Lumley House
3-11 Hunter Street
PO Box 1925
Wellington 6001
New Zealand

Tel: 04 496-6555
Fax: 04 496-6550
www.businessnz.org.nz

8 October 2010

Mervyn English
General Manager
% Submissions Administrator
Electricity Commission
Level 7, ASB Tower
PO Box 10041
WELLINGTON 6143

via e-mail: submissions@electricitycommission.govt.nz

Dear Mervyn

Customer Compensation Schemes

Business New Zealand is pleased to have the opportunity to provide a submission to the Electricity Commission on its consultation paper entitled 'Customer Compensation Schemes' dated 7 September, 2010.[1]

Introduction

Consistent with the view set out in its submission to the Ministerial Review of Electricity Market Performance, BusinessNZ supports the introduction of this scheme.[2] However, BusinessNZ is increasingly concerned that as this process progresses, the analysis is becoming more and more disconnected from the initial reason for it – removing access to a 'social hedge'.

Specific Comments

Therefore BusinessNZ wishes to comment on a number of specific matters. These are (in no particular order of preference):

1. despite two previous consultation rounds canvassing this issue (including the Ministerial Review) BusinessNZ remains unclear about the extent to which there is a clear analytical line of sight between the market failure (an ability to socialise costs on to third parties who are

---

[1] Background information on Business New Zealand is attached in Appendix One.

[2] BusinessNZ submission to the Ministry of Economic Development entitled 'Improving Electricity Market Performance', dated 16 September, 2009, page 7

not best placed to manage them), and the compensation scheme as the best means of addressing it. Interestingly, while the Electricity Commission lists four options in section 4.3 of the consultation paper as “Other reasonably practicable options” it lists three different (and in BusinessNZ’s view more likely) options in Appendix 4. The Electricity Commission states that:

> “one would expect that retailers would take steps to reduce the incidence of PCCs if they had lower cost alternatives. Possible alternatives of supply-and demand-side options could include:
>
> (a) increasing levels of hedge cover;
>
> (b) greater use of demand-side management; and
>
> (c) introduction of new tariffs that provide customers with scarcity signals, such as through variable price options supported by advanced metering technologies.[3].

BusinessNZ wonders why these were not included in the analysis set out in section 4.3;

2. the Electricity Commission attempts to draw a line between the ‘issues’ addressed by a customer compensation scheme and scarcity pricing. It is unclear why scarcity pricing, described by the Electricity Commission as follows:

   > “The primary driver of scarcity pricing is to strengthen the incentives to take action ahead of time to avoid shortages – either long term via investment *or short term via voluntary demand response* and/or plant commitment decisions.[4]
   > (emphasis added)

   does not counter-balance the desire to socialise the costs of security of supply and therefore minimise the likelihood of conservation campaigns as well as dampening the incentive to call for them. BusinessNZ considers that there may be some value in a customer compensation scheme, but only insofar as it is structured to ensure that it only impacts on those who are unwilling to make appropriate arrangements to manage risk. This implies some degree of targeting to dry-year risk profile;

3. the Electricity Commission needs to assure itself that the solution meets the rigours of the Electricity Authority’s new objective statement. BusinessNZ was, to say the least, surprised at the somewhat perfunctory dispatch of the issue of the Electricity Authority’s new objective statement in Appendix 2 (page 60) of the consultation paper.

[3] Electricity Commission consultation paper entitled ‘Customer Compensation Schemes’ page 76, paragraph A4.2.1.

[4] Op cit, page 6, footnote seven.

As noted in its submission on the Transmission Pricing Review: Stage 2 Options, BusinessNZ stated that:

> "The test is an efficiency one concerning the maximisation of consumer and supplier surplus. How the new Electricity Authority interprets its new objective statement could have significant implications for all elements of the market design programme. The Electricity Authority will need to provide certainty regarding its interpretation in fairly quick order in order to satisfy stakeholders that the options being pursued are consistent with it. BusinessNZ does not consider this to be a trivial exercise."[5]

BusinessNZ notes that the Commerce Commission would be unable to rely on such a response in meeting what is a similar test, and neither should the Electricity Commission attempt to do so;

4. to the extent that the Electricity Commission (and the Electricity Authority) is assured that a customer compensation scheme addresses a clear market failure and achieves the new legislative objective statement, simplicity of design must be its guiding touchstone. BusinessNZ continues to stand by the following statement made in its last submission on this issue:

> "Business New Zealand agrees that such a mechanism is likely to play a useful role in the overall market design, but its use or purpose should not be made more sophisticated than it is – that of a punitive tool signalling a cost to retailers of a conservation campaign."[6]

As such BusinessNZ continues to wonder about the extent to which this proposal is less about rewarding consumers as it is about providing suppliers with a blunt signal to make sure that future conservation campaigns are avoided. To this extent, the value of specified and targeted payments and the setting of pre-conditions to the payments are questionable (indeed, disproportionate to it intended effect); and

5. BusinessNZ is surprised that a discussion of the impact of the proposal on prices is relegated to an appendix (Appendix 4). Basic economics would suggest that if all retailers face the same cost, then all things being equal, all retailers will factor that cost into their prices. This is only unlikely to hold where a retailer has a lower view of the future price of new generation. Should all retailers face the cost of compensation then this risks dampening the effect of the scheme. Targeting the cost of the compensation on those who have the greatest incentive to socialise the costs to third parities could help to mitigate this effect.

---

[5] BusinessNZ submission to Electricity Commission entitled 'Transmission Pricing Review: Stage 2 Options' page 2.

[6] BusinessNZ submission to Electricity Commission entitled Scarcity Pricing and Compulsory Contracting: Options, dated 7 December 2009.

Summary

BusinessNZ considers that a broad-based consumer compensation scheme has a role to play as a measure to assist with the internalisation of the cost of managing dry-year risk. However, it is important that the Electricity Commission (and soon the Electricity Authority) assure itself (and market participants) that such a scheme is the right response, and not over engineered.

Yours sincerely

John A Carnegie
Manager, Energy, Environment and Infrastructure
Business New Zealand

APPENDIX ONE: ABOUT BUSINESS NEW ZEALAND

Encompassing four regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' & Manufacturers' Association (Central), Canterbury Employers' Chamber of Commerce, and the Otago-Southland Employers' Association), Business New Zealand is New Zealand's largest business advocacy body. Together with its 60 strong Major Companies Group, and the 70-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, Business New Zealand is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

In addition to advocacy on behalf of enterprise, Business New Zealand contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.

Business New Zealand's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services). It is widely acknowledged that consistent, sustainable growth well in excess of 4% per capita per year would be required to achieve this goal in the medium term.