricity, in a manner that avoids fluctuations in frequency or disruption of supply.

Transmission Advisory Group (TAG)

The advisory group that:

- provides comment and advice on key policy development areas of part F of the rulebook, as determined by the workplan, including input to the grid investment test, grid reliability standards, grid planning assumptions, Statements of Opportunities, transmission alternatives and the transmission pricing methodology; and
- provides comment as necessary to advisory groups whose work impacts on transmission.

Transmission Pricing Advisory Group (TPAG)

The advisory group that:

- provides advice on the transmission pricing methodology proposed by Transpower;
- considers and develops rule change proposals affecting sections IV and V of part F of the rulebook as determined by the workplan; and
- provides comment as necessary to advisory groups whose work impacts on transmission pricing issues.

Transpower

The state-owned enterprise which owns and operates the high-voltage transmission network (the national grid).

Undesirable trading situation (UTS)

An undesirable trading situation arises when there is a threat to orderly trading on the wholesale market or settlement that cannot otherwise be resolved satisfactorily under the rules. The Commission is able to investigate any potential UTS and can take actions as it considers appropriate, including suspending rule requirements and imposing new requirements on participants.

Wholesale Market Advisory Group (WMAG)

The advisory group that:

- considers and develops rule change proposals affecting part G (trading, pricing, dispatch, wholesale reconciliation) and part H (settlement and security rules) of the rulebook as determined by the workplan; and
- provides comment as necessary to advisory groups whose work impacts on the operation of the wholesale market.

Work programme/workplan

The workplan and the work programme set out the Commission's intentions on strategy, capability and performance (over the next three years), prioritised to meet policy objectives in the 2004/05 financial year.

Workstreams

The categories into which the Commission has divided its main functions, namely:

- market operations (wholesale and retail markets, system operation and common quality);
- policy and market design (development of market rules to enhance competition in wholesale and retail markets);
- reserve energy (including generation and demand-side options);
- transmission (benchmark contracts, grid reliability standards, pricing methodology, approval (or not) of new grid investments and facilitation of alternatives to transmission);
- supply and demand modelling and forecasting; and
- electricity efficiency.

Electricity Commission management team

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Transmission

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