Major Electricity Users' Group

3 December 2019

James Stevenson-Wallace
Chief Executive
Electricity Authority
By email to appropriations@ea.govt.nz

Dear James

Consultation Paper – 2020/21 Appropriations

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Authority (EA) consultation paper, 2020/21 Levy-funded appropriations, 5th November 2019.[1]

2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Some members may make separate submissions.

3. MEUG supports the proposed expenditure for 2020/21 comprising:

   - Electricity industry governance and market operations appropriation of $76.936m.

     This is $2m more than the 2019/20 budget. The additional $2m is for the incremental costs of implementing decisions stemming from government decisions following publication of the final Electricity Price Review (EPR) report. We agree this increment is appropriate for 2020/21. This agreement should not be assumed to carry forward to 2021/22.

     We note from page 8 and have been supportive of the already Cabinet approved budget of $3m for RTP implementation in 2021/22 and out years.

   - Continuing the current 5-year (July 2017 to June 2022) contingent appropriation for managing the security of electricity supply of $6m.

   - Continuing the contingent electricity litigation fund of up to $1m.

[1] https://www.ea.govt.nz/dmsdocument/25991-2020-21-levy-funded-appropriations-consultation

4. This year the draft appropriations has not included an indicative work program because the Authority are developing a new strategy development process to reset the current strategy set in 2013. We appreciated the briefing you and Rob Bernau provided MEUG members on that process at the MEUG meeting on 20th November. We have since had discussions with James Tipping on ways to effectively engage with MEUG members over the next few months on the new strategy development process. We agree the timing for conducting this over the next 6-months is appropriate and therefore consulting now on an indicative work programme would be premature.

5. While an indicative work programme was not published, the consultation paper helpfully included table 3 on page 9 titled "Existing work programme items likely to continue into 2020/21." Three observations follow:

   a) MEUG is about to start preparing our annual strategic plan for next year starting 1st April 2020. From an initial analysis we see no gaps in key topics we are planning for within the scope of the Authority and those listed in table 3 or elsewhere in the consultation paper. The latter reference to elsewhere in the consultation paper refers to MEUG's key topics list for this year and likely next year to include an overarching topic for "security of supply." There is no security of supply work programme listed in table 3 in section 3 (electricity industry governance and market operations) because it is partly discussed in section 4 of the consultation paper on managing the security of New Zealand's electricity supply.

   b) The following current work programmes (in the order listed in table 3), all of which are expected to carry over into 2020/21, are intended to improve competition in the spot and hedge markets.[2] Comments on each are listed below the topic descriptions with more general comments at the end of this list:

      i) Participation of new generating technologies in the wholesale market.

         This is closely related to work following the EPR report on "are there barriers to renewables in the wholesale market?" discussed in subparagraph iii) below. There may be value in combining both these work programmes.

      ii) Hedge market enhancements.

         Yesterday we submitted on the Hedge Market Enhancement (HME) paper on market making. We intend to stay closely engaged on the HME work.

      iii) Are there barriers to renewables in the wholesale market?

         A balanced view on identifying and removing barriers to new generation is needed because some new renewable generation supplies will require back-up non-renewable generation to meet both reliability and low-cost objectives.

[2] This is a list of work that is intended to directly improve competition in upstream markets. Indirect or secondary effects on competition in upstream markets will also be attributable to work on TPM.

In other words, barriers to both renewable and non-renewable generation need to be considered because both types of generation will be needed to achieve a low-cost outcome and both types of generation case challenges given uncertainties of future technology and climate change effects.

iv) Review of spot market trading conduct provisions.

v) Wholesale market information disclosure.

The description of this work could be expanded for 2020/21 to include adding more published analysis in addition to improving the information data sets the Authority collects and publishes. For example in the Market Making consultation paper we welcome the the consideration of how "to better shine a light on its work" on the routine monitoring of pricing when market participants are net pivotal, "that is, when their generation is required to meet demand and they have a financial incentive to raise prices, given their overall market position, taking into account their contracted sales and hedge positions."[3] More of that type of analysis is needed.

For example, monitoring should be extended to include trading period by trading period, where opportunism has been observed from time to time, i.e. moving beyond whether there is a potential code compliance issue, to testing whether the code is appropriate under stressed market conditions.

Changing the header to include the text underlined as follows would reflect this suggested change "Wholesale market information disclosure <u>and analysis</u>."

vi) RTP implementation.

MEUG is supportive of this work as noted in bullet point 1, paragraph 3 of this submission.

All the above are useful but what is missing is a view on the materiality of market power inhibiting competition to ensure there are no gaps or overlaps in various work programmes and use of other available metrics on market power. The Authority analyses and publishes Herfindahl-Hirschman Indices (HHI) for all the upstream competitive energy and ancillary services markets. HHI are helpful but give no estimate of excessive economic profits.

The Authority has tools such as the Doasa model that can compare actual short-run outcomes for a hydro-dominated market with predicted optimal solutions from an all-knowing central planner.[4] What's missing in the Authority's tool-kit is the output that an Economic Value Added (EVA) analysis might shed on the perennial question of whether the large suppliers have been making sustained excessive profits?

[3] https://www.ea.govt.nz/dmsdocument/26019-hedge-market-enhancements-discussion-paper.

[4] www.emi.ea.govt.nz/wholesale/tools/Doasa

The EPR, in our view, glossed over the question of excess economic profits. Decisions stemming from the EPR final report to make generator-retailers release information about the profitability of their retailing activities, and monitor contract prices and new generation costs more closely do not directly estimate economic profits over time.

We propose to discuss the comments above with EA staff on the various work programmes intended to improve spot and hedge competition after the Commerce Commission final report on the Retail Fuel Market study is published on 5th December. Use of EVA for that study, which is akin to assessing if the electricity supply industry collectively has been earning excess economic profits, was suggested by MEUG and independently by Garth Ireland or Ireland, Wallace & Associates.[5]

c) Throughout the discussion paper are phrases such as "decarbonisation challenges", "a transition to a low-emissions economy" and "preparing for a low-carbon future." Those phrases encompass two themes.

First, an expectation that electrification of the economy will grow and that will bring challenges of more infrastructure and cost, and reliability as some renewables are variable. As noted in paragraph 5. B) iii) above the future will need both renewable and non-renewable generation. Literally de-carbonising the electricity sector may be counter-productive to the wider aim of adapting at least cost the whole economy to climate change effects.

Second, a wider government programme to transform the economy through a managed transition.

The former is directly within the scope of the Authority and the latter needs to be considered but is not within the primary jurisdiction of the Authority. MEUG suggests using "climate change challenges" might be a more neutral phrase and would clearly encompass the physical generation supply and electricity infrastructure build challenges the Authority's programme should focus on.

6. We welcome an opportunity to discuss any aspect of this submission.

Yours sincerely

Ralph Matthes
Executive Director

[5] https://comcom.govt.nz/about-us/our-role/competition-studies/fuel-market-study