MAJOR ELECTRICITY USERS' GROUP

24 November 2015

Androula Dometakis
General Manager Corporate Services
Electricity Authority

By email to submisisons@ea.govt.nz

Dear Androula

Consultation paper – 2016/17 appropriations

1. This is a submission by the Major Electricity Users' Group (MEUG) on the joint Electricity Authority (EA) and EECA consultation paper[1] "2016/17 Levy-funded appropriations, Electricity Authority work programme, and EECA work programme", 13th October 2015. MEUG has made a separate submission to EECA on their proposal. MEUG members have been consulted in the preparation of this submission. This submission is not confidential.

2. MEUG supports the EA's aggregate proposed level of appropriations for 2016/17 of $76.037m for electricity industry governance and market operations and contingent appropriations for the multi-year appropriation for security management of $6m for 2012/13 to 2016/17 and $0.444m for the electricity litigation fund.

3. On the details of the budget and draft work programme MEUG members are:

   a) Appreciative of the 33.7% (-$4.535m) decrease relative to the 2015/16 appropriation for service provider costs other than the System Operator and a commitment to keep the Authority's operating expenses constant nominal at $18.729m.

   b) Disappointed that System Operator costs will increase by $4.372m (+10.5%). MEUG understands the importance and complexity of the work by the System Operator as evidenced by the information paper[2] published along with the levy consultation paper. Nevertheless MEUG recommend the EA ensure the new System Operator Service Provider Agreement (SOSPA) sets a WACC commensurate with the relative risks incurred and or incentive required to innovate and not just use the WACC set by the Commerce Commission for the grid owner. For example if the System Operator bears no risk except counterparty risk then the WACC should be equivalent to a 3 year risk free rate to match the 3 year Capital Recovery Factor period plus any debt margin for the riskiness of the government as counterparty.

[1] Refer web page http://www.ea.govt.nz/about-us/corporate-projects/201617-planning-and-reporting/consultation/#c15604, URL http://www.ea.govt.nz/dmsdocument/19972

[2] Ibid web page, URL http://www.ea.govt.nz/dmsdocument/19971

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The System Operator information paper does not describe how operating costs going forward will be recovered under SOSPA though we assume the annual CPI adjustments will be removed. As noted in MEUG's submission last year "Nowadays service provider contracts would unlikely to include automatically indexed price increases. We encourage the EA and System Operator when re-negotiating a new SOSPA to come into effect 1st July 2015 to put the arrangement on a more commercial footing."

c) Supports the proposed new project "review risk management incentives" (p36 of the levy paper) and reference in the description of that project to reviewing various arrangements including the stress test.

d) Notes that apart from the one new proposed project in c) above all of the other 28 projects listed in appendix C for the proposed 2016/17 work programme are carried over from the current year. This is good news in so far as there are no surprises in the overall strategic direction and priorities of the EA. This probably reflects the increasing complexity and inter-connectedness of projects. The EA should continue to undertake quality analysis to underpin its decisions subject to not delaying decisions that are becoming increasingly important as market participants make their own investment and operating decisions.

A prime example of the risks of delaying critical decisions is the impact of concluding the review of the Transmission pricing methodology (TPM). With the re-jigging of major thermal supply currently underway and critical decisions required in 2016 particularly on whether a commercial arrangement can be put in place to extend the life of the Huntly Rankine units beyond the end of 2018; participants need certainty on TPM as early as possible.

4. We look forward to viewing the final work programme for 2016/17 in July next year.

Yours sincerely

Ralph Matthes
Executive Director