Submission To:

Commerce Select Committee
Parliament Buildings
WELLINGTON

SUBMISSION ON THE

ELECTRICITY INDUSTRY BILL

Submission From:

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Mr Chairman, members of the Committee

1. Introduction

1.1. The New Zealand Manufacturers Federation Inc (ManFed) welcomes the opportunity to make this submission to the Commerce Select Committee considering the Electricity Industry Bill.

1.2. This submission is made on behalf of the New Zealand Manufacturers Federation. The Federation represents both regional associations and sector groups of manufacturers that support this submission.

1.3. ManFed has been involved in the development of a competitive electricity industry since the present reforms started well over a decade ago. The Major Electricity Users Group (MEUG) which has made significant detailed input into the reform process originated in the ManFed Energy and Environment Committee. ManFed is also involved in the Consumer Coalition on Energy (CC93) which was formed in 1993 to provide a wider base on behalf of the consumer throughout the reform process. The participants in CC93 are - ManFed, MEUG, Federated Farmers and the Consumers Institute. The fundamental purpose driving both groups has been to see the benefits of the electricity reform process delivered to the end consumer.

1.4. ManFed fully supports the submissions made by both those groups.

1.5. Manufacturing as a sector consumes large quantities of energy, the Census of Manufacturing showed $742 million being spent on electricity in 1995. With energy being such a large input into the cost structure of the manufacturing sector it is vital to the health of the sector and thus New Zealand's economy to have the benefits of the electricity reform process flowing through to the end consumer.

1.6. Much has been made of the need for New Zealand industry to be globally competitive in terms of its exports. Every opportunity must be taken to reduce the internal cost structures for exporters so that their competitive position is enhanced in global markets. Lower electricity costs for our exporters could be significant in their success or otherwise. Thus ManFed's membership is keen to see the benefits of the electricity reforms flow through to their businesses.

1.7. This Bill is the Government's response to the Ministerial Inquiry into the Electricity Industry and ManFed supports the intentions contained within it but wishes to comment on some of the provisions with the hope of a better outcome for the consumer.

1.8. ManFed notes that a good part of the Bill is intended as a "back stop" in case the electricity industry fails to establish of it's own accord suitable structures for the delivery of cost effective electricity supply at an acceptable quality (to the consumer). We support the industry initiatives provided that the consumer has and continues to have appropriate involvement in the process and the outcome is not just an imposed regime by the industry to suit the industry.

1.9. Such moves as the establishment of an effective Electricity Governance Board (with consumer input), the present Commerce Commission Inquiry and the proposed Electricity Ombudsman Scheme are supported by ManFed. While we remain hopeful of a suitable outcome from the present industry initiative we remain cautious as the history of the reforms has been one where it appears that the last group to be considered has been the one that "pays the bills" - the consumer.

2. Specific Comments

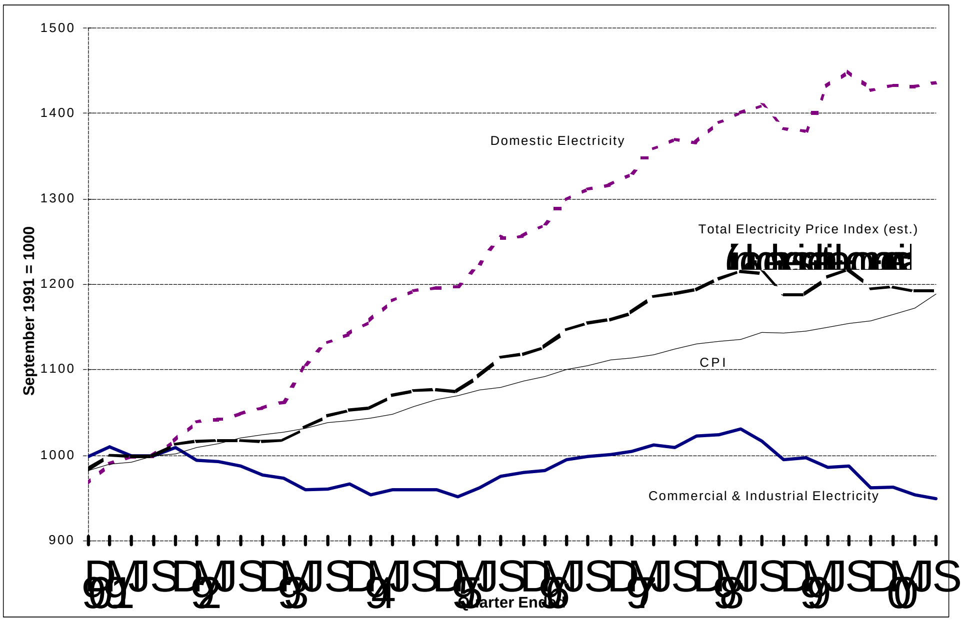
ManFed fully supports the CC93 and MEUG submissions and we would like to emphasise the following matters that are of direct interest to our membership.

2.1. The Need for Price Control

2.1.1. In spite of cost savings being made by the generation and energy companies during the reform process the consumer has yet to see much of the benefit, with the savings apparently being captured by the lines businesses.

2.1.2. Statistics NZ data tracked by ManFed shows the "Estimated Total Electricity Price Index" (Graph 1) increasing at a faster rate than the CPI. The strongest growth was during the period from 1995 to 1998, with the gap has closing since the 1998 reforms. The recent tobacco tax and oil price increases have also helped to close the gap, pushing up the CPI over the last 12 months. The estimated total electricity cost has been falling since peaking in March 1998 but is falling more slowly than the fall in generation costs

Graph 1 - Electricity Price Indexes



Percentage change between March 1998 and September 2000

Producers Price Index for generation and supply – Output prices	fell 7.8%
Commercial Electricity Prices	fell 7.3%
Domestic Electricity Prices	rose 3.4%
Estimated Total Electricity Prices	fell 1.2%

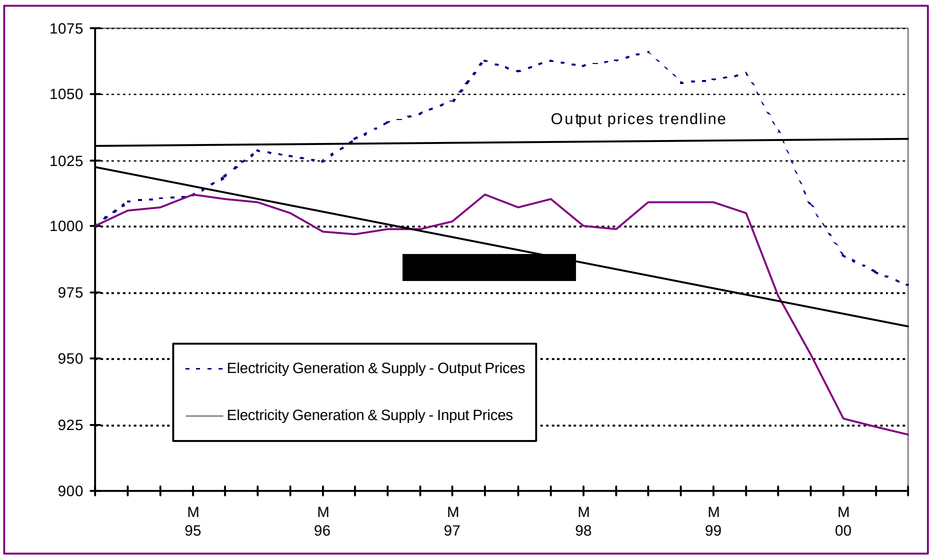
2.1.3. There are significant problems with showing more clearly differences in price trends for the retail, transmission and generation sectors. Statistics New Zealand have advised they commenced preliminary work on developing the following indexes using data collected for the producers price index:

- Generation
- Transmission
- Retail

2.1.4. Funding was not available from the Ministry of Economic Development or the Treasury for this project so work on it was stopped. We believe this work is a priority if price controls are to be introduced, as we need to be clear where the price controls are required

2.1.5. Graph 2, from the Producers Price Index (PPI) for electricity generation and supply, graphs the input and output prices for the sector (The generation and transmission components have a major share of the inputs index. In the outputs index generation has a 34% weighting, transmission 11%, commercial sales 29% and household sales 25%).

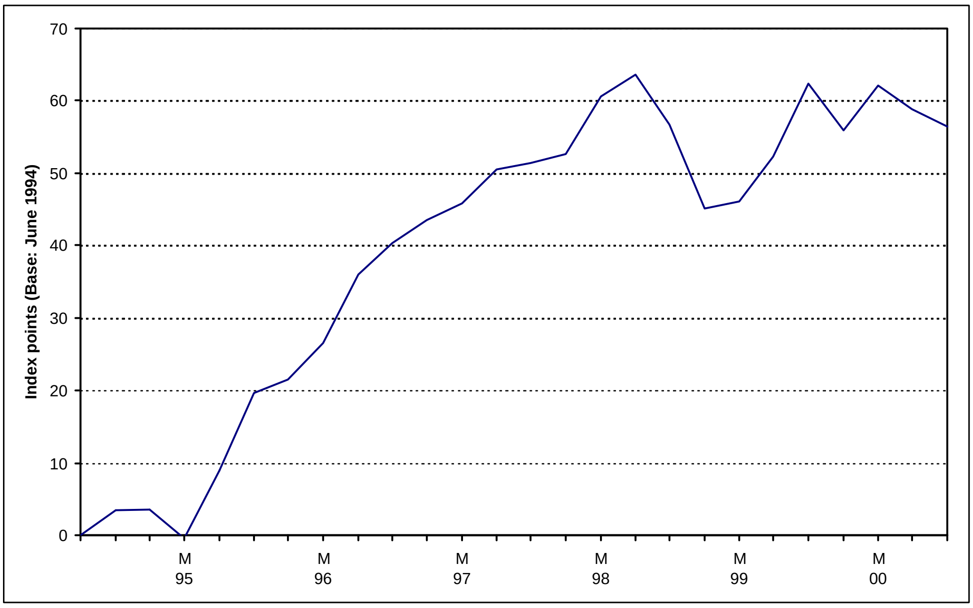
Graph 2 - Producers Price Indexes for Electricity Generation and Supply



2.1.6. Graph 3 shows the margin between Electricity Generation and Supply input and output prices. While substantial reductions have been made in input prices (with a higher weight for generation), the difference between that and the output price remains substantially constant. There have been no efficiency gains reflected through to the end consumer. If data was available separately for the generation and retail sectors we believe it would show a fall in margins for the generation sector and further margin growth in the transmission and retail sectors. The graph also shows that none of the margin growth prior to the 1998 reforms has been returned to consumers.

Graph 3 - Electricity Generation and Supply

Margin between Input and Output Prices



2.1.7. ManFed would suggest that the primary reasons for this are:

- Savings, eg when lines companies meters were sold, not being passed on;
- Lines companies seeking to earn high rates of return but avoiding all risk;
- Ever increasing asset valuations and thus the justification of higher charges.

2.1.8. From the above information ManFed sees the need for and welcomes the introduction of some form of price control contained in the Bill to allow the Commerce Commission to impose controls on monopoly lines businesses.

2.1.9. However we contend that the statistical evidence shows that monopoly rents have been and still are being extracted by the lines businesses and that an immediate form of universal incentive regulation should be imposed. ManFed recommended to the Ministerial Inquiry into the Electricity Industry that price control should be imposed in the form of incentive regulation such as an Inflation - X regime. [The typical form would be CPI - X].

2.1.10. ManFed recommends that the proposal in the Bill should require the Commerce Commission to implement such a regime. Alternatively the Commerce Commission should, at least, be given the power to determine all the available options for price control on the monopoly lines businesses. This would give end consumers a greater level of confidence that the lines businesses continue to operate with the optimum incentive to deliver the least cost electricity at agreed quality and service levels to the end consumer.

2.1.11. The Bill proposes that the Commerce Commission determine thresholds for declaration of whether a lines business could become liable for the imposition of price controls for a specified period (up to 5 years maximum). What has not yet established are the thresholds and the terms of exit (other than time) from them.

2.1.12. There is the fear that this type of price control provides little incentive to change behaviour. If this fear is realised then the effect would be to embed the present inefficiencies and cost structures and thus not achieve the desired outcomes for the consumer.

2.1.13. ManFed considers that universal incentive regulation such as CPI - X with an established method of exiting, such as an committed stakeholder agreement that includes end consumers would be a much more effective mechanism to achieve the Purpose as stated in Part 4A Subpart 1 Clause 57B. ie "*to promote the efficient operations of the markets for electricity distribution and transmission services through price control for the long-term benefit of consumers…*"

2.1.14. While we agree with the statement of purpose above regarding "…*long-term benefit…*" ManFed considers that the consumer also has a great interest in the short and medium term benefits as well. This is particularly so considering the length of time that the electricity reforms are taking with little real benefits yet to be seen by the consumer.

2.1.15. Whatever price control mechanism is imposed, there must be a requirement that any reduction in quality of supply would be the equivalent of an increase in price.

2.2. Information Disclosure

2.2.1. ManFed supports the proposal to have the Commerce Commission responsible for information disclosure. The past history of information disclosure by lines businesses has been a sorry one for consumers wishing to make informed decisions regarding their electricity supply. The ability to make comparisons has been frustrated by the inconsistencies in information disclosure returns and often an unwillingness to elaborate on disclosures on the part of the lines businesses.

2.2.2. The introduction of price controls on lines businesses will require an improvement in the information disclosed regardless of the need that consumers may have.

2.3. Lines Business ODV and Asset Valuations

2.3.1. The present valuations of the lines businesses based on ODV methodology appear to be excessive arising from a skewed interpretation of the ODV rules and a non-transparent process. A high valuation and the resultant pressure to base the business rate of return on that is one of the reasons the benefits of cost and efficiency improvements in the electricity industry have not been passed through to the end consumer.

2.3.2. The present regulatory disclosure regime does not allow for a lines company's ODV to be independently and transparently assessed for appropriateness thus allowing the present high valuations to persist.

2.3.3. Thus, ManFed welcomes the opportunity that the provisions of the Bill (Section 17 Subpart 4 Clause 57U) provide for the Commerce Commission to carry out a recalibration of every line owners system fixed assets. We also welcome the proposal to review the valuation methodologies fro system fixed assets.

2.3.4. ManFed, however, is at some loss to follow the reasoning that sees a recalibration of the lines companies prior to a review of the valuation methodologies, unless some retrospective adjustments are being proposed. ManFed would welcome any such adjustment to redress the balance for past monopoly rentals having been extracted from the consumer.

2.3.5. With the revision of the current ODV handbook we understand that there is a requirement to revalue lines assets. ManFed suggests that it would be appropriate to combine this revaluation with the transparent recalibration as proposed to be carried out by the Commerce Commission.

2.4. Powers of the Minister to Make Rules

2.4.1. The provisions contained in Clause 13 Sections 172F; G allowing the Minister to make rules that would effectively be regulations but without the same scrutiny are not supported by ManFed. There should be no need for such an open ended arrangement which by it's existence would create uncertainty in an industry that is heavily dependent on investor confidence for it's orderly development.

2.5. Existing Works and Maintenance

2.5.1. ManFed notes the Clauses 7 & 8 relating to existing works and maintenance. While we are not aware of a significant number of problems amongst the ManFed membership that these clauses are targeted towards, there are apparently major issues in rural areas that have not been resolved. ManFed recommends that these clauses be deleted from the Bill and further work be carried out to resolve the outstanding issues.

2.6. Amendments to the Electricity Reform Act 1998

2.6.1. ManFed does not support the Amendments to the Electricity Reform Act 1998 which will allow lines businesses further exemptions from installing generation [albeit from renewable sources]. This would have the effect of further diluting the split between line and energy business. ManFed believes that the deliberate intention behind the move to separate line and energy businesses was to minimise the monopolistic parts of the electricity sector. To allow the lines businesses to further re-enter the competitive trading environment would shift their focus from being the most efficient, least cost distributors of electricity.

3. Conclusions

3.1. The conclusion to the ManFed submission to the Ministerial Inquiry into the Electricity Industry included the following:

ManFed members as consumers of electricity would like to see:

- *Electricity delivered at the lowest possible price consistent with the quality of supply that is appropriate to their circumstances.*
- *This can be delivered through an electricity market where effective competition is introduced wherever possible and;*
- *Where competition is not possible effective constraints are placed on the monopolistic parts of the industry to curb the abuse of their monopoly power.*

3.2. This conclusion is still valid a year later. This submission contains many references to the fact that the end consumer has yet to see the benefits of electricity industry reform. ManFed is hopeful that the present Bill will see a greater share of the reform process being passed on.

3.3. It is pleasing to see that many of the recommendations suggested by ManFed (and MEUG and CC93) to the Ministerial Inquiry have been included in the present Bill and in initiatives currently being pursued by the industry itself. ManFed supports the general thrust of the Bill, that recognises that the light handed regulatory regime has not proved effective in ensuring that the monopoly parts of the electricity industry participate in delivering the benefits of the reform process to the consumer.

3.4. ManFed recommends that:

3.4.1. The Commerce Commission be empowered to put in place a form of universal incentive regulation such as CPI - X instead of the suggested threshold or targeted regime in the Bill.

3.4.2. Failing this then the Commerce Commission should have the power to consider all appropriate forms of price control thus giving confidence that the regime that is implemented is the solution that best meets the purpose.

3.4.3. The Minister should not have the power to make rules with the effect of a regulation without the scrutiny that a regulation would have.

3.4.4. The clauses relating to existing works and maintenance be deleted and the problems intended to be resolved by imposed regulation be dealt with elsewhere.

3.4.5. Lines businesses should not be able to re-enter the energy trading business thus diluting further the separation of line and energy business.