

*Major Electricity Users' Group (cont)*

[Hearing commences at 9.03 am]

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2  
3 **CHAIR:** Good morning. We'll start again and I'll ask MEUG to  
4 resume. Just before doing that, I just ought to say that the  
5 Commission does appreciate people's willingness to move some of  
6 these times around. I know that some of you have other  
7 commitments and there are, I think, in some cases commitments on  
8 the part of lawyers, but we're doing our best to try and fit  
9 people in keeping in mind that people who have made submissions  
10 do obviously need the opportunity to put those in full and be  
11 questioned on them.

12 So, the Commission does appreciate people's willingness to  
13 be as flexible as practicable and we'll do our best, keeping in  
14 mind, I guess, we won't save all of the people all of the time  
15 to try and cater for other people's other commitments. So, I  
16 pass it back to Mr Currie and Mr Matthes, please.

17  
18 **PRESENTATION BY**  
19 **MAJOR ELECTRICITY USERS' GROUP (Continued)**

20  
21 **MR CURRIE:** Thank you, Mr Chairman. Good morning, Commissioners.  
22 We were dealing with benefits and detriments, and I will  
23 pass the floor across to Mr Matthes.

24 **MR MATTHES:** This morning we're going to start with the claimed  
25 benefit of a lower cost of capital on page 16 of our hand-out  
26 notes from yesterday.

27 The applicant suggested that there was a net present value  
28 of about \$166 million due to a lower cost of capital should the  
29 proposal proceed versus a Crown EGB.

30 The Draft Determination divided that NPV by 10 and the EGBL  
31 has revised its estimate back to \$42 million. MEUG estimate the  
32 benefit or claimed benefit of a lower cost of capital as zero.  
33 The reason is that, in our view the applicant has only assessed  
34 change in the cost of capital for the generators and hasn't  
35 taken into account the offsetting change and the cost of capital  
36 for other sectors of the economy; because, everything else being  
37 equal, the market risk premium for the New Zealand economy as a  
38 whole will be unchanged. In other words, the equity beta --  
39 well, perhaps the equity beta for the generators may change, but  
40 there will be an offsetting change in the equity beta in other  
41 sectors of the economy, i.e. End-users.

42 I'll give you an example. When the Government was  
43 considering the break-up of ECNZ I'm sure that the people who  
44 were opposed to the break-up of ECNZ said, if you break up ECNZ  
45 the cost of capital of the baby SOEs would increase, and that's  
46 because ECNZ as a dominant market player could access equity  
47 debt at very good rates. But, if it was broken up, then those  
48 competing generators may have a higher cost of debt in equity.

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1           On the other side, of course, end-users would benefit from  
2 competition and the cost of them raising debt in equity would be  
3 lower with the break-up of ECNZ.

4 **MR CURTIN:** Could I ask a few questions about this calculation.  
5 I'm having some difficulty getting my mind around this.

6           You seem to be saying that it's almost impossible for a  
7 single sector to become more risky without some other sector  
8 having an offset in and reduction in risk, and that doesn't seem  
9 correct to me.

10 **MR MATTHES:** That is my proposition exactly. It all revolves  
11 around the New Zealand market risk premium remaining unchanged.

12 **MR CURTIN:** You took a hypothetical example of the oldest NZ. What  
13 if we took, say, airlines post -September 11? I mean, here is a  
14 sector that has arguably become riskier and it's hard to see  
15 there's any automatic offsetting improvement in risk anywhere  
16 else. [pause].

17 **MR CURRIE:** Potentially the in-house accommodation or tourist  
18 sector, which is not dependent upon the airlines for  
19 transporting its customer base; hypothetically.

20 **MR CURTIN:** I think we'll take your argument under advisement.

21 **CHAIR:** Just a question; do you know what actually happened to the  
22 cost of capital for the smaller SOEs when the split happened?

23 **MR CURRIE:** Presumably ERTU, or there must have been some monitor  
24 or survey or result as a consequence of the time ECNZ was split  
25 into, firstly -- or Contact was split off and subsequent to that  
26 ECNZ -- the rump was then split into the three baby ECNZs. So,  
27 there must actually be some empirical data around to demonstrate  
28 what happened to the market risk premium as a consequence.

29 **MR MATTHES:** There will be a market, of course, in the cost of debt  
30 that you should be able to observe.

31           I guess my argument again was that you should equally look  
32 at the cost of debt, the cost of equity for end-users; did that  
33 materially change, because they were no longer beholden to a  
34 dominant ECNZ?

35 **MS BATES:** And what information do we have to support that; is that  
36 self-evident?

37 **MR MATTHES:** No, it's not self-evident. That's my proposal.

38 **MS BATES:** No, I'm just trying to tease it out a bit.

39 **MR CURRIE:** I think we should move on, Mr Matthes.

40 **MR MATTHES:** I agree, it's a very complex area.

41           The next benefit I want to talk about is the claimed  
42 benefit of lower risk of over-investment in transmission. The  
43 original application estimated a net present value of  
44 \$85 million; the Draft Determination reduced that, EGBL said  
45 that they would accept that, but we don't believe that there is  
46 a risk of over-investment in transmission. In fact, I think  
47 we'll come on to it later on; we believe the risk is under-  
48 investment because of generator dominance or regional dominance.  
49 We had this discussion yesterday about this particular point.

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1 **MR CURTIN:** Could I just ask a question. You folks as major users  
2 obviously are probably well placed to answer this.

3 I would be interested in your perception, we've got these  
4 issues of over-investment and under-investment that have been  
5 quantified. I suppose I'd like to get your perception of the  
6 level of investment in the grid that has happened thus far.  
7 We've had a lot of evidence about whether it's inadequate,  
8 adequate, more than adequate. I'd be very interested in your  
9 perception, as major users, of the adequacy or otherwise of the  
10 level of transmission investment, and what you think the  
11 criteria have been for the amount of investment that has  
12 actually occurred.

13 **MR CURRIE:** The quick response to that -- no, we'll do a measured  
14 response to that Commissioner Curtin; is that major users, as I  
15 illustrated yesterday, have been concerned that there has been  
16 under-investment in the grid, and there has not been any  
17 significant investment in the grid, in terms of significant  
18 dollar amounts, probably for the last decade.

19 For a while it appeared that Transpower were running an  
20 infrastructural accounting approach to their core grid whereby  
21 they -- their treatment of depreciation was such that they  
22 concentrated on the core grid and the concept is, you invest  
23 enough lining to retain that core grid in sort of perpetuity or  
24 on sort of an ongoing basis.

25 That occurred, but beyond that there did not appear to be a  
26 major new investment upgrading, lengthening. I think there were  
27 some resource consent issues and access to land, and post-  
28 market -- so post-1 October 1996 -- the grid -- Transpower  
29 appears to have taken an attitude that if they make further  
30 investments in the grid that would be interfering with the  
31 market, because there will be winners and losers as a  
32 consequence of new grid capacity emerging from those  
33 investments. So, the major concern of major users has been the  
34 level of under-investment.

35 I can't think of any particular examples of over-  
36 investment, but under an ODV regime those are written out of the  
37 asset base under the economic value approach. So, there is no  
38 incentive, I would suggest, in an efficient ODV regime for a  
39 party to over-invest. They take the risk then that that  
40 investment is stranded and they cannot achieve an adequate  
41 return on it.

42 **MR MATTHES:** I think that's the reason why the parties negotiated  
43 the Part F arrangement whereby if there was a high threshold of  
44 parties who -- or beneficiaries of an investment in the grid  
45 were prepared to pay for enhancement of the grid, then there  
46 would be an immunity from the ODV standard provisions for about  
47 five years, I think it was.

48 So, I think all of that points to -- as Terrence says --  
49 the history of perception of under-investment, and Transpower

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1 perceiving that the ODV Rules was an asymmetric risk and as a  
2 result of that Part F was negotiated.

3 **MR CURTIN:** Thank you.

4 **MR MATTHES:**

5 **CHAIR:** Just a quick question, sorry. Have you supported the Part  
6 F approach?

7 **MR CURRIE:** As I indicated yesterday we strongly support Part F as  
8 a way to circuit break the dilemma of further investment in the  
9 grid. So, we are positive about Part F and we believe it will  
10 assist.

11 The concerns that major users have that I identified  
12 yesterday was that we would go another decade without the  
13 necessary investment in the grid. That would really be an  
14 enormous concern to us.

15 **CHAIR:** Thank you.

16 **MR MATTHES:** The next two benefits are relative to the previously  
17 discussed benefits, relatively small; nevertheless, I think it's  
18 worth commenting on them.

19 The applicant suggested that, with their industry EGB there  
20 would be lower transaction, compliance and lobbying costs  
21 relative to a Crown EGB.

22 We think that's incorrect. In fact, we think that there  
23 will continue to be a high level of lobbying as those who have  
24 voting rights lobby each other to trade-off their own self-  
25 interest; consumers will be lobbying the Minister to try and  
26 make sure that the overall objectives that the Minister might  
27 try and set the applicant's industry EGB are on track, so we see  
28 no difference really in terms of transactional lobbying costs.

29 **MR CURRIE:** As an observation from someone who has been providing  
30 contestable policy advice -- otherwise described as "lobbying" --  
31 -- for the last 35 years, it is unlikely that there is a -- no, I  
32 cannot determine or quantify a difference in the lobbying  
33 activities of a Crown organisation vis-a-vis an industry  
34 organisation, and I have done it once or twice.

35 **[Chairman comments off-the-record]**

36 They are, Mr Chairman, the other party to the equation. If  
37 I'm providing contestable policy advice, it's because you have  
38 given some advice or you may have given some advice earlier.

39 **MR MATTHES:** The final claimed benefit is that there will be  
40 increased competition for service provider roles with an  
41 industry EGB as opposed to a Crown EGB. We don't think that  
42 will be material at all. In our experience to date -- well, the  
43 Central Government agencies are increasingly more transparent  
44 about the way that they manage their resources; they do a lot of  
45 out-sourcing, bring in experts as needed. We've seen that this  
46 year, for example, with Dr Reid coming in to give expert advice  
47 on the FTR and allocation of loss and constraint rentals, and  
48 that was a very efficient way to manage the process.

49 If you go back and look at the way that the Ministerial  
50 Inquiry itself in 2000 was conducted, that was done with quite a

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1 bit of out-sourcing to manage the whole process. So, officials  
2 nowadays are accountable, and I can't see any reason why that  
3 would be different from an industry EGB in terms of making sure  
4 we were getting good value for money from the service providers.

5 Going to page 19, detriments. The Draft Determination  
6 identified two large detriments and MEUG in its submission on  
7 the Draft Determination suggested there were two other  
8 detriments that needed to be considered.

9 The first major detriment identified in the Draft  
10 Determination was the strike-down of pro-competitive rules. The  
11 applicant didn't observe that there was any -- sorry, didn't  
12 identify that as a detriment, but the Draft Determination  
13 certainly did.

14 The applicant in commenting on the Draft Determination came  
15 back with two options: Option 1 was, no, there is no detriment;  
16 option 2 was, well, if the Commission thinks it's a detriment  
17 then it's about half what the Commission thinks.

18 We've got some numbers there from MEUG which suggest that,  
19 it's really the direction -- what we're saying, we think that  
20 the Commission has under-estimated the potential efficiency  
21 effects of pro-competitive rules being struck down.

22 The two reasons why we think you've under-estimated that  
23 is, that the way that you have calculated the detriment in terms  
24 of demand elasticity is, I think, you have assumed price demand  
25 elasticity at average prices, when in fact the impact will be  
26 most important when prices are high and demand elasticities at  
27 high prices will be higher, in my view. Therefore, the  
28 detriment should be increased.

29 Also, the analysis of the Commission was to look at the  
30 impact on the generation market. We think also that there will  
31 be an impact in terms of strike-down of pro-competitive rules on  
32 the retail market, and I think we gave the example in our  
33 written submission of the MARIA Rules for switching, for  
34 example, not evolving to accommodate new technologies or  
35 processes in terms of faster switching for retail customers,  
36 because incumbent suppliers don't really want to go about the  
37 cost of changing, then they will be able to dominate the process  
38 on that.

39 Again, there's relatively small amounts there but we think  
40 that you have slightly under-estimated the detriment.

41 **MR CURRIE:** Just as an additional comment on the switching. I  
42 think that was a debacle for probably two and a half years as  
43 there was an attempt to develop retail customer competition.  
44 There was an opportunity for an efficient switching protocol  
45 agreed by all parties; that simply did not occur and I think  
46 there had to be a threat of regulation by the Minister with a 12  
47 month timeframe, still that deadline was not met. I think there  
48 is evidence that on areas of commercial interest, because it was  
49 certainly -- it was not in the retail's interests to encourage  
50 and simplify the customer switching process.

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1 I do concede that the restructuring of the electricity  
2 supply authorities and the removal or the separation of  
3 generation from retailing had a dramatic effect and there was  
4 the bumpy effect of companies taking on a new retail customer  
5 base.

6 Nevertheless, I think within the industry there is a  
7 recognition that they did not move as quickly as they could have  
8 on getting the customer switching protocols in place and working  
9 effectively, and the registry populated.

10 **MR CURTIN:** Thank you for that. While we're on the issue of pro-  
11 competitive rules and changes to competition or otherwise under  
12 the Rulebook, one of the larger features which we haven't really  
13 discussed very much before is the fact that bilateral physical  
14 trading would not normally be permitted for members of the  
15 Rulebook -- there are dispensations but the idea is everything  
16 through the spot market.

17 You folks as major users, presumably, have been reasonably  
18 active in bilateral or long-term supply arrangements for some of  
19 your chunkier things, and I just wondered whether we should be  
20 thinking about detriments in the loss of those trading  
21 arrangements or -- if you'd like to maybe let us know what your  
22 views are on the essential ban on bilateral trading as part of  
23 the Rulebook arrangements?

24 **MR CURRIE:** The major users or large purchasers of electricity were  
25 members of NZEM at or about -- at the time of Decision 280; I  
26 think they are listed as members of the market. Most of them  
27 within a short period of time stepped back and started using  
28 agents, either traders or one of the generator or purchaser  
29 class market participants to bypass agents for their  
30 requirements.

31 The cost impact on having to really run a 24-hour  
32 monitoring operation and do it, even though their purchasing  
33 requirements for energy may be 60, 80, \$100 million a year, they  
34 are in the business of making widgets, not necessarily wanting  
35 to set up a total -- become an electricity buyer and seller.

36 So, within a short space of time they all moved into a --  
37 the use of agents. Some of those agents traded inside NZEM,  
38 others traded around the side, and bypass. So, there was a  
39 mixture of circumstances, but at least the option was that they  
40 could obtain their physical supplies of electricity from two  
41 sources, or from several competing pools or the minor fringe  
42 pools and the main NZEM.

43 However, for risk management purposes certainly until --  
44 for the first four or five years of the market, they also were  
45 predominantly concerned with not only physical delivery but the  
46 hedge market, and the contracts for differences or the hedges in  
47 whatever shape or form they negotiated, and those contracts for  
48 differences, the hedges which have become probably the major  
49 feature, the major concern for the major users. I think they  
50 are concerned that pushing everything into an EGB Rulebook and

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1 the decline in the number of players -- because there has been a  
2 significant decline in the number of players in the market --  
3 the base from which they can access hedges, which as a  
4 consequence of 2001 clearly is dependent on a person having  
5 generation back-up. There are no independent traders or brokers  
6 standing in the market; the only people now as a consequence of  
7 the demise or the debacle that onEnergy went through in 2001,  
8 no-one stands out there as an offerer of hedge product without  
9 having the necessary physical generation capacity to back that  
10 up.

11 So, for a whole variety of reasons -- I don't want to  
12 extend the example or the answer any more than necessary -- for  
13 a whole variety of reasons the concentration of all the physical  
14 trades through the EGB pool and the decline in number of  
15 players, that is all going to concentrate power into fewer  
16 hands, and it is difficult and has been difficult for now 18  
17 months for major users, even the lower level, the smaller of the  
18 energy intensive people, to obtain hedge product at all or to  
19 get any real satisfactory replies in terms of physical delivery.  
20 Because the physical delivery side may charge a fee or, a fee or  
21 also being the agent, and the hedge products then have a  
22 different price equation about them as well.

23 So, a somewhat long reply to your question, but it is -- we  
24 want a sufficient number of generators competing to be  
25 dispatched and we want a high level of availability of hedge  
26 product, and anything which impacts or curtails that  
27 availability has an impact on our cost structures.

28 **MR CURTIN:** Thank you.

29 **MR MATTHES:** The second largest detriment identified by the  
30 Commission in the Draft Determination was the under-investment  
31 in transmission. There we have taken a bit of a ballpark  
32 approach again to the way that we might analyse it. We have  
33 suggested that the Commission, in terms of its analysis, has  
34 significantly underestimated that because if there is a risk of  
35 under-investment because of the Rulebook, then that will affect  
36 downstream investment by, for example, wood processors in New  
37 Zealand. I have to say, that's a pretty big number.

38 **MR CURTIN:** I'm sorry to be asking all the questions this morning,  
39 but on that one, going back to your original submission where  
40 you fleshed out the wool or wood issue in some more detail, I  
41 thought that was quite an interesting point. It did strike me  
42 though that if there is such a huge chunk of commercial business  
43 easily foreseeable within the timeframe of the businesses in  
44 that sector -- I hear what you say, but I'm still wondering if  
45 there's an obvious business opportunity for everybody involved,  
46 why they can't come to commercial arrangements to satisfy -- to  
47 meet that opportunity.

48 **MR MATTHES:** I agree that that is one scenario; that there will be  
49 expanded electricity sale opportunities for generators and  
50 retailers and, therefore, there won't be under-investment.

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1 But it all comes down to their margin. If they believe  
2 that they can actually constrain a region and make increased  
3 margins from their existing customer base versus, in some cases  
4 pretty slim margins from big users because that's what you'd  
5 expect, it's just a trade-off. All we're saying is, there's a  
6 risk there; maybe that number needs to be probability weighted  
7 down, but it is a risk.

8 **MR CURTIN:** Thank you.

9 **MR CURRIE:** I instanced yesterday a transmission line into the Bay  
10 of Plenty which has been constrained for 15 or 16% of the time  
11 so far this year, and one would suggest -- one would think that  
12 that would send a very high level signal to the grid operator  
13 that there should be further investment -- that further  
14 investment was required. The major users in the Bay of Plenty,  
15 which include two MEUG members, Carter Holt Harvey Limited and  
16 Norscke and Skoge, which used to be called Tasman Pulp and  
17 Paper, and TrustPower have been attempting to find a solution or  
18 get agreement for that constraint to be dealt with.

19 One would have thought, Commissioner Curtin, that there is  
20 such a clear incentive, because they may be paying 20, 30, 40%  
21 more than the national -- than the average price simply because  
22 of the nodal pricing impact of those constraints and the pricing  
23 consequences of power having to be re-routed, and several of the  
24 generators being in a loop where their generators -- you have to  
25 look at the Bay of Plenty geographical locators and the location  
26 of generators.

27 So, one would have thought that a logical outcome was  
28 therefore to have been an area of investment identified and the  
29 ready agreement of the parties. But, because of the nature of  
30 electricity, that once that investment had been made, even by,  
31 say, the two major users, the electrons will flow and one can't  
32 meter and necessarily -- one can meter, but one can't  
33 necessarily control the flow of electrons from that point on  
34 until that freeloading issue has been resolved. That has really  
35 prevented, in my opinion, that investment being made in the  
36 optimum timeframe, and I think the -- either a capacity right, a  
37 transmission capacity right, which we've been arguing about  
38 since the early 90s, or a financial transmission right, some  
39 form of hedge risk or risk management right or a physical  
40 capacity right, seems to me to be attached to new investment to  
41 ensure that the people who make that investment commit to pay  
42 over the life of the asset, can protect that investment. Part F  
43 goes a long way to achieving that and, therefore, I think Part F  
44 and the combination of a revised recalibrated and, I suppose,  
45 re-regulated ODV methodology, those two factors will, I think,  
46 address both over and under-investment in transmission.

47 **MR CURTIN:** Thank you very much.

48 **MR MATTHES:** Just coming on to paragraphs 96 to 99, which covered  
49 the two relatively small additional detriments that MEUG  
50 suggests the Commission needs to take into account.



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1           The first one is that there has been advice given to the  
2 Commission that some people will not be joining the Rulebook --  
3 I refer there to Meridian and Comalco, and no doubt there might  
4 be others -- in which case it is likely that there will be cases  
5 of quantum meruit that need to be pursued through the Courts,  
6 and we think that a detriment needs to be added to the  
7 application relative to the counterfactual. We've got a  
8 notional \$6 million NPV for that.

9 **MR CURRIE:** The industry EGB assumes the cost and it becomes the  
10 plaintiff in the case where it pursues quantum meruit on behalf  
11 of essentially the industry. So, although the relationship  
12 may -- the debt may arise as a consequence of a party remaining  
13 connected to Transpower rather than, or the grid owner -- rather  
14 than the grid owner pursuing the debt, the EGB becomes the  
15 pursuer of and seeking the remedy via quantum meruit.

16 **MR MATTHES:** The second new detriment we suggest is that quantum  
17 meruit will not be able to solve all of the issues in the  
18 industry; for example, information disclosure requirements that  
19 the system operator might need and, therefore, there will be  
20 need for further regulatory intervention, and we've assigned a  
21 cost of about \$3 million NPV for that as well.

22           Coming on to the net benefit or detriment, you will see  
23 that table there. The applicant's got big numbers which seem to  
24 have been getting bigger in the positive direction, and we've  
25 got a large negative number.

26           I'd just like to make a comment in terms of the scale of  
27 those numbers. I have had it put to me that in the whole scheme  
28 of things these numbers are relatively small compared to the  
29 turnover in the industry of about \$3 billion per year. I mean,  
30 I think it's just a case of comparing apples and oranges here.  
31 The \$3 billion per year is the cost that consumers pay for total  
32 power delivered to their houses or industrial sites. Whereas,  
33 what we say is a net present value detriment of \$146 million,  
34 the applicant says it's a benefit of \$231 million; are both net  
35 present value economic efficiency changes.

36           If you look at the way that the detriments are calculated,  
37 for example, we're talking about pricing, for example, with the  
38 detriment of under-investment in transmission. One of the  
39 detriments there was related to higher prices in regions than  
40 otherwise would have occurred. That's actually just a wealth  
41 transfer. For example, if prices over the next 10 years were 5%  
42 higher than what they should have been, that's \$150 million per  
43 year. The economic efficiency impact, of course, isn't  
44 \$150 million a year, it's just a small fraction of that because  
45 of the way that you calculate these things.

46           So, I think it's -- when people relate it to the \$3 billion  
47 that people pay in aggregate, that's not the right comparison.  
48 The way I think you should look at it is that if there was, for  
49 example, a 1% productive efficiency gain over the next 10 years,  
50 that would amount to about \$30 million per year, NPV at whatever

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1 it is, I don't know, that might be \$180 million per year; that's  
2 the sort of number that you should be comparing the benefits and  
3 detriments of this proposal relative to.

4 **CHAIR:** Nathan, did you want to ask anything here?

5 **MR STRONG:** Just in terms of what you said yesterday in regard to  
6 your preferred counterfactual, which was an industry EGB  
7 arrangement with an executive -- with the board having executive  
8 decision-making rights.

9 That would seem to solve your problem with the strike-down  
10 of pro-competitive rules relative to a Crown EGB.

11 **MR CURRIE:** Yes.

12 **MR STRONG:** But it wouldn't seem to solve your difficulties in  
13 terms of the under-investment problem, there's still the  
14 requirement for quantum meruit cases, still the requirement for  
15 further regulations where quantum meruit doesn't apply.

16 So, even in your preferred option of an industry EGB with  
17 executive decision-making powers, the Crown EGB under your  
18 benefit and detriment analysis would still seem to be  
19 preferable. I just wonder how you...

20 **MR MATTHES:** I think, if you take the quantum meruit one first,  
21 which is probably the easiest; under a CC 93 industry EGB you  
22 would have more participants than you would under the  
23 applicant's EGB, therefore the number of quantum meruit cases  
24 should be smaller; in fact, under a CC 93 Rulebook we're hoping  
25 that everyone would be in there.

26 I think there still is an issue in terms of some residual  
27 regulatory requirement to force payment, for example, or require  
28 information to be disclosed to the system operator. So, I agree  
29 that that detriment, relatively small, would apply to a Crown or  
30 a CC 93 counterfactual.

31 In terms of under-investment in the grid. Yeah, I don't  
32 know the answer to that one. It does come back to Part F, I  
33 guess. I don't know.

34 **MR CURRIE:** But you are prepared to think about it and if Nathan or  
35 the Commission staff wanted you to venture an opinion, you could  
36 do that at a later stage.

37 **MR MATTHES:** [nods head]

38 **CHAIR:** All right, thank you.

39 **MR CURRIE:** I'm conscious of time, Mr Chairman. We've moved  
40 through to key issue number 7, guiding principles, and the non-  
41 alignment of the guiding principles is a serious issue for us.  
42 I suppose when the guiding principles came out and we saw --  
43 there is very strong language in this, Mr Chairman, you're quite  
44 right -- when the guiding principles statement came out we  
45 identified almost as a touchstone the statement that the  
46 Government's overall objective is to ensure that electricity is  
47 delivered in an efficient, fair, reliable and an environmentally  
48 sustainable manner to all classes of consumers.

49 We anticipated that that would be the preamble to whatever  
50 industry Rulebook was devised. That seemed to us to be a very

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1 clear direction that whatever had happened in the past, the  
2 direction which the Government was signalling to the industry  
3 was that they are looking for efficient, fair, reliable and  
4 environmentally sustainable manner -- the electricity to be  
5 produced and delivered. And, it has been a source of intense  
6 frustration, hence the strong language in our submission to the  
7 Commission, in this area. We have simply failed and, therefore,  
8 in our sense we are -- if we just rolled over about it we have  
9 failed all consumers if we allowed that -- what we thought, this  
10 clear direction, this touchstone, to be simply eroded and  
11 watered down.

12 So, we make no apology for indicating that it is a critical  
13 area for us and we sensed -- I sensed, by participating on the  
14 Government's Working Group -- that this was from the supply side  
15 an equally important issue. There was a strong, almost outright  
16 refusal to contemplate the use of words such as "fair" and  
17 "reliable".

18 Perhaps I may have overstated and that sense of frustration  
19 has probably flowed through to the pen, but the proposition  
20 advanced by the applicant is that that primary objective,  
21 delivered in an efficient, fair and reliable -- does not mesh  
22 with the concept of guiding principles in a multilateral contact  
23 between stakeholders who have property rights. That's  
24 essentially what their explanation is, is that that primary  
25 objective cannot be translated into a set of guiding principles  
26 which these multilateral contract parties would be prepared to  
27 abide by.

28 Simply, from a consumer point of view, from a major user  
29 point of view, we had to do better and if they did not want to  
30 see it in the actual -- as a guiding principle, then it could  
31 have been included in the forward which does have a lower  
32 status, not legally binding. But even the intro in the forward  
33 is a far cry from that touchstone statement. So, it is a key  
34 issue and it is an issue which has, I think, deeply disturbed  
35 consumers in our inability to convince the participants in the  
36 process that it is appropriate and that it is possible to  
37 include, incorporate, those statements as the primary objective  
38 of a new industry EGB.

39 **MS BATES:** I'm just quite interested in that aspect of it from the  
40 point of view of, you are on the Working Group.

41 **MR CURRIE:** Yes, I was on the Governance Working Group.

42 **MS BATES:** And how many other people shared your interest in this  
43 particular topic?

44 **MR CURRIE:** The other consumer representative and one other member  
45 of the Governance Working Group, Mike Underhill, the Chief  
46 Executive of the Waikato Electricity, who happens also to be  
47 Chairman of the Energy Efficiency and Conservation Authority.  
48 He saw this as equally an important issue. I think one of their  
49 submissions, I think, did comment -- did raise this as a matter  
50 of concern.

*Major Electricity Users' Group (cont)*

1 **MS BATES:** And how much debate was there about it around the table?

2 **MR CURRIE:** It was on the agenda for probably 50 or 60% of the  
3 meetings. It was not an issue which was dealt with lightly; it  
4 was revisited time and time again. I simply am a slightly  
5 stubborn individual and did continue to insist that we turn  
6 around and have another crack at trying to get this as this  
7 touchstone into the document some way.

8 **MS BATES:** So you say, was the main stated argument against it that  
9 it was not capable of putting into Rules in a practical sense?

10 **MR CURRIE:** It was too outcome orientated, or it didn't mesh really  
11 with -- it simply didn't mesh. We raised our concerns at  
12 various stages to officials and various politicians. It was not  
13 an issue that we -- but the essential reason was -- that one  
14 could detect, is that, if one put a question of fairness or  
15 reliability as stark sort of issues, they were too difficult,  
16 they became too subjective to turn around and determine and,  
17 therefore, we needed to describe guiding principles in economic  
18 terms that could be tested under a robust efficiency arrangement  
19 and subjective matters, such as fairness and reliability, were  
20 too difficult to deal with but it was appropriate to retain  
21 efficient. So, an outcome may be efficient, it may not  
22 necessarily be fair or reliable.

23 **MS BATES:** And what was your view of that argument? Do you think  
24 that was the real reason why the principles deviated from the  
25 purpose of the Policy Statement?

26 **MR CURRIE:** In my generous moments, yes. I don't believe  
27 gentailers want to be accountable to deliver electricity in an  
28 efficient, fair, reliable and environmentally sustainable  
29 manner. I don't think they want to be accountable to that;  
30 that's too high a test.

31 I believe in terms of 172(N), I think it is of the Act,  
32 that that would become the primary objective and the touchstone  
33 for the Crown EGB.

34 Nevertheless, we would still, having -- the real  
35 significance of this primary objective, if we could get that  
36 into the industry EGB and some of the other improvements, we  
37 would still have a preference to go the industry way, but this  
38 is fundamental. I don't believe you can -- there is a simple  
39 comparison between a Crown EGB and an industry EGB absent this  
40 primary objective.

41 **MS BATES:** You talked about the possibility of putting it in as at  
42 least a preamble or a major touchstone. What was the response -  
43 - because you can do that, you can make a statement of principle  
44 without necessarily translating it into the practical Rules, but  
45 just as a philosophical touchstone, but what was the response to  
46 that?

47 **MR CURRIE:** Well, I think there was a -- sorry, I'll just need to  
48 look at the guiding principle in the Rules so I can quote to  
49 you -- in the forward. [pause]. [refers to document].

*Major Electricity Users' Group (cont)*

1 "the Rules have been prepared for the purpose of governing  
2 the arrangements between members to promote the satisfaction of  
3 consumers' electricity requirements in a manner that has least  
4 cost to the economy as a whole and is consistent with  
5 sustainable development."

6 That was the closest that we could get to achieving the  
7 primary objective. No reference to "fairness", no reference to  
8 "reliability", and "efficiency" is taken --

9 **MS BATES:** No "consumer" word there either, is there?

10 **MR CURRIE:** Oh yes, there is one; consumers are mentioned once,  
11 "satisfaction of consumers' electricity requirements", but it's  
12 dealt with in a macro, it is...

13 **MS REBSTOCK:** What bit isn't covered?

14 **MR CURRIE:** What bit isn't covered?

15 **MS REBSTOCK:** Isn't reliability an issue of efficiency?

16 **MR CURRIE:** Yes, it is possible to turn round and say simply, that  
17 forward is a reformulation, a rewording, a wordsmithing of the  
18 primary objective. But I think that from a consumer viewpoint  
19 they do see things in, sort of, efficient and fair and reliable  
20 terms; that's how they perceive; not necessarily in "least cost  
21 to the economy as a whole", they sort of personalise their  
22 requirements in terms of how electricity is delivered to them  
23 rather than thinking of it in terms of a macro sense. I think  
24 that focus is appropriate.

25 **MS REBSTOCK:** Can I just ask you, what is the practical effect of  
26 not adopting those words precisely?

27 I ask you this because the GPS applies to the industry EGB  
28 whether they wish to be accountable to the Minister for the GPS  
29 or not. It doesn't appear to matter whether it's adopted into  
30 the Rules, the Government has said through the legislation that  
31 it will be accountable for that and has set up a mechanism to do  
32 that.

33 So, what is the practical effect of this divergence in  
34 terms of what's explicitly written in the forward or anywhere  
35 else in the Rules?

36 **MR CURRIE:** I think that there is a multifaceted impact. If an  
37 organisation had as its primary objective or its vision the  
38 statement in the Government Policy Statement, that certainly  
39 means that when they set their strategic objectives for the year  
40 that will give them a sense and a purpose and a direction of  
41 where they want to go. So, it is in the agenda, it is part of  
42 their psyche then, that is the target, that is the objective  
43 they need to deliver.

44 In a practical sense each rule made or each rule changed  
45 has to be checked against how it delivers and achieves the  
46 guiding principles, and once again, if the touchstone of the  
47 guiding principles happens to be the delivery of electricity in  
48 an efficient, fair, reliable and environmentally sustainable  
49 principle, then that's the benchmark against the rule making,  
50 rule changing process.

*Major Electricity Users' Group (cont)*

1           So, in terms of meeting the performance objectives, we  
2 would think that it would have a -- would lead to a systematic  
3 evaluation of all Rules whether they are meeting, facilitating,  
4 enhancing the delivery of electricity in an efficient and  
5 reliable and fair principle.

6 **MS REBSTOCK:** I just want to pursue this a little bit further. It  
7 seems to me you are saying to us that in a sense the board will  
8 almost have a split and perhaps inconsistent accountability. To  
9 the industry it's accountable to that which it's put in the  
10 forward, but to the Minister it's accountable to the GPS; is  
11 that a fair sort of summary of what you are saying?

12 **MR CURRIE:** Yes, and that issue was raised, and I think it is an  
13 issue which has been shared by Transpower and ourselves that  
14 there is -- and it has been the subject of comment within the  
15 Working Group processes where, is there two masters? You know,  
16 is the board going to be accountable to the Minister via -- and  
17 Parliament -- via the annually negotiated performance objectives  
18 and the review and monitoring approach, and at the same time be  
19 responsible or be controlled via the industry via the Rules  
20 strike-down. So, yes, it has raised -- it has been discussed,  
21 the issue has not been resolved. From a consumer viewpoint we  
22 place, as I say, a high level of importance on this issue.

23 **MS REBSTOCK:** I just want to take this a little bit further. If --  
24 and I think it's an if, and we'll come back to whether it  
25 holds -- if there's a split accountability and what the board is  
26 accountable to the industry for and what it's accountable to the  
27 Minister for is inconsistent; in your view, how does a board in  
28 its governance role, how does it reconcile those  
29 inconsistencies?

30           And in terms of your view, what is the practical  
31 implication in terms of comparing this proposal with the  
32 counterfactual? What is the harm or the detriment that comes  
33 from this?

34 **MR MATTHES:** Perhaps just an example. Under the Rulebook common  
35 costs have to be allocated. Economic efficiency gets you only  
36 so far and then you have to have a judgment in terms of fairness  
37 or equity issues. The Rulebook doesn't say that the parties  
38 have to be fair or equitable in the allocation of those costs,  
39 whereas the GPS and the legislation does. So, there's a  
40 practical issue.

41 **MS REBSTOCK:** Can I ask you to clarify for me what you mean by  
42 "fair or equitable"? I mean, equitable is another term again,  
43 but what do you mean by that? Because, this is where I come  
44 back to, is there really a conflict between what is written in  
45 the GPS and what is written in the Rulebook? What do you mean  
46 by "fair and equitable"?

47 **MR MATTHES:** If the word "fair" isn't part of the consideration in  
48 terms of allocation of, for example, sunk costs, the parties to  
49 the Rulebook might decide to charge all of the sunk costs to

*Major Electricity Users' Group (cont)*

1 just one party. There's probably nothing inefficient about  
2 that, but it's certainly not fair.

3 **CHAIR:** I wonder whether we might just take a break now because the  
4 Chairman of the Market Surveillance Committee is here and we'll  
5 come back on this point. Where we got to is the question of a  
6 possible split of accountabilities and definitions of fair and  
7 equitable, just so we know where we're at.

8 I just leave you to think about, there are probably other  
9 Crown entities that have a similar dichotomy of accountability,  
10 maybe not quite so stark as in this one, but maybe it's worth  
11 thinking about.

12 So, if we could break for a couple of minutes while  
13 Sir Duncan comes up to the table and we'll resume when his  
14 submission has concluded.

15 **MR CURRIE:** Okay. And, I will respond.

16 **CHAIR:** Just mark where we've stopped so people are clear as to  
17 where we're at. Thank you. **[Pause]**.

18 I'd just like to welcome Sir Duncan McMullin, who is  
19 Chairman of the Market Surveillance Committee.

20 The Commission have asked him to come in this morning  
21 because we'd like to get a view on how the MSC has worked, and  
22 picking up some of the points that were made by earlier  
23 submitters in relation to the MSC responding or reacting to  
24 situations, and the other dimension was, the MSC were as  
25 monitor -- or, initiated action, and there also have been  
26 parallels or comments made about the Rules Panel and the  
27 independent board under the new proposal.

28 So, we've asked Sir Duncan to comment on where he feels  
29 able to speak on his experience in that context, but if the  
30 Commission seeks a response that you don't feel we should be  
31 asking, I'm sure you will say so, but it's more how you see the  
32 MSC; how its independence is operated; this question of  
33 monitoring market performance; responding on its own initiative  
34 rather than whether people put issues in front of it; whether or  
35 not you have got a view on the structure proposed by the  
36 applicants -- you may not have read it, in which case you will  
37 not have a view. So, it's general background.

38 If you wouldn't mind starting off on that and if you're  
39 prepare to take questions from us, we'll do that accordingly.  
40  
41  
42  
43  
44

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*Market Surveillance Committee***PRESENTATION BY THE MARKET SURVEILLANCE COMMITTEE**

1  
2  
3 **SIR DUNCAN:** Thank you, Mr Chairman. I have actually prepared some  
4 general comments, but I think that the substance of them you  
5 will already know, so I will leave those comments -- there's a  
6 copy for each person. You will read or digested those at your  
7 leisure.

8 **CHAIR:** They will be circulated to the Conference as well, if  
9 that's all right with you.

10 **SIR DUNCAN:** Certainly. So perhaps if I can start on the matters  
11 that you are alleging in your letter, and the first one is how  
12 the Market Surveillance Committee has operated. I can say that,  
13 when I took on this post in 1995 I thought that it was going to  
14 be a sinecure. I was disillusioned about that in October 1996  
15 when we obtained our full complement, and we now comprise an  
16 economist, Lew Evans, Professor of Economics; we have an  
17 electrical engineer who has a wide knowledge of the  
18 administration of the electricity industry, he was formally --  
19 had a managerial role in ECNZ; we have another lawyer, Quentin  
20 Hay, and we have a man who is a financier and has a considerable  
21 knowledge of the Futures industry.

22 We meet every month and we have full one day meetings, and  
23 from time to time we have hearings, and only last week we had a  
24 hearing involving the pricing manager of what has been an  
25 ongoing issue of what we call "the Mangahao error".

26 Each service provider is obliged under the Rules to provide  
27 us with a report each month, reporting its own breaches and the  
28 breaches of any other service provider or market participant and  
29 when that happens, if the matter does not effect anyone within  
30 M-Co, then Surveillance and Compliance, which is I suppose in a  
31 broad way the policing arm of the industry, investigates the  
32 particular complaint made to see whether there is substance in  
33 it.

34 If it does involve some arm of M-Co, such as the pricing  
35 manager or the clearing manager or the market administrator --  
36 and those cases happen from time to time -- we employ an  
37 independent investigator. Then the report comes back to us;  
38 notice of the alleged breach goes out to the party concerned,  
39 and that party is invited to make comments on whether or not the  
40 breach is admitted and how severe it is, if it is admitted.

41 We then consider the submissions and if the breach is  
42 admitted, in most cases we will write a letter giving an  
43 indicative penalty of territory in which we think a fine should  
44 be imposed. Very often that proposed fine is acceded to, in  
45 which case we impose it. In some cases it may be challenged and  
46 in that case we invite the market participants or the service  
47 provider involved to make any further submissions. We may  
48 adhere to our view, in which case we ask the party responsible  
49 whether or not it wants a hearing; normally it does not and we  
50 go ahead and make our determination.



*Market Surveillance Committee*

1           We have got a -- we've made provision for what I will call  
2 the "parking" type of offence, the small offences, and there  
3 Surveillance and Compliance has got the right to negotiate with  
4 the service provider or market participant concerned, a penalty.  
5 We have put a ceiling of \$8,000 on that but generally speaking  
6 the settlements negotiated by Surveillance and Compliance are in  
7 the territory of \$500, say, to \$3,000.

8           We're very much aware of our monitoring role; it's an odd  
9 function really, but we both monitor and we sit as a judicial  
10 body. We make sure that matters are not overlooked by the fact  
11 that we have what are called "red files" which come before the  
12 Committee each month, and they are the files in which we're  
13 looking for action being taken in respect of investigations,  
14 possible infractions of the Rules and so on. In addition, any  
15 one of our number has got the right to spend some time, a  
16 limited amount of time, looking into some matter which may call  
17 for further investigation, and that member then comes to the  
18 Committee and says, "I think we should be looking at this", and  
19 if the Committee thinks that it is a matter that should be  
20 looked at, then we take it on as a Committee.

21           So, the clearing manager is one of those service providers  
22 who has to make a report monthly, and the clearing manager  
23 would, in the course of the report, not only indicate whether  
24 there'd been any breaches of the Rules in the previous month,  
25 but he would report on such matters as the amount of  
26 constrained-on payments. Again, you might think they are very  
27 high and so it would commission an investigation by an outside  
28 investigator into it. We now have before us an investigation by  
29 an outside investigator which looks likely to result in a number  
30 of breaches being alleged against the clearing manager.

31           There is also what is called a "two hour" rule which  
32 requires monitoring. That's a rule which precludes a spot  
33 market participant from cancelling or revising an offer or  
34 making a new bid within two hours of a trading period. There  
35 are some exceptions to this Rule; the most notable one is  
36 whether revision of the offer is said to be caused by a bona  
37 fide physical reason, and an unanticipated breakdown in plant  
38 would be such.

39           One of the Surveillance and Compliance officers reports to  
40 the Committee each month on revisions made within the two hour  
41 rule. There were over 100 revisions considered by the Committee  
42 in May. We deal with this by considering a list of revisions  
43 with the recommendations made by Surveillance and Compliance,  
44 and one of our number happens to be, not surprisingly, the  
45 electrical engineer, then does the initial check as to whether  
46 we should accept the recommendations of Surveillance and  
47 Compliance, and in some cases where Surveillance and  
48 Compliance -- as this is a matter for the Committee to decide,  
49 we have no view upon it, we make up our minds. We may ask for  
50 further information on these revisions and if we don't accept

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1       them then we propose a penalty to be imposed on the party making  
2       the revision.

3       The Committee has necessarily to rely on Surveillance and  
4       Compliance to draw attention to various matters, and we have,  
5       I believe, a very, very good Surveillance and Compliance team,  
6       and we have found that they are able to act very objectively,  
7       and in most cases that's the starting point for our inquiries.  
8       But the Committee has commissioned inquiries into frequency  
9       keeping and reconciliation matters through the course of its  
10      office.

11      There is a situation called an undesirable situation which  
12      is defined in the Rules. Broadly, it relates to possible  
13      manipulative activity taking place. Where such an undesirable  
14      situation is drawn to our attention, we then move in; we have a  
15      telephone Conference involving the parties and involving  
16      ourselves and we move swiftly, I believe.

17      A classic case was the inquiry last year brought about by a  
18      complaint by Natural Gas and onEnergy. We received a complaint,  
19      which I think you will be aware of. We got that at 5.30 one  
20      Friday night and I arranged for a telephone conference of  
21      Natural Gas, onEnergy and the Committee to take place at 6.30.  
22      We finished that Conference at 9.30 that night and, because it  
23      was a big matter, we took it up again the next day. In the  
24      following week we had meetings with a number of parties in  
25      Wellington and, the week after that, with a number of parties in  
26      Auckland; and finally, we produced a report on the undesirable  
27      situation.

28      If these things do crop up, we regard them as being pretty  
29      urgent and we get on to them straight away.

30      **CHAIR:** Just to interrupt you, if I might. That was at  
31      NCG/onEnergy's -- they came to the Committee?

32      **SIR DUNCAN:** Yes.

33      **CHAIR:** And neither was a market participant?

34      **SIR DUNCAN:** That's right, yes.

35      The next thing you asked was, what initiatives the MSC has  
36      taken? I don't know that it has taken any initiatives other  
37      than those where there seems to be something wrong, and that  
38      will reveal itself from service providers' reports mainly or  
39      reports from Surveillance and Compliance who bring something to  
40      our notice.

41      The monitoring role of the Committee has, I think, been --  
42      I hope I've explained that but I'm happy to amplify that if you  
43      ask me any questions about it.

44      I move on to the next question which is whether the  
45      Committee has had to make trade-offs between the interests of  
46      the consumers and the market participants. I'm not aware that  
47      we have had to do that, but that may be caused by the fact that  
48      we are dealing in the wholesale market, so we're considering the  
49      relations primarily between generators and retailers, such as  
50      the Mercury's and so on of this world.

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1 We have got an activity which falls under the surveillance  
2 of the MCC; this time it's the MARIA Conduct Committee, and any  
3 three members of the five member Market Surveillance Committee  
4 can form the MCC. The activities of the MCC are primarily  
5 related to interconnections between new retailers and consumers,  
6 and there was a great deal of that sort of activity where the  
7 industry was opened up and one retailer took over customers of  
8 another retailer. There were a lot of complaints, some of them  
9 made by individual members of the public to the Surveillance and  
10 Compliance team; some were discovered on audits.

11 I think it would be thought that we came down fairly  
12 heavily on the retailers concerned. Some of them were smaller  
13 offences, perhaps due to a human factor, we might have visited  
14 them with fines of \$2,000 or \$3,000. There was one which  
15 involved already a systematic breach and it affected something  
16 like 350 customers, and we imposed a fine of \$50,000. Now,  
17 actually we wrote and indicated we were going to impose a fine  
18 of that magnitude, what do they have to say, and they didn't --  
19 we imposed it and there was never any appeal.

20 We've only had one appeal on the amount of a fine imposed  
21 by the MCC and that was dismissed.

22 But that is really the only situation where I can imagine  
23 that we consider the interest of consumers and market  
24 participants, and we were quite concerned for consumers, some of  
25 whom complained that they had joined another power company but  
26 had never got a bill from the new company; they didn't know who  
27 their supplier was. Some of them perhaps waited -- consumers  
28 waited for six, nine months and didn't know who it was. They  
29 were told when they rang up that they were -- not to worry, they  
30 would be getting an account in due course.

31 But, of course, a lot of those people, perhaps, are on  
32 wages; they have got a tight budget and we realise that it was  
33 quite one thing to get a monthly power bill and to pay it and  
34 another thing to get a power bill at the end of six or nine  
35 months.

36 And so in some cases, in addition to imposing a fine, we  
37 suggested to the power company that they ought to do something  
38 in the way of perhaps remitting part of the bill or making  
39 satisfactory arrangements for the amount to be paid over a  
40 period of time.

41 The next is the degree to which parties have been able to  
42 have access to the MSC and make submissions to the MSC. I think  
43 we have endeavoured to be more than accommodating in this  
44 respect. As I've indicated, a lot of the fines are imposed  
45 after written submissions have been made, and a lot of market  
46 participants and service providers are very happy for us to act  
47 on written submissions. But where they want a hearing we give  
48 them a hearing. If it's a hearing at which the submissions and  
49 the evidence are recorded in the same way as it's being recorded  
50 here; indeed, we're obliged to make a record of the hearing. We

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1 don't give decisions at the end because very often there's not  
2 the time. We consider them and then we give a full decision  
3 covering the submissions that have been made to us and the  
4 points that we seem to think are the outstanding ones.

5 There is under the present regime a right of appeal to an  
6 Appeal Board, and perhaps I can just say something about that.  
7 We have always recognised that we are subject to Judicial Review  
8 in the High Court, and Ms Bates will correct me if I don't state  
9 the principles accurately, but I think that we would recognise  
10 that any service provider or market participant is entitled to  
11 take one of our decisions to the High Court and have it  
12 judicially reviewed on the basis that we haven't afforded  
13 natural justice, we haven't acted in accordance with the  
14 principles of natural justice, or that we had placed undue  
15 weight on the relevant considerations or failed to take account  
16 of relevant considerations, or that we are in error on the law,  
17 or that we are plainly wrong.

18 So far nobody has sought Judicial Review of our -- any  
19 decision.

20 **MS BATES:** Sir Duncan, just while we're on the topic of -- not that  
21 I'm being so bold as to correct, so I'm not -- do you think  
22 there would be a difference between the MSC and the ability to  
23 review it and what's proposed with the Rulings Panel?

24 **SIR DUNCAN:** I've had a look at that. I don't think that there  
25 would be. It's very hard to oust the right of Judicial Review,  
26 so I don't see it as a great problem.

27 **MS BATES:** It doesn't have such a statutory base as...

28 **SIR DUNCAN:** No, that's true. Well, I don't -- I haven't really  
29 thought that there would be a great deal of difference. I was  
30 going to go on and talk about the Appeal Board, if that's all  
31 right.

32 We are subject at the moment to appeals to an Appeal Board  
33 which is an entirely ad hoc body; it has no permanent members;  
34 although as a matter of practice the Chairman, Sir David  
35 Tompkins, has been the Chairman throughout all the hearings.

36 I think we've had six appeals but three of them are  
37 concerned with the Mangahao error, and I think I can honestly  
38 say that in the end the Committee's initial administrative  
39 decision was upheld.

40 But I have got complaints about the Appeal Board structure,  
41 and we did make a submission which seems to have been acceded  
42 to; that is that there should be no appeal to an Appeal Board  
43 and the reason is this: That in all appellate structures  
44 throughout the Commonwealth you have a common pattern, that you  
45 go from a single Judge to a greater number of judges up the  
46 tier, maybe three in the Court of Appeal, maybe five, and  
47 ultimately you go to the Privy Council where you get five Law  
48 Lords.

49 So, I'm not saying in any conceited way, but I think that,  
50 as you go up, you are expecting a greater concentration of

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1 judicial minds, and I think because you are going up the tier  
2 you might expect to get more experienced people.

3 Now, with the present system I think you don't get that.  
4 Perhaps I can illustrate it by saying this: That the first  
5 appeal involved quite a technical electrical engineering matter,  
6 and it was heard by the Chairman, whom I will call "A", and a  
7 lady engineer from Canada who came across because I think there  
8 were no people available who didn't have ties. So, that was  
9 heard by A and B.

10 The next appeal, which was on a compensation matter, was  
11 heard by A and C; C being an economist.

12 The next appeal, which was the start of the Mangahao  
13 appeals, was heard by A and C and D; C and D being economists.

14 I'll explain shortly about it, but the next appeal on that  
15 Mangahao matter was heard by A, C and E and another appeal on  
16 Mangahao was heard by A, C and E.

17 On the latest appeal, not concerned with Mangahao, the  
18 appeal was heard by A, C and F.

19 So, what I'm really saying is that that doesn't seem, to  
20 me, to make for a continuity of experience, a uniformity of  
21 experience.

22 There's a further point, and that is that we have already  
23 emerged very well from the appeal process. I think it's fair to  
24 say that when all things are considered there's only one appeal  
25 which has been allowed and which has sort of remained allowed,  
26 and that was a reduction of a penalty we imposed from 75 to  
27 \$50,000.

28 The Mangahao case has really presented some difficulties,  
29 and it's cost people a lot of money. It was a Rule, no longer  
30 present in the Rules, G 4.5, which said that if in the  
31 calculation of final prices there was an error which caused any  
32 spot market participant to suffer a material financial  
33 disadvantage then the committee, the MSC, could make an order to  
34 that effect, and the automatic result was that final prices  
35 would then be recalculated.

36 Way back in 1998 an error was found in the calculation of  
37 final prices because the generation of a small power station  
38 called Mangahao was omitted. When it was found that the  
39 calculation was incorrect because of the omission, final prices  
40 were recalculated and it was found that the retailers of this  
41 world, the Vectors and so on, the TransAltas, had paid  
42 \$9 million more than they would have paid if the error had not  
43 occurred. It followed that some people, the generators, and I  
44 think principally ECNZ and Contact, had benefitted -- and  
45 Transpower by considerable amounts.

46 Now, we then called for spot market participants to tell us  
47 whether or not they claimed a material financial disadvantage,  
48 and several did. Some said that they suffered that, whether or  
49 not you took into account hedges.

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1           So we went ahead and in an administrative decision, having  
2 considered the case of only Mercury -- we only had to consider  
3 one because it was "any spot market participant", we decided  
4 that Mercury had suffered a material financial disadvantage in  
5 that, without hedges, didn't take into account hedges. They had  
6 suffered a loss of \$1.5 million, if you took into account hedges  
7 it was about a million. So we said that is material.

8           It went to the Appeal Board, the Chairman said we were  
9 right, material; \$1 million in anybody's language was material.  
10 The other two members of the Appeal Board took the view that  
11 materiality had to be considered from an accountancy point of  
12 view, and they made reference to an accountancy document, SAAP6,  
13 which talked in terms of materiality being related to profits  
14 and so on. They said that that Mercury had not satisfied that  
15 test.

16           So, by two-to-one majority they said materiality hadn't  
17 been proved. They then went on and unanimously held that hedges  
18 had to be taken into account.

19           Now, a number of the spot market participants whose cases  
20 hadn't been considered, which it didn't have to be considered,  
21 we only had to consider the case of one complaint about this, we  
22 obtained an opinion as to whether or not we could go back and  
23 reopen the whole matter, and we were told that we could.

24           So we issued a memorandum to the market saying we proposed  
25 to hear these matters but we would have a jurisdictional hearing  
26 first of all, just to hear submissions from the market as to  
27 whether or not they agreed, and if we decided we would have  
28 jurisdiction we would then go ahead and consider the substantive  
29 question of material financial disadvantage, what it meant.

30           So at that stage ECNZ sought an interim injunction from the  
31 High Court to stop us doing it. The High Court said, no, we  
32 were the first port of call. So we had a three day hearing on  
33 what I'll call the "jurisdictional" point, and we delivered a  
34 long decision in which we said that we had the jurisdiction to  
35 hear it again, that the Appeal Board had not set the matter back  
36 to us; all they had given us was a judgment of sort of a non-  
37 suit and cancelled the recalculation.

38           That matter was then taken by two dissatisfied parties to  
39 the Appeal Board which upheld us saying yes, we had the right to  
40 go back and do it. So then we had a three day hearing on  
41 material financial disadvantage -- I'm not an accountant. We  
42 took the view that materiality, it was materiality -- I'd rather  
43 not get into a long discussion about that, but we did say that  
44 this accountancy test of SAAP6 already was beside the point and  
45 we held that some, I think four market participants, had  
46 suffered material financial disadvantage, including Mercury; the  
47 one we had dealt with originally.

48           We went on to hold that hedges had no relevance. Somebody  
49 alleged a material financial disadvantage; hedges were  
50 immaterial.

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1 Now, our finding on that went to the Appeal Board and they  
2 all agreed that there had been material financial disadvantage  
3 suffered by a number and so a recalculation should follow. But  
4 by a two-to-one majority they held that hedges -- and by a two-  
5 to-one majority they held that hedges were irrelevant.

6 So, we've had the two hearings -- further hearings arising  
7 out of the Mangahao error which seems not to want to go away.  
8 But I mention that because I think that the philosophical  
9 reasons I gave for saying that there should be no appeal to an  
10 Appeal Board can be added to by reference to the practicalities  
11 of different people hearing matters and expressing views, and it  
12 being a rather long drawn out litigation.

13 **CHAIR:** Just if I could ask you a question before you move on to  
14 something else.

15 Leaving aside the composition of the Appeal Board, the  
16 continuity issue you raised, do you think that the appeal  
17 process, as it can be drawn out quite so extensively, detracts  
18 from the position of the Committee, in that admittedly this is  
19 one particular case, but could that appeal process be used  
20 vexatiously or frivolously by parties?

21 **SIR DUNCAN:** I suppose any appeal process could be used vexatiously  
22 or frivolously. One couldn't say that any of the appeals  
23 arising from Mangahao were brought vexatiously or frivolously; I  
24 think there was very much an arguable point in each case.

25 I think the difficulty about the composition of the Appeal  
26 Board is this, that it goes back to my philosophical point, that  
27 if you are going to have an Appeal Board, one would think that  
28 just as there are nominated persons for the Market Surveillance  
29 Committee, and they're appointed and they stay until they are  
30 retired or they are deposed, so you would expect to have  
31 nominated members of an Appeal Board, they would be X, Y and Z,  
32 and you would expect that perhaps there should be five -- the  
33 same number as on the Market Surveillance Committee -- and that  
34 they should comprise people really of the same sort of  
35 experience; economics, law, electrical engineering.

36 But I think that it would be virtually impossible, in a  
37 country the size of New Zealand, to get people who were  
38 objective in every case; there'd always be complications of  
39 people being involved here and there, and I think that's one of  
40 the difficulties which has laid in the way of the establishment  
41 of a permanent Appeal Board.

42 But I really don't think that anybody would suffer by the  
43 abolition of the Appeal Board because, so long as you've got  
44 your rights to go to the High Court and challenge the  
45 discretion.

46 **MS BATES:** Could I follow you up on the composition of the MSC or  
47 its equivalent. Do you think that it should be so that there  
48 has to be representatives from the categories you mention? I  
49 mean, how important, for example, is it to have someone with a  
50 high degree of legal experience on there?

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1 **SIR DUNCAN:** I think it's very important and we have been very  
2 lucky. I say, first of all, you've got to have an economist.  
3 My knowledge of economics, I've got to say is limited to stage 1  
4 as part of my LLB degree many years ago, so it is great to have  
5 first class economists.

6 Great to have an electrical engineer, particularly, say, in  
7 relation to those two hour rule cases. But, the electrical  
8 engineer knows how power companies work, how generation occurs,  
9 knows all about frequency keeping and so on.

10 We've got -- Mr Lyttle, it happens to be. He's got two  
11 degrees in finance and he's got a very acute mind, and he is  
12 very good on the operation to market and of constrained on  
13 payments, and he's looking to see whether any fiddles -- or  
14 there have been any manipulative activity.

15 I think it's necessary to have two lawyers. We dare to  
16 have Terrence Arnold QC, who is now the Solicitor-General. We  
17 now have Mr Terrence Hay. I say that because I think as much  
18 time is spent on writing our decisions as would be by a Judge of  
19 the High Court, and that particular jurisdictional decision was  
20 one of 61 pages, and I really was a major contributor to it and  
21 I know I spent as much time on that as I would on a judgment in  
22 the Court of Appeal.

23 So, there's a lot -- some people make their contribution in  
24 exchange of words and they can debate issues very well. They  
25 are not decision writers; they don't want to take it on. And so  
26 I think the decision writing falls very much, I think, perhaps  
27 on the lawyers and perhaps on the economist, and, I suppose  
28 really, I think principally on me. So, you do need a good legal  
29 content.

30 **MS BATES:** I suppose I'm exploring in my own mind how the need for  
31 an appeal is not so great having regard to the certain quality  
32 of the initial decision-maker.

33 **SIR DUNCAN:** I think that's right. Fortunately those who pick the  
34 MSC -- with sort of the exception of myself -- I think pick very  
35 wisely; they got these people and they make good choices.

36 **MS REBSTOCK:** Can I ask just a follow-up question. What has been  
37 your experience with access to the information and the expertise  
38 you need in order to make your decisions? Has there been any  
39 issue for you as a body that's independent from the industry, in  
40 terms of access to information or expertise?

41 **SIR DUNCAN:** I don't think so. I think that there may have been  
42 occasions when we didn't think that people hadn't dug deeply  
43 enough and we went back and we said, "No, look, we want more  
44 information on this." one case, the decision of which we  
45 haven't completed yet, but we felt that -- there we felt that  
46 some of the factual information on which submissions were being  
47 made possibly hadn't been disclosed, we wanted further  
48 information; nobody was trying to put it across us, but we  
49 didn't -- we thought that the arguments, perhaps, were



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1 superficial so we went back on two occasions, said we want more  
2 information on this and we want a submission on this.

3 I think that we haven't been in danger of -- we've never  
4 felt that we haven't been told everything, because if we haven't  
5 been told everything in the first place we've taken steps to get  
6 it and all these inquiring minds around me on the Committee  
7 bring that to light.

8 **MR CURTIN:** As far as you are aware, is there anything that's  
9 currently over-viewed by the Market Surveillance Committee that  
10 won't be under the oversight of the new Rulings Panel?

11 **SIR DUNCAN:** You mean, are there matters which will be carrying  
12 forward?

13 **MR CURTIN:** Take the undesirable situation, for example, and where  
14 the MSC currently looks at events of that nature. Will the  
15 Rulings Panel be looking at everything that the Market  
16 Surveillance Committee currently looks at or has there been any  
17 change of the scope of the overview of the Rulings Panel vis-a-  
18 vis the MSC?

19 **SIR DUNCAN:** Looking at the Rules it seemed to me that every  
20 activity was covered but that there was perhaps -- well, I'll  
21 call it a transfer of power, so that matters in the way of  
22 monitoring and undesirable situations, which have been the  
23 province of the MSC will now be the province of the Governance  
24 Board, although in the case of undesirable situations there's a  
25 right of appeal not to the Rulings Panel.

26 The other thing is that whereas the present MSC decides on  
27 penalties, subject only to what I called those parking offences,  
28 where the negotiation of a penalty is done by Surveillance and  
29 Compliance and then brought before the Committee for its  
30 approval, the new regime will provide for the Governance Board  
31 to appoint an investigator, which one would expect to be the  
32 case, and it leaves it to the investigator in every case to make  
33 a recommendation and to try and effect a settlement. Then if  
34 the matter or recommendation comes before the Governance Board  
35 and it approves of the settlement, of course that's an end of  
36 it, it's approved; and a fine, one would think, would be the  
37 order of the day as part of the settlement.

38 If it's not approved then it gets sent on to the Panel,  
39 Rulings Panel. I notice also that there's provision, and I  
40 think it's a very good one, that the Rulings Panel should give  
41 its decisions, if at all possible, within 40 days. I've got to  
42 be honest and say our decisions are not given within 40 days,  
43 possibly because you only meet once every month. But the  
44 existence of that Rule and the fact that the Governance Board is  
45 both doing the monitoring and also really leaving it to the  
46 investigators to negotiate a settlement, seems to me perhaps to  
47 indicate a desire to get on with things and have them done as  
48 expeditiously as possible, and that's very commendable and it's  
49 not for me to say as to whether that system is better than the  
50 existing one.

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1 **MR CURTIN:** Just one very quick detailed question. As far as you  
2 are aware, has the definition of "undesirable situation" been  
3 just translated from the present Rules to the new Rules?

4 **SIR DUNCAN:** I thought my original notes had a note of undesirable  
5 situation -- no, I can't answer offhand, I'm sorry.

6 **CHAIR:** Could I just -- another question. I know you're talking  
7 about the Ruling Panel and the board. Do you think the culture  
8 that's been built up in NZEM in relation to the MSC, and that  
9 from what you have said and, I think, from what some of the  
10 Commission members understand, people who have seen the MSC as  
11 being only -- I guess, completely independent but not be  
12 unwilling to get into issues that are brought in front of it.

13 Do you think that's a culture that presumably has permeated  
14 through the market, will in essence transfer through to the new  
15 Rulebook in these proposed arrangements?

16 **SIR DUNCAN:** I don't know. I do know that in dealing with matters  
17 we have come down on the market administrator, the pricing  
18 manager and the clearing manager, which are service providers'  
19 functions controlled by M-Co; we have come down on them quite  
20 hard. I can think in one case we fined the market  
21 administrator, I think, \$40,000 for not implementing a proper  
22 market information system -- it was a breakdown in their market  
23 information system but there was no back-up and in the defended  
24 case we held there was a breach and fined them \$40,000.

25 In another case there was a failure to accord a particular  
26 market participant proper voting rights. The market participant  
27 was told that it had no voting rights; in fact it did have  
28 voting rights and it ought to have been accorded those. As it  
29 happens, had it exercised its voting rights it wouldn't have  
30 made any difference to the ultimate outcome of the case, but  
31 there we imposed a fine.

32 We are currently considering a complaint by ECNZ, a rather  
33 large one -- the one which resulted in a three day hearing last  
34 week -- about the pricing manager's failure to get on with a  
35 recalculation of prices after Mangahao. It's alleged by ECNZ  
36 that it allowed its hedges to lapse, and then it was caught with  
37 the full force of the readjustment.

38 **CHAIR:** And then, has that, if you like, confidence or culture  
39 extended to market participants and the system operator? I  
40 mean, the Committee doesn't feel that -- well, switch it around;  
41 have you a view that they see the Committee for what it is and  
42 (a) apart from an appeal situation, so they have accepted the  
43 jurisdiction, and (b) feel completely neutral about being able  
44 to go to the Committee with issues?

45 **SIR DUNCAN:** I think we do. We would make a point of according a  
46 hearing to anybody who wanted to come before us. I do think  
47 that I can say that the market participants and the service  
48 providers have got, I think, a reasonably good expectation of  
49 the MSC. I think no litigant wants to lose, but so far as -- if  
50 you take account of that, I think that they all feel that they

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1 have had justice, and we were told that in a survey which was  
2 conducted. I think initially some thought we might have been a  
3 little bit legalistic, but others thought that we were not  
4 sufficiently legalistic. But we run the place as a Court would,  
5 but with less formality.

6 I mean, I feel perfectly at ease appearing before you and I  
7 suppose that we would hope to run our establishment and the  
8 hearing in much the same way as you are conducting the hearing  
9 today.

10 **CHAIR:** Thank you. I guess what I'm trying to lead to is that in  
11 the new structures proposed, participants will come at it with  
12 an environment that has been well tested through the MSC  
13 process, that's the point I'm driving at.

14 **SIR DUNCAN:** I'm hopeful that they would.

15 **CHAIR:** Thank you.

16 **MS BATES:** Could I just take you back to the appointment process.  
17 I just want to clarify a couple of matters so I can compare it  
18 with the new structure.

19 Who actually does the appointing of the MSC?

20 **SIR DUNCAN:** Well, I think I'm right in saying that -- the Chairman  
21 is appointed independently for a period of three years and his  
22 appointment may be renewed as it was in my case. The other  
23 people, they do not have a time restriction on their  
24 appointments. One appointed by a vote of the generator class,  
25 the other the purchaser class and the trader class and the  
26 service providers. Initially I think that the Chief Executive  
27 of M-Co probably singled out people who thought -- whom he  
28 thought would be suitable and then suggested to the particular  
29 classes, trader, generator, purchaser etc, that that might be a  
30 suitable person, that they were free to put up the other --

31 **MS BATES:** So who appoints the Chair then?

32 **SIR DUNCAN:** I think M-Co really does.

33 **MS BATES:** But on a different basis than the others?

34 **SIR DUNCAN:** Yes.

35 **MS BATES:** Because you talked about what you perceived as being the  
36 wisdom of the people who made their decisions, appointment  
37 decisions, and I'd like to ask you then, do you think that we  
38 can expect the same sort of wisdom to prevail in the proposed  
39 new arrangement?

40 **SIR DUNCAN:** I can just say that when one of our number, it was Dr  
41 Keith Turner -- I forget whom he represented -- resigned to take  
42 up his new appointment, Mr Muldoon, electrical engineer, was  
43 appointed in his place; and I think that that was probably done  
44 on the recommendation of the then Chief Executive, would be  
45 Mr Philip Bradley.

46 Then, when Mr Arnold had to resign and take up his new  
47 appointment Mr Hay came on the scene, and I think that that was  
48 really -- he was elected -- I won't say the more democratic way,  
49 but I don't think there was a nomination -- there was a

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1 suggested nomination by the Chief Executive which a particular  
2 class didn't wear, and they selected Mr Hay.

3 Now, do I think that the same culture will prevail? Well,  
4 I've really got -- I have no reason to suggest or to doubt that  
5 it will.

6 **MS BATES:** That it will?

7 **SIR DUNCAN:** I think it will carry on. I think you could expect  
8 the same sort of independence.

9 **MS BATES:** There's no Rules around -- we've talked about  
10 composition and how important it is to have the various  
11 representatives you've talked about. There are no Rules around  
12 that at the moment, are there?

13 **SIR DUNCAN:** No.

14 **MS BATES:** And so you wouldn't think there needed to be any Rules  
15 around that for the new proposal?

16 **SIR DUNCAN:** No, I don't. It would be unlikely that I would be  
17 asked to be the Chairman of the Rulings Panel -- on account of  
18 my age -- and I'm 75 now, I regret to say, but -- and I'm not  
19 sure whether I would want to take it on except for a short time.  
20 But I've got so much faith in the other four that I think people  
21 would be hard pressed to go past them.

22 **MS BATES:** So you think that the same personnel will --

23 **SIR DUNCAN:** I think they should be there; they've got all the  
24 qualifications, I think.

25 **MS BATES:** I suppose that leads me to another question before we  
26 leave it. I don't mean this would be in a formal way, but does  
27 the MSC itself have some influence over new appointments?

28 **SIR DUNCAN:** Well, I'll just consider the -- we had no influence at  
29 all over the original appointments. There have been two  
30 appointments following on resignations of two members; so three  
31 of us from the original Committee remain and there have been two  
32 other appointments. The name of a replacement, a couple of  
33 replacements were suggested to us on one re-appointment. One of  
34 them would have been excellent but wasn't available; the other  
35 one was excellent and was available. We were told that about  
36 this person.

37 I think that if we had doubts about the person, we would  
38 have said so. We would have said, "Can't work with that  
39 person", or, "We think that that person hasn't got sufficient  
40 objectivity, he wouldn't be seen to be objective by the market".  
41 The same with the second person; we didn't have much say about  
42 that, but -- and when the name was suggested we saw no reason to  
43 defer.

44 Yes, I think that's really all I have to say about that.

45 **MS BATES:** If we look at the counterfactual, which is a Crown EGB,  
46 again, I'll ask you, do you think you'll get the same philosophy  
47 of the quality/composition importance?

48 **SIR DUNCAN:** I don't know that you would.

49 **MS BATES:** And have you got any reasons?

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1 **SIR DUNCAN:** Well, it's just that, I've got no reason to think that  
2 there have been any political influences lying behind the  
3 appointment of the MSC and, if there were Crown appointments,  
4 you could get political influences. That's how I would put it.

5 **MS REBSTOCK:** I just, Sir Duncan, would like to follow-up on some  
6 of your experiences and I wonder if you've ever had an occasion  
7 where a party has brought a matter to you for which you didn't  
8 have jurisdiction because the issue or concern related to the  
9 Rules themselves rather than a question of whether a Rule had  
10 been breached. In other words, a Rule itself gave cause for  
11 some behaviour in the marketplace that was of concern?

12 **SIR DUNCAN:** We have from time to time perhaps felt, perhaps,  
13 unhappy about a particular Rule and we have suggested to the  
14 Rules Committee a modification of the Rule. I think we've  
15 generally been listened to; perhaps not always.

16 There have been cases, though I can't give the specifics,  
17 where we've had to say that perhaps that Contact should have  
18 been the subject of a Rule, but it wasn't.

19 **MS REBSTOCK:** The reason I ask this question is, depending on the  
20 view we take on our own jurisdiction with respect to Section 30,  
21 it is possible that in the future these Rules will receive an  
22 authorisation that will not make them challengable under some of  
23 the means that are available to parties now outside of your  
24 jurisdiction. And we have before us a proposal, as you know,  
25 that will allow Rules over time to be developed or maintained by  
26 a chapter-by-chapter voting structure.

27 So, while you will have in the proposal the benefit of a  
28 body such as what you now sit on, the bit that you don't  
29 currently have jurisdiction for may be subject to greater  
30 protection in terms of parties not having the ability to  
31 challenge, for instance, through the Commerce Act as they can  
32 now, the Rules themselves in situations where they may have an  
33 adverse market effect.

34 I value your views on whether that causes you any concern  
35 given your experience with the industry.

36 **SIR DUNCAN:** I'd have to admit that I haven't really given a great  
37 deal of thought, or really any thought, to that question, and I  
38 don't know a lot about the operation of the Commerce Act. But I  
39 think it would be desirable that anybody, be it the MSC or the  
40 Governance Body, should have the ability to flutter its wings  
41 and comment on these things as we have at present.

42 So, whether it's vested in the Governance Board or in the  
43 Rulings Panel or -- I wouldn't like to see any diminution of the  
44 powers of the present Committee to comment on Rules, suggest  
45 Rule changes or deal with any other of its functions. I know  
46 that's not a very good answer, but it's rather generalised, but  
47 I can't improve on it.

48 **MS REBSTOCK:** I guess the issue for us is, over time the Rules are  
49 now in place and the ones that may develop, while the industry  
50 EGB board can influence it to some degree, what actually happens

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1 will be decided by voting rights chapter-by-chapter. The  
2 Commission has raised concerns about the potential for pro-  
3 competitive rule changes to be blocked. Other parties have  
4 raised concerns about other matters where you could get hold-out  
5 or blocking behaviour, and in the past we did at least have the  
6 protection of the Commerce Act, people could take cases under  
7 it. It is at least one outcome that we will not have that under  
8 these Rules, and it's in that context that I framed the  
9 question.

10 It's very hard for us to know whether the fact that the  
11 previous Rules were not authorised and, therefore, were not  
12 sheltered from the Commerce Act constraint behaviour; it's very  
13 much a hypothetical question, but whether that should cause us  
14 any concern for the future?

15 **SIR DUNCAN:** I apologise, Commissioner Rebstock, and say really I  
16 don't think I can sort of say anything that's very useful on  
17 that.

18 **MS REBSTOCK:** I know that I was taking you beyond the role that you  
19 have had. So, thank you for that anyway.

20 **CHAIR:** All right, well look, just on behalf of the Commission can  
21 I thank you for making the time to come and talk to us, indeed  
22 for being very frank with us, which is appreciated, because as  
23 you can guess some of these interfaces and relationships are  
24 pretty critical to the proposal.

25 As I say, your willingness to be very open is much  
26 appreciated.

27 I think we'll break now and reconvene, say, about 25 past  
28 11. Thank you.

29  
30 **Adjournment taken from 11.07 am to 11.25 am**

31  
32  
33  
34  
35 \*\*\*

*Major Electricity Users' Group (cont)*

1 **CHAIR:** All right, well, I think we'll reconvene. As might be  
 2 expected, we're having to make some ongoing changes to people's  
 3 slots. We'll have MEUG for the rest of the morning and breaking  
 4 at 12.30; from 1.30 to 2.30, Comalco; and then 2.30 to 5.30,  
 5 Meridian. We would ask Todd Energy and CC 93 to transfer over  
 6 to next week.

7 We'll have a discussion with Transpower in relation to next  
 8 week so we can re-circulate a suggested list of times. My  
 9 concern is that, (a) people have an opportunity to make their  
 10 submissions in full and, (b) of course that the applicant will  
 11 want to be able to reply at the end of the hearing and we'll  
 12 need a little time to bring the last submitter in at that time.  
 13 So we're just trying to juggle all this together. I think we  
 14 will get there.

15 So, back to MEUG and we'll pick up exactly where we left  
 16 off. Mr Currie, please.

17  
 18 **PRESENTATION BY**  
 19 **MAJOR ELECTRICITY USERS' GROUP (Continued)**  
 20

21 **MR CURRIE:** Thank you, Mr Belgrave. Can I perhaps ask Commissioner  
 22 Rebstock to rephrase the question that she posed to me just at  
 23 the point -- it was relating, I think, to the absence of those  
 24 words "fair and reliable" in the guiding principles, the  
 25 practical effect on decision-making, I think that was the gist,  
 26 but I wasn't --

27 **MS REBSTOCK:** Yes, I also asked what you meant by "fair", and I  
 28 think your colleague mentioned "equitable"; and then I asked the  
 29 follow-up question, what practical effect does it have in terms  
 30 of comparing the -- any concerns we might have under the  
 31 Commerce Act and the proposal as compared to the counterfactual?

32 **MR CURRIE:** That's how I took, as I recall it, the way the question  
 33 was framed. The question of fairness. I think I may have  
 34 mentioned or replied in the context of perhaps the transitional  
 35 dispensation arrangements where existing -- owners of existing  
 36 plant, the costs of their non-compliance, assuming that  
 37 dispensation is granted, is spread across all industry  
 38 participants vis-a-vis a new entrant who will have to pay as  
 39 part of obtaining dispensation the explicit costs that  
 40 Transpower or the system operator incurs in connecting that  
 41 party to the grid and if ancillary reserves are required, those  
 42 costs will be paid by that new entrant; that's potentially a  
 43 fairness argument, but I think it is probably a more general  
 44 approach where our concerns are reflected, which is, will there  
 45 be a bias and any form of bias where commercial self-interest  
 46 takes a stronger priority or has greater weight than dealing  
 47 with issues on a fairness basis?

48 It is a difficult issue to provide specific examples, and I  
 49 suppose I'm conscious that the new Act or the amendments to the  
 50 Act have now sort of placed a new threshold. It is not

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1 competition for competition's sake now; it is competition really  
 2 to look to enhance the consumer interests in the long-term over  
 3 the long haul.

4 So, I suppose we think there is a -- not a subtle change; I  
 5 think Parliament has directed and placed a greater emphasis on  
 6 consumer enhancing activities, and we therefore feel that the  
 7 concept of fairness is one that needs to come through any form  
 8 of self governing regulations which create the framework  
 9 environment for trading and the delivery of electricity.

10 **MS REBSTOCK:** The second part of the question was, given the  
 11 accountability of an industry EGB to the Minister via the GPS  
 12 and the accountability arrangements built in around that, what  
 13 is the practical effect of any divergence between what's written  
 14 in the forward to the Rulebook and what's in the GPS?

15 **MR CURRIE:** I believe that -- MEUG believes that the approach of  
 16 the industry EGB and in a practical sense when they are making  
 17 their working party; setting the terms of reference for the  
 18 working parties, responding to proposed Rule changes or  
 19 initiating new Rules, in a practical sense I think my  
 20 introductory comments about the primary objective being a  
 21 touchstone being visionary in establishing a benchmark.

22 So, I can't think of an immediate sort of a "for example"  
 23 in the context of a particular Rule change, but it could be in  
 24 the -- potentially in the information area, the provision of  
 25 information. It is a sense that it is -- more or less a gut  
 26 reaction that with the primary objective as a vision for the  
 27 industry EGB it will be more -- it will feel more accountable  
 28 than simply responding to the annual negotiation of performance  
 29 objectives and the fact that the GPS is there. It is more in  
 30 there, it is a more direct context in front of them all the  
 31 time.

32 **CHAIR:** Thanks very much.

33 **MR CURTIN:** We've been talking about the consistency of the guiding  
 34 principles of the Rulebook with the Government Policy Statement,  
 35 and I wonder if there's been any debate about whether the voting  
 36 by chapters concept itself accorded with the Government Policy  
 37 Statement or whether the Government Policy Statement had that  
 38 kind of industry governance arrangement in mind?

39 **MR CURRIE:** The Government Policy Statement certainly set out what  
 40 they expected from an industry EGB, that consumer interests or  
 41 that by establishing the criteria I think for the members of the  
 42 EGB, the direction that all generators, retailers, distributors,  
 43 Transpower and directly consumers should be members of the board  
 44 or should prescribe in part of the arrangements.

45 There are quite a number of directions or strong signals in  
 46 the Government Policy Statement which have been picked up and  
 47 translated into the new arrangements, but whether they exactly  
 48 reflect or whether they meet those objectives of the Government,  
 49 that's probably subject to that threshold test when it's deemed  
 50 to be an EGO or not.



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1           So, I don't know whether I can really reply in a lot more  
2 detail than that, Mr Curtin.

3 **MR CURTIN:** But your submission would be that voting by chapter is  
4 not necessarily inconsistent with the Government Policy  
5 Statement; would you go that far?

6 **MR CURRIE:** It is not inconsistent -- or may not be inconsistent,  
7 but if it is a sub-optimal outcome, if it doesn't lead -- if  
8 that voting chapter-by-chapter, or the voting structure, or the  
9 allocation of votes does not improve the ability, enhance the  
10 ability of the industry EGB to meet that primary objective, then  
11 one still has to have a question mark attached to it.

12 **MR CURTIN:** Thank you.

13 **MS BATES:** I just want to look at the counterfactual for a moment  
14 and think about this. The decision of the Minister is  
15 reviewable, of course, and can be reviewable on one basis being  
16 that it didn't accord with the Act or the policy.

17 **MR CURRIE:** Or that he may not have followed the consultative  
18 processes or whatever, yes.

19 **MS BATES:** But that there's an avenue open to your group, say, if  
20 things don't go right?

21 **MR CURRIE:** Yes.

22 **MS BATES:** If you look at the proposal, whilst it's true that you  
23 could review any decision of the -- if it's an EGO then it gives  
24 a statutory basis, it would be difficult to see how you could  
25 review the exercise of the voting.

26 **MR CURRIE:** Yes.

27 **MS BATES:** So, given that that takes away an avenue of redress, if  
28 you like --

29 **MR CURRIE:** Yes.

30 **MS BATES:** -- why is it that on balance you prefer the industry EGO  
31 proposal?

32 **MR MATTHES:** I think you mean, why do we --

33 **MS BATES:** Well, I suppose "proposal" wasn't right, I was thinking  
34 about that. Why do you support an industry EGB rather than a  
35 Crown EGB?

36 **MR MATTHES:** Yes, I think it's the industry EGB model proposed by  
37 CC 93 which is the sort of normal commercial corporate model,  
38 whereby the EGB makes the decisions but is accountable to the  
39 shareholders who include consumers; which is a totally different  
40 model, of course, from what the applicant is proposing in terms  
41 of their EGB.

42 **MR CURRIE:** I think I observed yesterday that it is quite a fine  
43 call, in terms of an industry EGB that meets our prerequisites  
44 versus a Crown EGB. There are trade-offs between those two  
45 models, and it's really -- we have been part of the challenge of  
46 trying to construct and devise an industry EGB which delivers  
47 all the outcomes sought by the GPS and delivers our outcomes,  
48 and we haven't given that game away, we still have a hope that  
49 we can achieve that objective.

50 **MS BATES:** Thank you.

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1 **CHAIR:** All right, thank you. Perhaps move on to issue number 8,  
2 the use of conditions.

3 **MR CURRIE:** Yes. I think we've really had a quite extensive  
4 discussion in that area, and perhaps just a very quick  
5 recapping; there is no question that the Commission does have  
6 wide powers in terms of Section 61(2) of the Act. Those  
7 conditions are constrained or they must be consistent with the  
8 Act. I don't believe that there is a narrowing, that they can  
9 only deal with the -- I think there was a proposition advanced  
10 by the applicant that they saw conditions somewhat constrained  
11 to dealing with perceived detriments; I think there is a wide  
12 power in terms of 61(2) but the backstop to that is simply the  
13 conditions must be consistent with the Act.

14 I've canvassed about the due process, I think we've already  
15 had a discussion about that, and in terms of para 115 we have  
16 looked at the kiwifruit case, the circumstances surrounding  
17 that. I think you can distinguish that case from the particular  
18 set of circumstances which the applicant has advised.

19 **CHAIR:** Thank you.

20 **MR CURRIE:** Moving through then to Part 2 of this presentation and  
21 the commentary on the applicant's case.

22 Can I just draw the Commission's attention to point 118, or  
23 paragraph 118 of ours. It is simply impossible, because we'd be  
24 here for the rest of the year, to simply comment on every single  
25 issue, every single line, so we have not attempted to rebut  
26 every single opinion, comment or observation from the applicant  
27 and silence -- our silence, our not doing that, should not be  
28 taken as acquiescence my MEUG to either the applicant's view of  
29 the history or the supporting party's view of events. Even  
30 though we've taken longer than we have, we've tried to  
31 concentrate on key issues from a new perspective.

32 In para 120, I think, one of the opening questions from the  
33 Commission to the applicant was, "What constitutes a substantial  
34 majority?" it appeared in, I think, the Chairman of EGEN's  
35 introductory comments in para 2.26.

36 As already advised, the allocation of votes, the voting  
37 structures and the voting thresholds were a major area of  
38 dissent. At one stage, or at several stages during the  
39 Governance Working Group procedures, consumers did have 50% of  
40 the votes in respect of the election of the board. That was a  
41 proposal that went from the Government's Working Group through  
42 to the plenary body, the EGEN. But that threshold or that  
43 allocation of votes for the election of the board did not  
44 survive its reference to EGEN, and the decision that came back  
45 from EGEN was, one-third generator/retailers, one-third  
46 distributors, including Transpower, and one-third consumers.

47 Then another requirement or a decision of EGEN was that a  
48 referendum would be held to measure the level of support for the  
49 industry for the particular set of arrangements, and the method

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1 of checking and surveying that level of support was to do it by  
2 way of a referendum.

3 The Governance Working Group, having regard to the early  
4 decision regarding 50/50 coming back at one-third, one-third,  
5 concluded that one-third, one-third was a reasonable threshold  
6 in a referendum.

7 We felt that a substantial majority, the Governance Working  
8 Group, needed to be determined and I think we set the threshold  
9 at 75%. But EGEC rejected the threshold of 75% as, under the  
10 simple numerical qualification, that would leave the veto rights  
11 with the consumer sector of the industry given that we had 33  
12 and a third percent of the votes; a 75% majority meant that  
13 potentially we could block any further progress past beyond the  
14 referendum, assuming that was an absolute threshold and,  
15 therefore, EGEC concluded in its wisdom that a 75% majority was  
16 not appropriate and that instead a substantial majority would be  
17 required, leaving not predetermined what exactly constituted a  
18 substantial majority.

19 So, there is nothing in the Rulebook which provides for  
20 what substantial majority is. It may be 51%, although that  
21 seems to me to be a bare majority, not a substantial majority;  
22 but it is not our expectation that they would set the  
23 substantial majority above 67%.

24 **MS BATES:** It would be something less than 75 anyway, won't it?

25 **MR CURRIE:** That would be our expectation, Commissioner Bates.

26 I'm not too sure that we need to deal with para 123. I  
27 think we have canvassed it. I think the only point we need to  
28 make out of that para is that in the EGEC reporting to the  
29 Ministers I think there was a -- it was either an express -- or  
30 a requirement that the Chairman, the Chairman of the three  
31 codes, MARIA, NZEM and Grid Security Committee be involved in a  
32 reporting process to the Minister. If that was the case then  
33 that left a section of the electricity industry, consumers,  
34 absent from that reporting structure and there was no move by  
35 EGEC, notwithstanding the facts that two representatives were on  
36 EGEC -- there was no attention or no invitation to consumers to  
37 be part of that reporting process.

38 In paragraph 124 there was this question of whether there  
39 was any sense of gaming the process. I, on behalf of consumers,  
40 believe that I have detected a sense of brinkmanship; perhaps I  
41 have misunderstood the intentions or the activities of the  
42 industry side of the sector, but there just has been a sense  
43 that the arrangements would be devised as though they were a  
44 carry over from NZEM which was in essence a voluntary set -- it  
45 was an opt-in and it was definitely a multilateral contract;  
46 there was no other legal sort of institutional arrangement, and  
47 there was a strong attempt to preserve those levels of control  
48 and how the industry ran its own affairs into the new  
49 arrangements which have, to me, a much broader function and a

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1 function where consumer welfare enhancing activities should be a  
2 significant thrust.

3 I think I've already commented in paragraph 125 and 126 etc  
4 about the alignment of the guiding principles.

5 Paragraph 128, I think I have just covered. It is  
6 probably noteworthy that although there are three  
7 representatives on the Grid Security Committee, it was not  
8 possible for the Grid Security Committee -- or it did not occur  
9 that the Grid Security Committee appointed one of those consumer  
10 reps to EGEN. It ended up to be the Chairman and one of the  
11 generator members on the Grid Security Committee.

12 I have canvassed at length the question of the  
13 counterfactual. I'm not too sure whether I need to address the  
14 attention of the Commission to too much of that, although  
15 perhaps in paragraph 138 there was a suggestion in the  
16 applicant's case in the notes for the Conference in paragraphs  
17 1.7, that given the level of concessions already made to  
18 consumers any re-negotiation would invite reappraisal and the  
19 unraveling of those concessions, and I suppose we haven't found  
20 it easy to identify what those concessions were that the supply  
21 side made to consumers.

22 There is also a suggestion that consumers may have some  
23 more say in the Rule changing process, and I recall that the  
24 Chief Executive of WEL, Mike Underhill, when appearing before  
25 the Commission last week, thought that when Part B of the  
26 Rulebook was populated, which dealt with consumer matters, then  
27 he would expect consumers to have some say in those matters.  
28 But there was a caveat added to the comments to that direction,  
29 that consumers had to actually -- or may have to prove that they  
30 were democratically constructed and that no class of consumer  
31 held undue influence.

32 Could I draw to your attention pages 127 to 129 of the  
33 Rulebook in Part A. Is it possible to at least either -- if the  
34 Commission staff may be able to just make that available to a  
35 couple of Members of the Commission; it is -- [**Two rulebooks**  
36 **handed to Commissioners**].

37 **MR CURRIE:** This is schedule A4, voting entitlements to electing  
38 something to the board. One-third/one-third/one-third is  
39 described. Generation by purchasers is dealt with by para 2.1.  
40 Distribution of grid owners are dealt with in 2.2 and consumer  
41 groups are dealt with in 2.3, and then there is a section on how  
42 consumer groups become eligible to vote.

43 There is a detailed prescriptive approach to how consumer  
44 groups must qualify, must in fact meet certain thresholds before  
45 they are entitled to vote, and the Ruling Panels will consider  
46 relationships with other voters.

47 It may just sound like -- that we are being a bit precious,  
48 but it does seem that there is considerable -- considerable  
49 attention has been placed on Clause 3 of that schedule A4 to  
50 consumers and putting in various thresholds by which consumers

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1 have to actually be approved before they can participate. That  
 2 is probably appropriate, that some form of mechanism is  
 3 established, and I don't think we ever contemplated that 1.3,  
 4 consumers were going to be polled on the logistics etc. But it  
 5 does seem that, this is -- as I say, perhaps reflects our sense  
 6 of frustration, but those hurdles will impose costs on the  
 7 consumer groups in obtaining an entitlement to participate and  
 8 there are various thresholds which those consumer groups have to  
 9 meet.

10 **MS BATES:** Do you accept that the decision is going to be  
 11 independent though, because it's going to be done by the Rulings  
 12 Panel?

13 **MR CURRIE:** Yes, in the first instance it is being done by the  
 14 Market Surveillance Committee, and my comments are not in fact  
 15 adversely on the Market Surveillance Committee, but that is a  
 16 totally industry appointed body. It has no -- there are no  
 17 consumers involved at all in determining how that MSC will be  
 18 appointed.

19 **MS BATES:** That's true, but under the EGB proposal, although  
 20 there's no consumer representative as such, one of the  
 21 requirements for members is to --

22 **MR CURRIE:** To be independent, yes.

23 **MS BATES:** Yes, and there's a specification for some consumer  
 24 expertise to be on there, I think?

25 **MR CURRIE:** Yes.

26 **MS BATES:** So, under what is proposed, do you accept that we're  
 27 going to get an independent judgment?

28 **MR CURRIE:** Yes, the board will be independent. There is a  
 29 requirement, and I think in the specification of the criteria  
 30 for independence and expertise the search panel or the search  
 31 process will determine, will ensure that there is a mix of  
 32 experience put up for election or a panel of potential  
 33 candidates, and that board, independent board, does have the  
 34 task of appointing a Rulings Panel.

35 So, that is the process. I suppose I was --

36 **MS BATES:** Are you focusing then on the actual specific  
 37 requirements that the Rulings Panel has -- the prescriptive  
 38 nature?

39 **MR CURRIE:** The prescriptive approach, vis-a-vis generators and  
 40 retailers by definition are prescribed, distributors in  
 41 Transpower are prescribed, consumer groups, there needs to be a  
 42 mechanism, but I think it is just the aspects of that  
 43 prescription which I think offended us.

44 **MS REBSTOCK:** Can you tell me what the alternative would be to  
 45 ensure you got a balance of representation of consumers, because  
 46 that seems to be the objective, just as we see on the supply  
 47 side there, whether it's been achieved or not we can debate, but  
 48 an attempt to balance representation across the supply side?  
 49 This reads to me like an attempt to balance representation

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1 across the demand side from consumers, and I just wonder what  
2 the alternative is?

3 **MR CURRIE:** At various stages CC 93 debated an electoral college  
4 approach. Certainly, within the CC 93 there has been experience  
5 with an electoral college approach in primary Producer Boards.

6 We also looked at CC 93 and we listed all the organisations  
7 who are consulted, or who could be consulted under a CC 93 sort  
8 of banner. We looked at alternative approaches, and for a  
9 variety of reasons I think those were simply -- those were not  
10 proceeded with, by the Governance Working Group.

11 So there were alternatives looked at.

12 **MS REBSTOCK:** I guess the question for us is, the impact of this in  
13 the proposal compared to what would happen under the  
14 counterfactual, and I'm trying to see -- what I'm asking you  
15 really, is there any detriment in this as compared with the  
16 counterfactual?

17 **MR CURRIE:** Relative to the counterfactual, whereby one would  
18 imagine the members of a Crown EGB would evolve or would emerge  
19 from a Cabinet appointment's process under Government, and there  
20 would be no voting by consumers on the election of that Panel.  
21 We may have some opportunity to nominate or to put members  
22 through or to indicate an expression of interest, but relative  
23 to the counterfactual, does in fact our concern with that  
24 prescriptive approach have any material impact on how the board  
25 will eventually work or decisions -- I can't suggest that there  
26 is a quantifiable detriment.

27 **MS BATES:** Can I just ask you a question, which is slightly off the  
28 subject we've been talking about in a way, but I did want to ask  
29 you while I remembered it, and that was: The fact that the  
30 consumer chapter wasn't written in the Rulebook, was that a  
31 contentious matter or was there general agreement that that  
32 could come later?

33 **MR CURRIE:** Well, simultaneously, while the EGEC process was going  
34 on there was work on the electricity consumer complaints  
35 Commissioner approach, the structure of that. There was at some  
36 stage a consideration given to whether that process should be  
37 incorporated into the arrangements. There was always this  
38 pressure on timing and that the direction of the GPS had been to  
39 put together the MARIA, NZEM and GSC codes and not necessarily  
40 embark on new activities.

41 But there was also some resistance by consumers to putting  
42 the Consumer Complaints Rules into the Rulebook with the  
43 governance and the voting structure, because under the Consumer  
44 Complaints Rules there was rule making and rule changing  
45 processes; there had to be six consumers and six industry, and  
46 we weren't going to readily sacrifice that process.

47 **MS BATES:** So there wasn't consensus amongst consumers about what  
48 ought to be done in the Rulebook?

49 **MR CURRIE:** On that particular issue there was a sense that we may  
50 be giving away too much by simply incorporating that. But I

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1 have to say that we didn't spend a lot of time in the Governance  
2 Working Group debating the population of the consumer chapter at  
3 length; there was simply too many other issues.

4 **MS BATES:** So I take it there was broad acceptance, that was a  
5 matter which could be dealt with down the track?

6 **MR CURRIE:** Reluctantly I think we accepted that.

7 **MR MATTHES:** I think in a way all of the chapters that deal with  
8 mandatory rules should have some consumer voting, I guess that's  
9 what we were saying, but quite cynically, in our belief, we were  
10 marginalised and the majority of the votes in the other chapters  
11 are dominated by suppliers. And the Part B was sort of a throw-  
12 away to appease the call for consumer concerns to be put  
13 somewhere.

14 **MS BATES:** So you didn't think it would make much difference; is  
15 that what you are saying?

16 **MR CURRIE:** I'm not too sure that we wanted to see consumer issues  
17 in there locked in, given the reservations that we had about the  
18 voting structure. So, it is a two-edged sword.

19 **MR MATTHES:** If you look at common quality at the moment, consumers  
20 have the call-through option, they have 50% of the voting rights  
21 in terms of the call-through under MACQS, but that's essentially  
22 washed away under the new Rulebook so, you know, it's a constant  
23 battle across all fronts to try and keep consumers involved in  
24 it. We were outvoted.

25 **CHAIR:** I think you were suggesting yesterday how the process might  
26 evolve for the industry on this issue.

27 **MR CURRIE:** One final matter on the counterfactual, and it goes  
28 back to the circularity question posed by Commissioner Rebstock  
29 to me. I indicated that I would do it as part of CC 93 but I  
30 think it's more appropriate.

31 I think there was a concern expressed that perhaps if the -  
32 - I canvassed a situation where the Commission could indicate in  
33 its final determination areas where there was a shortfall in the  
34 arrangements or could even do it by way of conditions, but that  
35 would involve an authorisation with conditions rather than a  
36 decision to decline to authorise but signal. There was -- I  
37 think Commissioner Rebstock correctly pointed out that that did  
38 involve the Commission getting quite involved in the design and  
39 that became a circular argument.

40 I think, having reflected on that overnight, I do step back  
41 from suggesting that it is the role of the Commission to signal  
42 design elements, areas where they believe that X, Y, Z needs to  
43 be done to improve the arrangements.

44 The, I suspect, stark choice for the Commission is to  
45 authorise or to decline to authorise, and I don't believe that  
46 it is an appropriate role. I do not want to see, as I say, that  
47 circularity issue arise.

48 So, I think our position overnight attempted to clarify the  
49 question you posed, Commissioner Rebstock.

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1 **CHAIR:** But you are not saying we couldn't put a condition on an  
2 authorisation as under Section 61, I think?  
3 **MR CURRIE:** No. You have --  
4 **CHAIR:** That's fine.  
5 **MR CURRIE:** In terms of price fixing, I think we have dealt with  
6 this at length --  
7 **MS REBSTOCK:** Sorry to do this to you, but in effect does that mean  
8 you have shifted your position on the counterfactual?  
9 **MR CURRIE:** No, I think I was responding to the particular question  
10 that you posed to MEUG. It is still a plausible scenario, that  
11 if you decline to authorise without giving any particular  
12 direction to the applicant that EGENC will, in reviewing its  
13 position, decide that potentially it could make changes to the  
14 arrangement which would warrant a further application to the  
15 Commission.  
16 **CHAIR:** You have been pretty insistent on that view, haven't you;  
17 of the counterfactual?  
18 **MR CURRIE:** Yes.  
19 **MS REBSTOCK:** I guess when we give a decision we always give the  
20 reasons, which we pretty much must do. So, it's a bit of a fine  
21 line between reasons between why we either approve or decline  
22 and suggesting areas --  
23 **MR CURRIE:** Getting involved in the design, yes.  
24 **MS REBSTOCK:** Suggesting areas where improvements might be made, so  
25 I'm not sure that possibly going with the counterfactual that  
26 you have suggested doesn't retain that basic circularity  
27 problem, and I just want to be clear.  
28 You seem to be maintaining your view that you propose a  
29 different counterfactual and we don't necessarily have an issue  
30 then with, sort of, a self-fulfilling prophecy, sort of, if I  
31 can paraphrase it?  
32 **MR CURRIE:** I believe that the Commission has to keep that option  
33 open. The judgment will be yours, as it is, in terms of  
34 determining what is the counterfactual to measure and benchmark  
35 the applicant's case against. I have seen no evidence yet which  
36 says that we have to jettison the alternative counterfactual  
37 that we have put in front of -- without actually developing it  
38 in massive detail.  
39 **MS REBSTOCK:** Thank you for that.  
40 **MR CURRIE:** Really, in terms of price fixing, which has and will  
41 obviously continue to attach the interest of the Commission, I  
42 recall there has been this dialogue about purpose, and purpose  
43 effect or likely effect. And I was never any good at statutory  
44 interpretations but I don't see there being a separation of  
45 purpose effect or likely effect. I think they can be read in  
46 combination or in the alternative and, therefore, while the  
47 purpose may be pro-competitive, if the outcome or the effect or  
48 likely effect of the Rules as such, that there is a fix, control  
49 or maintenance of price, then I still believe that it is caught  
50 by Section 30.



*Major Electricity Users' Group (cont)*

1           On a second note, much has been made of the -- if you find  
2 that the price discovery mechanism in the EGB Rulebook is in  
3 breach of Section 30, that that will have tremendous impact or  
4 flow-through impact on to all sorts of other price discovery  
5 processes, such as trading exchanges, auctions, tenders; I don't  
6 accept that a finding in terms of Section 30 will have that  
7 flow-on impact, and I think that most other markets -- in fact,  
8 I can't think of a market that won't be able to distinguish  
9 between its pricing arrangements. I am not aware of another  
10 market that if you want to buy from an alternative source you  
11 have to obtain an exemption from that governing institution to  
12 be able to buy from an alternative source, and you have to  
13 demonstrate net public benefit in being granted an exemption to  
14 do that.

15           I think this particular market, algorithm, to solve a price  
16 discovery or to solve where the supply demand curve intersects,  
17 is not novel; but it is the particular characteristics, it's the  
18 Rules and the total combination of Rules surrounding that which  
19 I believe would enable other markets, other price discovery  
20 processes to distinguish themselves from.

21           I'm unaware of whether there's anything else within the  
22 pricing section which we need to bring specifically to the  
23 board's attention. Obviously there is quite a lot of material  
24 there; some of it deals with matters which we've already covered  
25 or I have covered -- I have referred to in passing.

26           In para 157 I do observe that there are other models used  
27 in electricity systems around the world, and they all produce a  
28 variety of results and there is an enormous number of learned  
29 treaties about these. The one thing that the industry -- the  
30 electricity sector is not short of is a wealth of material in  
31 commenting on every individual -- on every single aspect of it  
32 in a global sense.

33           I think I observe in paragraph 164 that the EGB electricity  
34 market will become the only game in town; from a date yet to be  
35 determined NZEM and MARIA for practical purposes actually  
36 terminate, or the Grid Security Committee. The Grid Security  
37 Committee in a sense and the MACQS process -- at least the Grid  
38 Security Committee -- its role is preserved as a specialist  
39 Working Group for a particular period of time, but from a date  
40 that NZEM and MARIA governance structures control or determine  
41 as appropriate, they in fact then terminate. That does mean  
42 that a new entrant or a party who wishes to obtain an exemption  
43 from the EGB to trade in a different principle is going to have  
44 to re-invent or pick up or find some other way of dealing with  
45 metering reconciliation settlement and those other issues.

46           So, it won't be necessarily an easy hurdle to overcome for  
47 a party to demonstrate to the EGB that there is some intrinsic  
48 or some public benefit in that party being granted an exemption.

49           In para 167 I simply reiterate the question of this tension  
50 absent from our current market. Now, that is not an issue which

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1 one expects the Commission to address, because there is no magic  
2 wand that you can wave which is going to ensure that there is  
3 dynamic tension between the parties in the supply/demand  
4 equation, but with the limited number of parties participating  
5 in the trading activities and with those predominantly being  
6 generators on one side of the equation, on the supply, and the  
7 retailing arms of those same generators on demand, it is  
8 difficult to envisage that there is the maximum amount of  
9 tension in that competitive price setting process.

10 Paras 170 to 174 really just reiterate the point that we  
11 have made previously, that an opportunity to challenge the price  
12 discovery process is an important element in ensuring that at  
13 least a party which believes it's aggrieved can take -- can seek  
14 redress. For a variety of reasons I was not here to listen to  
15 the Chairman of the Market Surveillance Committee, but it is  
16 worthwhile noting that the inquiry that the Market Surveillance  
17 Committee undertook last year into allegations or claims by  
18 several of the parties to the market that an undesirable  
19 situation existed, that inquiry was dealt with under the Rules  
20 of NZEM and, therefore, a certain outcome, or an outcome  
21 occurred, but it was open to the plaintiffs to turn round and  
22 take action under the Commerce Act if they had felt so -- if  
23 that was their desire. There was no -- the fact that a Rule,  
24 that an issue, question of market power had been dealt with  
25 under the Rules did not preclude that party from still seeking  
26 redress or seeking the issue to be determined in another arena.

27 So, we will have a Rulings Panel; it is possible for a  
28 party to challenge this particular Rule, but at the end of the  
29 day, if Part G has been authorised an aggrieved party no longer  
30 has that explicit or that backstop opportunity to raise the  
31 matter in terms of the Commerce Act.

32 **CHAIR:** And are you making the extra point that compulsory  
33 participation removes another avenue of redress?

34 **MR CURRIE:** Yes.

35 **MS REBSTOCK:** I guess the question it sort of begs is whether  
36 there's -- the factors that are considered when a proceeding is  
37 brought under the Commerce Act, somehow differs to the factors  
38 that are considered in coming to a view by the Rulings Panel?

39 **MR CURRIE:** I believe that there is a -- if we take precedent, the  
40 Market Surveillance Committee dealt with the allegation that an  
41 undesirable situation had occurred strictly in accordance with  
42 the Rules of NZEM. There is no wider public interest addressed,  
43 there is no primary objective or a -- the Government -- even the  
44 Government's Policy Statement is not relevant to how NZEM -- it  
45 can only look at that allegation strictly in the Rules and  
46 strictly in accordance with the prescriptive Rules and cross-  
47 referencing to the guiding principles. But a breach -- the  
48 Market Surveillance Committee does not have a wider public  
49 interest --

*Major Electricity Users' Group (cont)*

1 **CHAIR:** The Chairman this morning of the Committee, in reference to  
2 that inquiry last year, did make the point that, I think, none  
3 of the parties to the inquiry took it further; in other words,  
4 took action under this Act or presumably under the normal  
5 contractual provisions.

6 So, while I accept your point in relation to the MSC's  
7 terms of reference, it does seem by the way it's operated to, I  
8 guess, a defacto basis had picked up issues that would have a  
9 wider public interest nevertheless.

10 **MR CURRIE:** Well, I think the Commission would be aware that we  
11 were not totally happy with the outcome of the events of winter  
12 2001, and that has been a matter of a submission, and I think  
13 there is an ongoing investigation into aspects of the events  
14 surrounding winter 2001.

15 So, it may not have been possible for a variety of  
16 commercial reasons for one of the parties that alleged that  
17 undesirable situation to take any further legal action as --  
18 just as part of a commercial undertaking that was consequent --  
19 was a consequence of winter 2001.

20 There may be a variety of reasons -- I'm not trying to  
21 conduct any witch hunt -- but there may be a variety of reasons  
22 why one of the parties did not take any further action.

23 **CHAIR:** Thank you.

24 **MR CURRIE:** In issue 4 we actually don't believe that the quality  
25 in decision-making -- the evidence or the material advanced by  
26 the applicant, that an industry EGB where the board sets the  
27 agenda and is a process supervisor but the industry controls the  
28 votes -- the decision-making and rule changing process via the  
29 chapter-by-chapter votes is going to produce optimal outcomes  
30 forwards. I don't know whether there is.

31 I've observed in para 179 there was the question of the  
32 prudential requirements. Certainly, that was an issue at the  
33 time of the 1996 inquiry, the Commission in Decision 280 left  
34 the issue of prudential requirements as an unauthorised item.

35 There were still ongoing concerns that the prudential  
36 requirements which were set on a gross basis could impose --  
37 could potentially be a barrier to entry, they may impose  
38 significant costs. There were concerns, ongoing concerns, I  
39 know, felt by some of the smaller generators or the smaller  
40 trader participants that -- generators engaged in both sides of  
41 the market, both supply and purchasing, that they would be --  
42 there would be a less costly alternative which would be to have  
43 a net approach, so the prudential requirements would be based on  
44 the -- between their supplies and their purchases out of the  
45 market rather than the -- some of their -- the total of their  
46 supply side, or either side. But it was not really until winter  
47 2001, when there was the threat of imminent default, and that  
48 was the second leg of the July 17 report by the Market  
49 Surveillance Committee, that this issue really came to a head,  
50 and by the 30th of August 2001 the Rules regarding prudential

*Major Electricity Users' Group (cont)*

1 requirements had changed to the extent that a clearing manager  
2 could take into account the hedge element.

3 So, one ends up then with a net exposure which then  
4 determines the prudential requirement, rather than a gross.

5 **CHAIR:** Just a question which may be better directed to NZEM. Has  
6 there been any occasion that you know during the NZEM history  
7 where somebody has been in default?

8 **MR CURRIE:** No, the closest was -- no, perhaps as far as I'm aware,  
9 because that is not my --

10 **CHAIR:** We can ask NZEM anyway.

11 **MR CURRIE:** But as far as I'm aware the first time that the risk of  
12 default was imminent was during winter 2001 when prices  
13 rocketed, you know, they were ten times the average level. So  
14 at that stage there was a constant adjustment necessary on a  
15 monthly basis -- or whatever the frequency is determined by the  
16 Rules -- by the clearing manager of what the prudential -- so  
17 there was an escalating prudential element and it was the -- I  
18 think identified by the clearing manager that there was  
19 potential risk, where one of the parties had signalled either an  
20 inability or an unwillingness or a problem with meeting their  
21 prudential requirements when that issue was referred to the  
22 Market Surveillance Committee.

23 **CHAIR:** Thank you.

24 **MS BATES:** Could I just ask you a question about decision-making by  
25 the industry when it's voting. It's a process matter I'm really  
26 curious about.

27 What information will the industry players have to gain an  
28 industry wide or public -- even a more public orientated  
29 perspective before exercising the vote? I mean, there's --

30 **MR CURRIE:** Are you talking about the past or in the future?

31 **MS BATES:** No, in the future. Presumably the issues are debated at  
32 the EGB board level, and then it's just how the information  
33 surrounding the debate gets to the various people who vote.

34 Are you following the line of my question?

35 **MR CURRIE:** I was just going to attempt to reply. A rule change is  
36 proposed, the EGB determines that it is not trivial or  
37 vexatious. It is obligated, as I interpret the Rules, to refer  
38 that to a Working Group. The Working Group will be appointed,  
39 terms of reference or -- and that Working Group will engage on  
40 analysing that Rule proposal to death or as much as required, I  
41 don't mean to be trite, but they will then come back with a  
42 recommendation to the board and the board really is sort of like  
43 a conduit --

44 **MS BATES:** Yes, that's what I wondered, yep.

45 **MR CURRIE:** And then will put out the rule change.

46 Obviously it will be dependent upon the board and its modus  
47 operandi, but one would imagine that all the reports, the  
48 background -- I think there is provision for a dissenting report  
49 or certainly consumers want to make sure that if there was any  
50 dissent within a Working Group, that the dissenting report or

*Major Electricity Users' Group (cont)*

1 the dissenting opinion went out to the industry prior to any  
2 vote being conducted.

3 So, I would have to say that there is -- by precedent there  
4 is an attempt by all the parties to make sure that everyone is  
5 fully informed as possible. We have cut down several forests to  
6 ensure that the -- and there is both the use of electronic and  
7 hard copy -- to make sure that all the material is put out and I  
8 wouldn't think that an industry EGB would depart from that.

9 So, there is no question in my mind that by way of website  
10 and hard -- and the distribution of material, that informants  
11 who are required to vote will be fully informed.

12 Now, whether the working party could be enhanced by  
13 ensuring that there are mandatory consumer reps involved; that's  
14 obviously a strong view of MEUG and CC 93, but --

15 **MS BATES:** So that that perspective pays what you would consider to  
16 be adequate attention to?

17 **MR CURRIE:** Yes, I have to say, I don't have a problem with  
18 material being placed in front of the parties who are required  
19 to make a decision.

20 **CHAIR:** All right, paragraph 182, I guess is the principal part of  
21 this.

22 **MR CURRIE:** Yes, I think that's a matter which we feel as strongly  
23 on, on that, as we do about guiding principles and touchstones.

24 Paragraph 187 simply reiterates that view in a different  
25 way. I think, if there is imperfect competition, if there are  
26 structural defects or there is evidence -- if to the evidence,  
27 at least allegations or a sense that that market power may be  
28 actually exercised from time to time, or there is a long history  
29 of non-co-operation and collaborative activities, and I would  
30 think that the hold-out on investment in under-investment --  
31 which has forced under-investment in the grid, that this  
32 absolute belief that self-interested parties will make welfare  
33 maximising decisions simply is not it. The consumers do not  
34 accept that that occurs.

35 I think that EGBL issue 11 we have dealt with at length.

36 The transitional dispensations is an issue which has only  
37 been touched upon. There was -- it was issue number 12 for the  
38 applicant. The Commission made reference to transitional  
39 dispensations which, I think as I recall, suggested or indicated  
40 that because transitional dispensations maybe as short a  
41 duration as six months, no particular issues were raised. I  
42 think our response to the Draft Determination, and I think there  
43 has been other material laid in front of the Commission, which  
44 says that the -- a dispensation for non-compliant plant may be  
45 for the life of the plant, of those assets, or may be for a  
46 shorter period, i.e. That is until the next plant -- upgrade of  
47 plant.

48 But the transitional dispensation does in our view warrant  
49 attention. There is a transitional dispensation agreement.  
50 This was entered into between Transpower and the Grid Security

*Major Electricity Users' Group (cont)*

1 Committee. That prescribed or detailed a process and para  
2 7.1.11 of that agreement requires, and I just read the text:

3 "That the Commerce Commission has considered that the  
4 transitional dispensation provisions of the draft Rulebook do  
5 not contravene the Commerce Act 1986."

6 That is a pre-requisite for the transitional dispensation  
7 agreement to in fact come into force. I don't believe, in my  
8 opinion, that that issue has been specifically drawn to the  
9 attention of the Commission and that the appropriate cost-  
10 benefit analysis or quantitative assessment has been undertaken  
11 given that there is -- the competition policy issue is whether  
12 incumbents, or a decision has been made which favours incumbents  
13 vis-a-vis new entrants.

14 So, we just raise the issue again. One other party has, I  
15 think, indicated in its submission that this was a reflection of  
16 anti-competitiveness or -- it was really a contradiction that  
17 every decision in the past had been pro-competitive.

18 I just want to make sure that the provisions of agreements  
19 which authorisation is sought, because granting authorisation to  
20 comprehensive coverage -- or in response to the applicant's  
21 request -- will mean that the transitional dispensations in Part  
22 C are then authorised. There is some quite sharp distinctions  
23 between the process for existing and incumbent generators or  
24 distributors or Transpower itself in respect of non-compliant  
25 assets, and the process and costs allocation which a new entrant  
26 will have to meet at some stage in the future.

27 **CHAIR:** Thank you.

28 **MR CURRIE:** In terms of issue 17, imposition of conditions; I do  
29 believe that we have covered that at length, and --

30 **CHAIR:** I think the point at paragraph 200 is the same point made  
31 by the applicant, I think, bottom of page 39.

32 **MR CURRIE:** Oh, this was that we were -- we could be described as  
33 disingenuous, I think was the --

34 **CHAIR:** No, I just make the point about the date of communication,  
35 I'm not commenting on any other comments in the applicant's  
36 statement; it's only the date I'm referring to.

37 **MR CURRIE:** Yes. I don't think we -- in making a -- in commenting  
38 on the timing I think it was -- that was of lesser substance to  
39 us, and I think we've already addressed whether procedural  
40 defects or the due process -- but it was the substance. So,  
41 that was not a particular issue of concern.

42 I'm just trying to see whether there was --

43 **CHAIR:** I'm not making any comment on any other part of the  
44 applicant's submission. The main point is paragraph 205.

45 **MR CURRIE:** Commissioner, I think there are a variety of other  
46 matters that we could touch on, but I think we have had a full,  
47 lengthy, much longer than expected appearance before the  
48 Commission. I think we have had every opportunity to raise the  
49 issues that we want to raise.

*Major Electricity Users' Group (cont)*

1           So, unless -- Ralph -- there are issues that you think we  
2           should re-raise, that's our presentation.

3   **CHAIR:** Thank you for your submission and also for your willingness  
4           to get into a debate, that's been very useful.

5           Even though it means a little less than an hour for lunch,  
6           I'd like to start as close to 1.30 as we could, please. So,  
7           we'll adjourn until then. Thank you, Mr Currie and Mr Matthes.

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10                           **Adjournment taken from 12.37 pm to 1.33 pm**

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**PRESENTATION BY COMALCO**

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2  
3 **CHAIR:** We'll resume, and Comalco are the next submitters.  
4 Mr McDonald, over to you, please.

5 **MR McDONALD:** Thanks very much, John. By way of introduction, my  
6 name is Kerry McDonald. I'm Executive Director of Comalco New  
7 Zealand and I'm Executive Director of Comalco Power. On my  
8 right is Jason Franklin, who is Power Manager for Comalco in New  
9 Zealand. On my left is Loren Blauensteiner, who is the Power  
10 Analyst for Comalco.

11 We'll cover, following our introductory comments, specific  
12 issues relating to Comalco Power agreements and specific issues  
13 relating to the application.

14 We oppose the authorisation of the application. We don't  
15 intend restating our written submission at this point but would  
16 be happy to take questions on it, and I should note, we support  
17 the submissions made by MEUG and by CC 93.

18 As most people know, Comalco is New Zealand's largest  
19 electricity consumer, we account for about 15% of demand. We've  
20 been involved in the electricity reform process since the mid-  
21 1980s. I was Deputy Chairman appointed by the Government of the  
22 Transpower Establishment Board for the first break-up of NZED  
23 and I was a member of the Interim Grid Security Committee and  
24 have been involved in various other processes.

25 Our focus throughout this has been to get the best outcome  
26 for all consumers on the basis that if we simply pursued a  
27 narrow interest for Comalco we would be unsuccessful.

28 The reforms, in my view, have consistently failed to  
29 deliver sound arrangements for the industry. The one exception  
30 which showed some promise was the last process which led to the  
31 MACQS arrangements and the Grid Security Committee, that stands  
32 head and shoulders above the rest. The reasons being: It got a  
33 sound voting structure for decision-making, there were a robust  
34 set of guiding principles to guide decision-making, the process  
35 required the identification of clear benefits if change was to  
36 be made, and overall the governance structure around the process  
37 was a powerful and balanced one.

38 We supported the authorisation of the MACQS arrangements  
39 and are a member of that contract. However, we see significant  
40 dilution of that arrangement in the attempt to transfer it into  
41 the proposed new Rulebook.

42 Energy intensive industries need to be able to put in place  
43 secure long-term arrangements for their energy requirements.  
44 However, this Rulebook, due to its governance structure, poses  
45 serious risks for existing and potential industries. If value  
46 added processing is to be undertaken in New Zealand an efficient  
47 electricity industry is essential to support this investment.  
48 The proposed arrangements give no confidence that the reasonable  
49 needs of electricity consumers are recognised. With the voting  
50 rights dominated by vertically integrated generators, being a



1 major user of electricity in New Zealand will be an unacceptably  
2 risky proposition and one that prudent investors will avoid.

3 We believe that the arrangements need to ensure the  
4 following features are present: existing contractual rights  
5 should be fully protected and there needs to be an Electricity  
6 Governance Board with executive powers, preferably Crown owned  
7 with acceptable guiding principles and an appropriate  
8 review/appeal process.

9 The decision-making on Rule changes should only be allowed  
10 where there is a clear defined net benefit such that there is a  
11 capacity to compensate those that are adversely affected by the  
12 change, and this is a criteria in the existing MACQS  
13 arrangements; broad industry-wide representation should be  
14 guaranteed for the Rulebook chapters; the guiding principles  
15 should be fully aligned with the Government Policy Statement on  
16 electricity; and bilateral contracting for electricity supply  
17 should be freely allowed.

18 Specifically on the Comalco position, we have a major  
19 investment in New Zealand, assets worth well in excess of two  
20 billion, a major export industry, and in the mid-90s we spent  
21 some 500 million NZ in upgrading, refurbishing and expanding the  
22 smelter.

23 We have a series of long-term contracts in place with  
24 Meridian Energy and Meridian has subcontracted some of their  
25 obligations to us to Transpower, therefore -- although parties  
26 have significant long-term contractual obligations linked with  
27 the supply of energy to the aluminium smelter.

28 We believe that the proposed Rule arrangements would  
29 undermine the existing contracts. The areas of concern relate  
30 to transmission and Part F of the Rules are relevant there;  
31 common quality, and Part C is relevant, and governance Part A is  
32 relevant.

33 After detailed analysis and legal advice I can state that  
34 Comalco has no intention of joining the Rulebook as it is  
35 currently set out. It does not support the governance  
36 structure, and the other arrangements; the lack of appropriate  
37 guiding principles, the lack of proper decision criteria and the  
38 lack of review and appeal facilities of an adequate standard  
39 mean it would be foolish for us as a business to subject  
40 ourselves to the Rulebook jurisdiction.

41 It is also our view that neither Meridian or Transpower  
42 should join the Rulebook because the risk to the existing long-  
43 term arrangements with Comalco would make it unwise for them to  
44 do so. Should either party decide to join the arrangements,  
45 then Comalco will have no option but to remind them of their  
46 legal obligations.

47 The specific issues of concern to Comalco will be of  
48 concern to any company wishing to enter into contracts for the  
49 long-term supply of electricity at the wholesale level, and if  
50 we look ahead to the development of the forestry sector and the

1 processing of the large amount of wood coming to maturity in the  
2 near future, I suggest that this is an important issue to be  
3 considered.

4 **MS REBSTOCK:** Can I just ask you a question there. The applicant  
5 in one of the first few days of these hearings addressed that  
6 point and has suggested that it has no intention of interfering  
7 with the contracts that you have and that it can and will find a  
8 way to deal with that under the Rules.

9 I believe there's been some dialogue with Comalco and  
10 Meridian on that point, and I wonder, even if there is a way to  
11 address your particular concern today -- first of all, I'd like  
12 to know whether you accept that they are able to address that  
13 concern adequately and that we can accept that assurance when we  
14 consider our decision, but even if they were to address your  
15 particular concern, would there in your view be an ongoing  
16 concern looking forward for similar industries?

17 **MR McDONALD:** Thank you. In commenting I'll focus on two areas;  
18 the specific and the general. In the specific I'm not aware of  
19 any approach to us or any suggested solution to the question of  
20 the long-term agreements, but it would be typical of the way  
21 that the industry governance arrangements have operated in the  
22 recent past, that this would be promised at the final hurdle  
23 simply as a compromise to be able to achieve their particular  
24 objectives.

25 Now, for us to be comfortable with any proposed solution we  
26 would have to see it set out in writing and have the opportunity  
27 to review it and agree or otherwise to it, and as I said at the  
28 outset there's been nothing of that nature suggested to us.

29 I think from a national point of view the second element is  
30 principles are at least as important because there has to be a  
31 clear ability for organisations to enter into bilateral  
32 contracts, and it would require a significant shift in the  
33 existing arrangements to allow that, and then there's the  
34 question of the ability of the Rules to be changed by a group of  
35 people who have no alignment at all with the interests of the  
36 other parties. The voting chapter, for example, in most key  
37 areas for us is the combination of retailer and generator.  
38 There is no basis for alignment, other than perhaps with  
39 Meridian, with our interests.

40 The guiding principles don't focus on national interest.  
41 Unlike the Government Policy Statement, the guiding principles  
42 do not give the sort of comfort that the MACQS arrangements do.

43 Now, we don't want a perfect world, we take a whole lot of  
44 risks and a whole lot of markets in different areas, and, as I  
45 said, we went into MACQS; there are significant risks for us in  
46 MACQS but they are acceptable risks.

47 **MS REBSTOCK:** The applicant has put it to us that -- and I think  
48 there's some case to be made -- that the GPS applies whether  
49 it's embedded in the Rulebook itself or not, the industry EGB  
50 would be held accountable to that GPS.

1           It has been suggested that the role of the Minister with  
2 the industry EGB will ensure that that happens, and the ongoing  
3 threat of regulation. So, I'd just like to hear your response  
4 to that.

5           A lot of emphasis in terms of what we would normally look  
6 for in terms of the constraint on market behaviour, a lot of  
7 emphasis has been put on the role of the Minister and the text  
8 that is created by the GPS and the ongoing threat of regulation.  
9 So, I'd welcome your comments on that.

10 **MR McDONALD:** My view is that that perspective is not a credible  
11 framework within which to make major investments. As an  
12 accountable executive in a business and director of a range of  
13 companies, including a major company in the forestry sector, you  
14 would have to have more substance to rely on before you  
15 invested, before you made a substantial commitment, because you  
16 simply couldn't rely on that sort of framework.

17           In contrast -- I mean, it doesn't even get traction within  
18 a political context. We're exposed day-by-day to changes in tax  
19 rates, for example; those changes will be made in a political  
20 context. So we accept the risk of that, but what we're looking  
21 at here is a much narrower context and a much smaller degree of  
22 alignment of interest between our potential interest, or the  
23 interests of an investor in a major asset, and those of the  
24 interests of the people who are making the rule change.

25 **CHAIR:** Just a follow up point. You say at page 4 of your response  
26 to the Draft Determination, an EGB with executive powers,  
27 preferably Crown owned, with acceptable guiding principles. A  
28 Crown EGC, one assumes, is also subject to direction,  
29 interference or guidance.

30           There's a risk there as well, from what you are saying?

31 **MR McDONALD:** Yes.

32 **CHAIR:** Do you see that as being a more manageable risk from your  
33 point of view?

34 **MR McDONALD:** Yes, we do, Chairman.

35 **CHAIR:** Why? Practically, how would you see that risk as being  
36 more manageable?

37 **MR McDONALD:** Any decision-making body within the State Sector, the  
38 accountability flows through to Cabinet almost without  
39 exception. We're quite happy to accept decision-making in a  
40 political environment because there are a range of political  
41 checks and balances that come to bear.

42           For example, if there's a change that's going to adversely  
43 affect industry, then the people -- the politicians making that  
44 decision will be conscious of the community reaction to that  
45 change. That's a normal part of the business environment that  
46 we operate in, and presumably the politicians will operate in  
47 the national interest.

48           If we look at the EGB, it has no equivalent alignment. It  
49 doesn't even have a -- it won't even have a consumer interest of  
50 significance in the Rule making decisions.

1 **CHAIR:** Well, there was a submission made to us yesterday, I think  
2 by Contact, who in their view saw the ability of parties to  
3 influence the Crown EGB, not necessarily the national interest,  
4 that's a point of definition, I guess, as being a pretty strong  
5 detriment to a Crown EGB. In their view, for what it's worth,  
6 and I think it's on the record, was that a particular interest  
7 inferencings the Crown EGB would in essence outweigh any  
8 national interest.

9 So, that's been made to us fairly strongly. MEUG has  
10 suggested possibly some changes in the executive role, if you  
11 like, of an EGB for the industry. One assumes, as you said,  
12 that you are basically in line with MEUG; you'd support that  
13 approach which has been suggested.

14 But, are you still saying though that a Crown EGB,  
15 notwithstanding if there were changes like that, is still  
16 preferred?

17 **MR McDONALD:** At the end of the day the ownership of the EGB is  
18 much less important than the Rules under which it operates, and  
19 if there's a good -- if the voting structure is appropriate, if  
20 the guiding principles are appropriate and there's a good basis  
21 or good process of review and appeal, then that is a highly  
22 desirable outcome and it takes the pressure away from who owns  
23 it.

24 As we fall short on each of those other grounds, so the  
25 ownership becomes more important, and I feel at the present  
26 we've got the worst possible outcome, it's right at one extreme,  
27 a Crown ownership one is a better compromise.

28 **MS BATES:** Could I just ask you whether you would prefer the status  
29 quo to either option?

30 **MR McDONALD:** Operating under MACQS?

31 **MS BATES:** Yes, the status as it is now?

32 **MR McDONALD:** Yes, we would. We do want to see continuous  
33 improvement in the industry. Transpower is a good example, in  
34 our view, of that being achieved and MACQS is a framework which  
35 allows improvement to move forward. So we would be -- there are  
36 issues around NZEM and MARIA, for example, there needs to be  
37 improvement there; those again are just generator dominated  
38 forums which have almost complete disregard for the interests of  
39 consumers. But the MACQS framework and the Grid Security  
40 Committee has developed into a broadly acceptable arrangement.

41 **MS BATES:** Thank you.

42 **MS REBSTOCK:** You indicated before, and I know you have stepped one  
43 step away from the notion of supporting a Crown owned EGB, but  
44 the counterfactual that we have adopted for the purposes of  
45 looking at the competition effects is not that you would have an  
46 independent EGB making the decisions, it's that they would make  
47 recommendations to the Minister who would make the decisions.

48 So, when we do the comparison of the proposal, it's with  
49 that scenario, it's not with an independent Crown appointed EGB,  
50 that is one step removed from the Crown.

1 I wonder if your comments and your preference extends to  
2 the actual counterfactual that we are comparing with here?

3 **MR McDONALD:** I believe that the counterfactual is preferable to  
4 what's proposed here, because the counterfactual is equivalent  
5 to a Government Department operating with the Chief Executive  
6 reporting to a Minister, and that covers a whole lot of the  
7 areas that we have to deal with.

8 Now, if we can move on from that sort of arrangement, if we  
9 can have an industry-based arrangement that is robust, that in  
10 my view is a preferable outcome. But the arrangement that's  
11 being proposed now is well removed from that, and I think we're  
12 much better to go back to a genuine old-fashioned public sector  
13 type arrangement rather than get caught up in what's proposed  
14 now.

15 And the key issue there is the lack of alignment in the  
16 proposed arrangement between the interests of the people that  
17 are making decisions and the people who will be affected by the  
18 decisions, other than those voting parties. In other words,  
19 there's no one voting in what's proposed that has an inherent  
20 alignment with the interests of major consumers, or minor  
21 consumers really. And I'd rather take the risk with the  
22 political process than have that degree of exposure, and I  
23 simply -- if I'm recommending to a board on a decision, I simply  
24 could not recommend that we take the risk in that sort of  
25 environment, because it's too unpredictable and there's too  
26 little alignment with our interests.

27 **MS REBSTOCK:** We've heard a lot of evidence that the commercial  
28 interests of the players aligns well with the public interest  
29 and you could expect the industry players to vote in a way that  
30 would promote the public interest, and I guess you are very  
31 clearly stating that you don't accept that proposition, and I  
32 wonder if you can give us any evidence from the current  
33 environment to support that?

34 **MR McDONALD:** The best way of -- for us to answer that, if it's  
35 acceptable to you, would be to give you a brief note that set  
36 out a list of examples. There are some within our submission in  
37 supplementary comment where we've identified things that have  
38 been of concern, the concerns have been raised with the industry  
39 decision forums; there has either been absolutely no response  
40 or, at the last minute in response to intense political pressure  
41 or risk, some sort of adjustment has been made. But there are  
42 numerous examples of concern by consumers that simply haven't  
43 been addressed by the industry.

44 **CHAIR:** If you'd like to give it now we'll circulate it to other  
45 parties.

46 **MR CURTIN:** Just taking your point about major energy intensive  
47 projects and the business risks they would run.

48 I just wondered, when you're talking about the conflict  
49 between the Rulebook and your existing long-term supply  
50 contract, are the difficulties there wholly related to the

1 effect of prohibition on bilateral contracting or are there  
2 other elements of the Rulebook that in your view impede the  
3 long-term supply contracts that you have presently got, or other  
4 large projects might be thinking about?

5 **MR FRANKLIN:** Broadly the concern is that the Rulebook has a  
6 potential -- and real potential from our legal advice -- to  
7 over-ride existing contractual provisions. Whether that is due  
8 to Part C or part -- so there are some real risks that the  
9 arrangements you may make bilateral can be interfered without  
10 any consent or any redress. So, that is our major concern.

11 **CHAIR:** Presumably it's likely that there will be other parties to  
12 the Rulebook, generators for example, who also have long-term  
13 contracts that don't see the proposition as currently framed  
14 putting those at risk?

15 **MR FRANKLIN:** We're unaware of any other long-term contracts of our  
16 particular nature that are out there. We don't think Transpower  
17 have a similar long-term contract with anyone else.

18 **MS BATES:** While I can see that there may be situations where the  
19 Rulebook and contractual obligations conflict, I can't see at  
20 the moment how the Rulebook can unilaterally change contractual  
21 obligations.

22 If you have had some legal advice to the contrary, I'd be  
23 interested to hear what it is.

24 **MR FRANKLIN:** Yes, we can provide that, and it does say that it  
25 does put parties in a very awkward position where they have two  
26 conflicting obligations and one is going to have to be breached.

27 **MS BATES:** Yes, I've got that far, but I don't think -- can you go  
28 the rest of the way where you say that the contractual  
29 obligations are actually wiped out? The contractual obligations  
30 would still exist.

31 **MR McDONALD:** Yes, I think that's the key issue. So, if you enter  
32 into the Rulebook you are putting yourself in a situation where  
33 potentially changes to the Rules will be inconsistent with your  
34 legal obligations. So, you know, just a --

35 **MS BATES:** You can't please everybody.

36 **MR McDONALD:** You can't please everybody. So to paint a scenario,  
37 if Comalco is not a member but parties contracted to us are, and  
38 their position is adversely affected by Rule changes, that  
39 doesn't in any way negate the legal obligations they have got to  
40 us. So, if they are not performing we would certainly respond  
41 and take appropriate legal action.

42 **MS BATES:** I haven't thought this through a lot but I suppose on  
43 the other side of the coin, if you did join, then you may have  
44 been thought to have acquiesced to the Rules?

45 **MR McDONALD:** Yes, exactly.

46 **MS BATES:** Does that influence your thinking about joining?

47 **MR McDONALD:** Very much so. You know, and I'm sure, as you  
48 understand, as executives you have accountabilities, you have  
49 got to give advice. If we recommended that we become subject to  
50 these circumstances given the extent of the uncertainty and the

1 risks involved, then I think we'd be looking for other work  
2 fairly quickly.

3 **MR CURTIN:** I think you mentioned the wall of wood, and I know it  
4 was mentioned earlier by MEUG. Is it your opinion that wall of  
5 wood style projects require bilateral physical trading  
6 capability to take place?

7 **MR McDONALD:** There is a significant likelihood that they will.  
8 Now, I'm using experience here as a director of a substantial  
9 forest owning and forest processing company; there will be a  
10 strong focus on using waste wood resource as an energy source,  
11 but that is unlikely to go far enough to satisfy the Rule  
12 requirements of a major processing plant.

13 The world has changed -- we have major processing  
14 facilities in New Zealand that don't have long-term contracts  
15 for electricity supply, but in the current circumstance major  
16 investments won't take place without the energy supply being  
17 reasonably secured. So, having attempted to supply as much as  
18 possible from waste wood and other type projects, there will be  
19 a strong focus on contracting to fill the gap.

20 **MR CURTIN:** And you would argue that that would have to be on a  
21 long-term basis, a bilateral physical supply basis rather than  
22 through the spot market?

23 **MR McDONALD:** Yes. The alternative to the spot, if you couldn't  
24 get the long-term contract, the last resort would be to invest  
25 in your own generating capacity as an alternative to taking the  
26 risk on the spot market.

27 **MR CURTIN:** And is the risk on the spot market a price risk or a  
28 delivery risk, if I can put it that way?

29 **MR McDONALD:** It's both, and that's given -- we look at the  
30 supply/demand forecasts very closely. There's a good set of  
31 forecasts from the Ministry of Economic Development, recently  
32 updated, and you would be aware of the debate around the gas  
33 supply position in New Zealand and Maui; we are all aware of the  
34 Government's position on additional coal fired generation.  
35 There hasn't been a major hydro project authorised in New  
36 Zealand under the Resource Management Act; there have been some  
37 small ones, but nothing big.

38 So, if you look at supply/demand forecasts, that it is a  
39 serious issue for major investment in an electricity using  
40 industry. So it's not just a price risk and the underlying  
41 supply/demand position causes a sharper focus on the price risk  
42 than there might otherwise be.

43 **MR CURTIN:** It was put to us this morning by MEUG that, in doing a  
44 cost-benefit analysis we had under-estimated the dynamic  
45 inefficiencies of the Rulebook in general, and again this is  
46 particularly related to wall of wood kind of issues. Would that  
47 be your thinking, or would you have any feel of what the scale  
48 of dynamic inefficiencies might be?

49 **MR McDONALD:** I haven't looked at that aspect of it in any detail  
50 at all. So, I'd prefer not to comment on that.

1 **MS REBSTOCK:** In your submission you did briefly comment on  
2 Section 30, and you may recall that in the Draft Determination  
3 we raised the issue about whether the divisions are caught by  
4 Section 30.

5 I note at the end of the section of your submission you  
6 indicate that you don't think the wholesale pricing mechanism  
7 should be given an authorisation. Are you saying it's caught  
8 and it shouldn't be authorised, or are you saying it's not  
9 caught and, therefore, shouldn't -- doesn't need to be  
10 authorised?

11 **MR FRANKLIN:** I think this is the same sort of dilemma that we  
12 heard yesterday which MEUG raised and, if it is caught, then it  
13 does get the protection from authorisation which you may not  
14 necessarily want either. So there is a dilemma there.

15 The issue that we have raised around Section 30 is more  
16 that it needs a closer look when the NZEM arrangements were  
17 initially before the Commission. We're merely noting that the  
18 industry has moved on significantly since then. The number of  
19 active buyers and sellers at the wholesale level has changed  
20 dramatically and those buyers are, on the whole, normally the  
21 sellers as well.

22 So, we believe that it requires a closer look.

23 **MS REBSTOCK:** And you have also raised an issue about -- in the  
24 context of this discussion on Section 30 -- the additional levy  
25 on non-members being potentially in breach of the Commerce Act  
26 and being discriminatory.

27 Is that -- is there any further comments you want to make  
28 on that?

29 **MR FRANKLIN:** Not particularly, other than that does assume that  
30 those parties don't have existing arrangements in place and have  
31 been paying for those and have those arrangements structured and  
32 set-up for a long time, which obviously we do have.

33 **MS REBSTOCK:** You may be aware that the Commission raised the  
34 possibility of conditions being imposed on any authorisation  
35 should we find that the proposal is authorisable.

36 Have you given consideration to the question we posed about  
37 what conditions might be appropriate?

38 **MR McDONALD:** We've made a range of comments that -- including  
39 today -- which broadly cover our views on that, but if you wish  
40 to we would be happy to provide a brief but specific  
41 specification of what we think would be necessary.

42 **CHAIR:** Well, I think, again, it would help but I just make the  
43 point we'd probably need any written supplementary information  
44 by tomorrow so we can circulate it in time for the end of the  
45 Conference. Of course, the applicant may wish in summing up to  
46 comment, so make sure -- that would need to be done fairly  
47 quickly, but it would be useful to have it.

48 **MR CURTIN:** Just one question, and it got a bit technical -- I have  
49 to admit it got a bit technical for me, and this was the  
50 discussion of removal of demand bids as an example of blocking



1 of pro-competitive rule changes, but I wonder if you'd just like  
2 to go through the chronology and explain to us why you found  
3 that to be an example in your view of the bulking of pro-  
4 competitive rules, bearing in mind we're not engineers on this  
5 side of the table?

6 **MR FRANKLIN:** I'm not an engineer either. I think -- if you don't  
7 mind, Commissioner, what I can do is give a general view on the  
8 pro-competitive rule change issues that we did raise, which I  
9 can cover the demand bids as well.

10 The issue here goes back to the heart -- back to governance  
11 and the ability to change the industry Rules. We do note that  
12 the Commission has raised some concern or raised the question  
13 about Part G especially, trading, and the ability for pro-  
14 competitive rule changes to be blocked or stalled.

15 It would be fair to say, from our observations and  
16 experience within the various industry forums and Working  
17 Groups; which have been EGEC, not quite so much MACQS, but more  
18 recently NZEM as well, that we do share those concerns.

19 I think examples of those have been with those bid  
20 removals, release of generation offers, real time pricing and  
21 FTRs. We found the process to finally get some of these  
22 initiatives advanced to be very slow and have been resisted.

23 In order to get progress for a lot of these initiatives,  
24 which the demand side has been pushing for a considerable amount  
25 of time, what we found needs to be present is some extreme  
26 political pressure and also normally a combination of  
27 undesirable events. Recently that combination was a Government  
28 Policy Statement with a lack of progress towards the GPS in  
29 meeting some of the demand initiatives.

30 The winter 2001 situation, the Ministerial review of that  
31 winter and also the prospect of another winter situation in  
32 2002; we found with that combination of events that progress did  
33 start happening, but it's very frustrating to have to wait to  
34 have to go through those sort of situations before some of these  
35 things actually get advanced.

36 The demand bids situation was reflective of what happened  
37 during the EGEC process. While the assumption was that the  
38 change would be baseline minimal, we found there were  
39 significant changes made which did suit those parties under the  
40 trading chapter, and when we consumers or the CC 93 consumers  
41 proposed what we thought were logical changes to advance  
42 consumer's interests, they were blocked. Unfortunately you're  
43 outvoted; a majority occurs and it moves forward.

44 We felt, especially in that situation, that we put up some  
45 logical arguments to counter what was stopping it happening.  
46 However, it didn't occur.

47 Just clarification on that, removal demand bids, what it  
48 does do, it allows the demand side to more freely interact and  
49 to react up to real time without having been held back through  
50 NZEM Rules. We believe there is a case for it. We believe that

1 the security concerns that Transpower may have can be  
2 accommodated and that could have been worked through. The real  
3 reasons for retaining demand bids seem to be to provide  
4 information for generators which they want to use to have an  
5 idea of what their next day commitments are, not really  
6 satisfactory reason to restrict demand to interact.

7 **MR CURTIN:** Thank you.

8 **CHAIR:** Just to pick up, I think, on two or three of the main  
9 issues you mention when you started; Part F, I think you have  
10 concerns with. I think MEUG this morning, and one of your  
11 colleagues may have heard Mr Currie, does see a fair bit of  
12 merit in Part F.

13 I just wondered, is it Part F in principle or are there any  
14 particular provisions of it that are of concern?

15 **MR FRANKLIN:** Part F, I think the processes for looking at new  
16 investment and getting agreement on that are generally good.  
17 Our main concern with Part F is the over-riding of our long-term  
18 contracts.

19 However, some of the decision processes to get parties to  
20 address some of the much needed transmission investment is a  
21 step in the right direction.

22 **CHAIR:** I mean, that certainly has been said by other submitters,  
23 that the lack of investment in the grid is a cause for overall  
24 concern, and I think Mr McDonald mentioned it in relation to the  
25 various wood processing requirements etc.

26 So, you see that as a plus for Part F anyway?

27 **MR FRANKLIN:** We do, and it's probably about the only positive that  
28 we've seen come out of the process, and it is one that we think  
29 Transpower did take some leadership on in the Transport Working  
30 Group.

31 **CHAIR:** The other one comes back to a point, again, contrasting the  
32 Crown EGB and the EGB that's in the applicant's proposal.

33 I guess the obverse of the comment you made was made to us  
34 yesterday by another submitter; that the Crown EGB, because of  
35 the political dimension of it, would dissuade them from making a  
36 number of investments they say are imminent. Now your view, I  
37 think is completely a 180 degrees spectrum of that one;  
38 completely the opposite, as I read you?

39 **MR McDONALD:** I think it's a bit more complicated than that,  
40 Commissioner. There are risks both ways and it really -- the  
41 thing I come back to is less one of ownership and more one of  
42 the governance principles etc that are around the particular  
43 body.

44 I think there's quite a bit of denigration of a Crown owned  
45 EGB. One of the examples I'd use, for example, on the positive  
46 side for that is the performance of Transpower over the past  
47 five years. I know a lot of people choose to denigrate it.  
48 Five, six seven years ago we were probably the harshest critic  
49 of Transpower because they were not being pro-active; they were

1 allowing costs to increase, they were not seeking improvement on  
2 a consistent basis in the system.

3 Now, I would say there was a fundamental shift in their  
4 approach about five years ago; they are a Crown owned, directly  
5 Crown owned and controlled entity, but they have shown a lot of  
6 leadership and a lot of progress in improving the industry and  
7 were one of the leaders in getting the MACQS arrangements in  
8 place.

9 **CHAIR:** Are we talking about the same animal, do you think?

10 **MR McDONALD:** Yes, I think we are.

11 **CHAIR:** I'm not saying that Transpower is a bit of an animal. Is  
12 the Crown EGB and Transpower the same animal structurally,  
13 that's what I'm talking about?

14 **MR McDONALD:** You have choices over how you would structure it.  
15 I'm talking about Transpower as being a Government owned,  
16 Government controlled entity as distinct from an industry-based  
17 body.

18 My main point here is the prior one, I'm less concerned  
19 about who owns it and more concerned about how the decisions are  
20 made, the governance framework, the rights of review and appeal;  
21 that's the critical issue. But if it's a choice between a  
22 Government owned EGB, Government controlled EGB and what's  
23 proposed in the current application, I would go to the  
24 Government option quickly.

25 **CHAIR:** Notwithstanding, as you said earlier, that a Crown owned  
26 EGB would take strongly into account, I think, political  
27 processes and so on, whereas as I understand the SOE model, once  
28 the SCI is set and the objectives of the organisation are agreed  
29 with the Government, that's it, the Minister has very little  
30 direct involvement year by year?

31 **MR McDONALD:** If it was set-up as an SOE with an SCI -- and again  
32 Transpower has an SCI -- then that is, in my view, a  
33 satisfactory option and, in fact, it's a much better option than  
34 what we're faced with under the current Rules because Transpower  
35 are held accountable for performance against the SCI.

36 The point I was making earlier about political risk is that  
37 we would prefer to accept political risk with a Crown owned  
38 organisation than be subjected to the uncertainty and the lack  
39 of alignment that's inherent in the EGB as it's currently  
40 proposed. There are simply insufficient guidelines, constraints  
41 and so on.

42 Now, if the guiding principles conformed with the  
43 Government Policy Statement, that would be a major step in the  
44 right direction. Now, no doubt the people supporting the  
45 application will say they already do. The reality is, they  
46 don't.

47 Now, I think it's quite a significant thing to have a  
48 strongly private sector based and focused organisation like  
49 Comalco saying that the best thing going for it is the  
50 Government Policy Statement on electricity, and we've said that

1 for years; so I can't understand why basically Government owned  
2 organisations are not embracing it with enthusiasm.

3 **MR CURTIN:** Could I just ask one question while we're on this  
4 general issue of the Crown EGB.

5 In the Draft Determination one of the qualifications we  
6 suggested was that the cost of capital for people involved in  
7 the power industry could rise, reflecting the fact that had an  
8 activist political influence on the industry that wasn't there  
9 before, particularly from overseas it might be viewed as a more  
10 risky industry where Governments are likely to do God knows  
11 what.

12 I wonder if you have got any views on what the impact of a  
13 Crown EGB might be on the cost of capital compared to the  
14 arrangements today?

15 **MR McDONALD:** I'll answer the question directly, although there's a  
16 risk that I may be answering it in a way that you -- I may give  
17 you an answer to a different question.

18 Cost of capital obviously is explicit within the lines  
19 companies and so on; and I take it we're not focused on that  
20 area at all, we're talking about a market response to a  
21 particular set of circumstances.

22 My view would be that the cost of capital would inherently  
23 be substantially higher under the arrangements proposed in the  
24 application, because of the uncertainty surrounding it.

25 Now, and I would think that that would tend to apply, not  
26 just to -- as an outside perspective on the industry, but within  
27 the industry as well.

28 In terms of my understanding, there is nothing to stop --  
29 there's nothing in the present application to stop a particular  
30 group currently associated with the EGB or in one of the  
31 chapters from isolating and making adverse decisions about some  
32 other member or some other category within the group.

33 Now, I think once due diligence identified that as a risk,  
34 then your cost of capital is immediately higher.

35 **MR FRANKLIN:** Just to add to that, I think one area of comfort we  
36 have with the MACQS arrangements was an underlying assumption  
37 there that if any rule changes were to progress or to advance a  
38 net benefit must be demonstrated and those parties who are  
39 adversely affected would have to be compensated to allow the net  
40 benefit to advance; and the checks and balances in the  
41 governance gave that comfort. We don't see those sort of  
42 comforts or checks and balances at all within the proposed  
43 arrangements, which add to that risk.

44 **MS BATES:** Could I just take you back to something you said about  
45 Transpower, which was that there was a fundamental shift five  
46 years ago. I'm just curious as to whether you have any reasons  
47 to advance as to why that might be?

48 **MR McDONALD:** I've given the odd speech on the topic, so I'm happy  
49 to respond to it.

1 In my view, the depth of reaction in the community  
 2 generally, and particularly within the power industry, to  
 3 Transpower's performance was such that the Government decided it  
 4 had to act. There was a series of changes affecting Transpower,  
 5 including major changes at the board level, and a marked change  
 6 in the Statement of Corporate Intent, and that seemed to be a  
 7 significant resetting of Transpower's approach; and there have  
 8 also been changes in the senior executive structure and in the  
 9 way the business generally approaches issues.

10 Now, I know there's a very -- divided views on Transpower  
 11 as I'm sure you have seen --

12 **MS BATES:** It's political reasons really, what you are describing,  
 13 aren't they?

14 **MR McDONALD:** There was a political trigger to the change, but I  
 15 think in parallel to that there were -- you know, the position  
 16 was building up to the point where something had to happen.

17 Now, the political trigger is consistent with my view that  
 18 I would rather have an EGB which is subject ultimately to  
 19 political influence, rather than one that is sort of a totally  
 20 independent body with a complete lack of alignment with,  
 21 firstly, national interest and, secondly, the interests of  
 22 consumers.

23 **MS REBSTOCK:** Didn't that example actually happen in the context of  
 24 an industry EGB in effect?

25 **MR McDONALD:** No. It was a specific -- it was a series of changes  
 26 that just affected Transpower in isolation; so it was a matter  
 27 between Cabinet, the SOE Minister, the Minister of Energy, the  
 28 governance of Transpower and its SCI.

29 **MS REBSTOCK:** But it was in response to industry concerns?

30 **MR McDONALD:** Yes, including consumer concerns.

31 **MS REBSTOCK:** So why would the Government not continue to play that  
 32 role on behalf of the public interest under the proposal?

33 **MR McDONALD:** Where my comments get to is that I expect the  
 34 Government would continue to play that role. If it's a Crown  
 35 owned EGB then it is the more exposed to the checks and balances  
 36 of the political process. If it is an industry EGB then it's  
 37 one stage further removed.

38 I see this as an absolutely critical issue in that, as  
 39 proposed the EGB -- if its guiding principles were consistent  
 40 with the Government Policy Statement then I'd be rather more  
 41 accepting of it, and I can't understand why you would wish to  
 42 set up an EGB to regulate an industry with a set of Rules that  
 43 are inconsistent with the Government Policy Statement when that  
 44 Government Policy Statement is widely accepted.

45 **MS REBSTOCK:** Can you tell me exactly how you think it's  
 46 inconsistent, the Rulebook, with the GPS?

47 **MR McDONALD:** Well, if you compare -- I mean, I haven't done this  
 48 personally -- we have done it and MEUG have done it and I have  
 49 had the benefit of the advice from that. There is a key  
 50 statement within the Government Policy Statement and within the

1 MACQS arrangements, which I believe was in the MEUG submission  
2 to you yesterday, about the supply of electricity, that the  
3 critical factor is the supply of electricity to consumers at  
4 lowest sustainable cost with a reasonable rate of return to the  
5 supply industry; that's that sort of package view.

6 **MS REBSTOCK:** And what is it in the Rulebook that doesn't yield  
7 that -- meet that?

8 **MR FRANKLIN:** I think it reflects more that that overarching  
9 objective is not within the Rulebook's guiding principles and  
10 you can't rely on that for the protection of consumers of the  
11 consumer enhancing guiding principle. It's just not there; it's  
12 skirted around, but it's not there.

13 **MS REBSTOCK:** It's been emphasised that the industry EGB however  
14 would -- is still accountable for the GPS, and if it, for  
15 whatever reason, failed to meet the obligations under the GPS,  
16 that we would revert to a Crown EGB anyway.

17 So, first of all, that would be an ongoing discipline and  
18 even if they didn't do so you would quickly find the industry  
19 with a Crown EGB.

20 **MR McDONALD:** I think a relevant issue here is why the proponents  
21 of the EGB in its present form don't simply adopt the guiding  
22 principles in the MACQS arrangements. I mean, they were  
23 intensely debated through and they were finally accepted as  
24 being appropriate, and they bear a close alignment to the  
25 Government Policy Statement.

26 Now, if the EGB proponents are of the view that you are  
27 outlining, well, I would simply suggest that they adopt the  
28 MACQS guiding principles; it's easy.

29 **MS REBSTOCK:** Can I just take you to a point in the Meridian  
30 submission -- and I will paraphrase and I'm sure Meridian will  
31 correct me if I get it wrong -- but they strongly objected to  
32 the imposition of any conditions which would enable consumers to  
33 vote on matters affecting their operations or the value of their  
34 assets.

35 We've heard that proposition from a number of players and  
36 some have gone on to make the point that companies such as your  
37 own would certainly never allow your own consumers to play that  
38 role in the way you govern your own business.

39 So, I invite your comment on that.

40 **MR McDONALD:** We operate in many markets, and the way the  
41 electricity market has been established in New Zealand is  
42 absolutely unique. It's probably the best example you can  
43 imagine of a market in which the role of the demand side has  
44 been neutered and simply taken out of any active role. You  
45 can't get a real time bilateral bidding process -- I'm talking  
46 about the spot wholesale market in this.

47 Our situation is that other parties, i.e. Our customers,  
48 determine the value of our assets day by day. What we are -- I  
49 think you have two options with the electricity market in New  
50 Zealand: you either change the price formation process to allow

1 consumers to have a genuine role in setting price, i.e. You bid,  
2 if the supply side doesn't match your bid, then there's no deal;  
3 or you establish thresholds bands and all the rest of it. If  
4 the supply side is not willing to allow a genuine open market  
5 process to form the price of electricity, then there has to be  
6 an adjustment in the governance arrangements around the market,  
7 i.e. In line with GSC now and the MACQS arrangements, which  
8 allows a genuine consumer role.

9 So, I disagree with the Meridian view. They are not  
10 recognising the fact that in virtually all industries the  
11 consumer side of the equation has a major impact on the value of  
12 the assets. In the electricity industry the generators,  
13 particularly given their vertical integration, have a highly  
14 protected position.

15 **MR FRANKLIN:** Just to add to what Kerry said, this was an argument  
16 or a position that came through the EGEN Working Group processes  
17 on the justification to exclude consumers, for example, from  
18 Part G, trading.

19 The argument is that they don't have any assets at risk or  
20 they don't have any -- there's no real impact on what happens  
21 there. That can be a very narrow view. I think we just need to  
22 look at the result of last winter and the wholesale prices that  
23 were reflected in the market and the impact that has had on  
24 pretty much all consumers in New Zealand, whether it's a steep  
25 change in contract rates or retail rates, that these flow-ons do  
26 affect consumers directly, and pretty quickly, and to argue that  
27 they don't have any value or assets at risk is a very narrow  
28 argument.

29 **CHAIR:** Did you basically agree with the conclusions of the Market  
30 Surveillance Committee when they investigated that event or --  
31 I'm not sure how it was described.

32 **MR McDONALD:** I think the short answer is, no, Chairman. The word  
33 "white wash" comes to mind.

34 **MR CURTIN:** Just briefly coming back to your comments on the demand  
35 side and, you know, different ways of establishing a real time  
36 market clearing price. We did have evidence from  
37 Professor Hogan towards the end of last week from Harvard who  
38 had overall quite nice things to say about the design of the  
39 spot market, he had questions of governance and issues that are  
40 aligned with some of the ones that you have raised, but as far  
41 as the pure wholesale spot market and the mechanisms for  
42 establishing price he basically ticked the box.

43 Now, I think you are saying, from the sound of it you don't  
44 agree with that, perhaps because the demand side doesn't get a  
45 look in or somewhere along those lines you have got better ideas  
46 for establishing the price.

47 I wonder if you'd care to flesh those out for us given that  
48 we had such a -- an endorsement of market design as relatively  
49 leading edge.

1 **MR McDONALD:** There's only one point I'd make and it's really a  
2 repeat of what I've really just said. The price formation  
3 process is one that's driven by the supply side; the supply side  
4 bids according to a set of Rules, the demand side takes the  
5 consequences of that. The demand side is not in a position to  
6 say that we will not buy at a price above, say five or six or  
7 seven cents a unit. You are just absolutely neutered on the  
8 issue, there's nothing you can do about it.

9 To me that's particularly significant in the context of  
10 demand side management, and the focus on energy conservation,  
11 because the market arrangement -- as was demonstrated last  
12 winter -- makes it extremely difficult for the demand side to  
13 actively contribute to energy conservation through that market  
14 mechanism, because they have got no seat at the table and no  
15 role in the market; so anything you do has to be done outside  
16 it.

17 So, that basic and fundamental principle is the one that I  
18 would focus on.

19 **MR CURTIN:** I hear that. Essentially you are saying that demand  
20 side participants put in a quantity bid and they get filled at  
21 any old price?

22 **MR McDONALD:** Well, who is actually putting that bid in? Who's  
23 bidding the demand quantity?

24 **CHAIR:** It was put to us by one submitter that a price is bid into  
25 the market and if that price isn't met they may not necessarily  
26 offer product.

27 **MR McDONALD:** Chairman, that's not my understanding of the market.  
28 My understanding is that there is a demand curve there, but it's  
29 not the -- in a normal market, as you would all well know, the  
30 demand curve would normally be the compilation of a series of  
31 inputs from the demand side. Now, that's missing in this  
32 market. The closest you get to it is the role of generators  
33 acting as retailers on the other side of the market which may  
34 influence quantity.

35 **CHAIR:** The point I was making, a supply side witness said that  
36 above a certain price they wouldn't offer in, depending on what  
37 they are offering up in the merit order.

38 **MR FRANKLIN:** I think what the issue here is --

39 **CHAIR:** A price below which they wouldn't offer.

40 **MR McDONALD:** Yes, I understand that.

41 **MR FRANKLIN:** I think the issue here is the lack of ability for the  
42 demand side to respond to what is happening, and it does come  
43 back to the governance around the Rule change process and the  
44 ability for demand, to be able to respond in real time to what  
45 they are seeing. We are slowly getting some movement on it but  
46 it's one that has been very slow in coming. For the demand, to  
47 be able to see something respond in real time and take into  
48 account their production, has been very difficult in the past  
49 due to the restraints that have been there and are in place, and



1 that is probably what -- those restraints have been the  
2 significant amount of concern.

3 **MS REBSTOCK:** I just wanted to ask you a question on the submission  
4 that you put in around the risks around the transitional  
5 dispensations.

6 The applicant has suggested to us that they have advanced  
7 this issue now in a way that will allow parties to know what  
8 will happen before the Rulebook actually comes into place, and I  
9 wonder if that meets your concern about the need for these to be  
10 agreed in a transparent principle?

11 **MR FRANKLIN:** I did note the comments made last week around this,  
12 and there was some confusion on what our position was. We are  
13 clear of what the Rules or what the transitional regime does  
14 provide, and that is what our concern is; it's not the lack of  
15 knowledge of what's going to happen.

16 We do recognise there is a need for the transitional  
17 regime; Transpower's grid operator has to know for sure what the  
18 compliance is or not of connective plant, and this is a fair  
19 opportunity to have a stocktake, if you like, so they have some  
20 confidence moving forward.

21 I suppose the real concern that we've had through the  
22 process on this has been that the regime has been designed to  
23 protect generators to get them into the Rulebook. The plant  
24 capabilities will be known to other parties only if the Rulebook  
25 becomes operational, so you will not know whether other parties'  
26 plant is actually non-compliant unless the Rulebook becomes  
27 operational, and it's there -- when it is operational they will  
28 already have their dispensation.

29 Now, the reason why there's no transparency up until the  
30 end is, if this Rulebook falls over and parties, generators and  
31 buyers of non-compliant plant, and in future if that plant  
32 fails, then they could be liable to other affected parties.

33 I think what our concern comes down to is that the regime,  
34 the transitional dispensation regime, is suggesting that the  
35 cost of that non-compliant plant for this transition will be met  
36 by what they deem in the industry which -- for example, if that  
37 plant needs traditional ancillary services what will happen is  
38 Transpower will procure that and charge it to the parties who  
39 pay for that. Now, those parties are directly connected  
40 consumers; such as us, New Zealand Steel and others, and also  
41 retailers who I assume incorporate that to the retail tariffs to  
42 consumers.

43 So, it comes back to the costs that non-compliant plant has  
44 been met by consumers.

45 The other concern is, any new plant that comes along,  
46 generation plant that wants to connect, they have a different  
47 regime; any cost of non-compliance there, and quite rightly, has  
48 to be met by them. So, it appears that the playing field is not  
49 level, and it may create a barrier to entry to new generation.  
50 That is what our concern was.

1 **MR McDONALD:** It's a very good example, and it's a key example,  
2 because if we connect to the grid all of our plant has to be  
3 compliant, and there's no question about hiding whether it's  
4 compliant or not. But, as Jason has outlined, the lack of  
5 transparency is at odds with the standards that are applied to  
6 consumers, and then the fact that consumers are exposed to  
7 picking up the cost of non-compliant generator plant, I think,  
8 is unreasonable.

9 **MR FRANKLIN:** I think the confusion around the Conference was that  
10 we didn't have confidence to apply for a transitional  
11 dispensation; that is wrong. We don't need to apply for one;  
12 our plant is compliant.

13 **MR ADAM:** Could I ask a question on general governance. I think,  
14 Mr McDonald, at the beginning you said that Comalco in its work  
15 that it's done on EGEN and the development of various Rules and  
16 so on didn't take a narrow self-interest approach but took the  
17 approach of what you have regarded as being the wider interests  
18 of consumers, because if you take a narrow approach I think you  
19 said you would net nowhere.

20 I was just wondering why generators wouldn't have adopted -  
21 - got to the same conclusion that if they are going to vote in  
22 the Rulebook in a way which is purely on a narrow interest, on a  
23 vote-by-vote basis, the industry EGB is going to be taken away  
24 from them, that their interests may well align with a broader  
25 public interest?

26 **MR McDONALD:** Well, it didn't work with NZEM and it hasn't worked  
27 with MARIA, and MACQS was the first occasion on which I would  
28 say there was any alignment, and if you look at the processes  
29 around the market -- the establishment of the market and the  
30 complaints and the appeals against the formation of the market,  
31 there were virtually no decisions which gave any support or  
32 comfort to consumers, and consumers or the demand side of the  
33 industry was totally excluded from the governance process.

34 Now, that was at the start and it's continued through.  
35 MACQS I think, or IGSC, was an aberration for a particular set  
36 of reasons, and it's the only exception in a long history going  
37 through WEMs, WEMDG etc; in all of those the supply side of the  
38 industry successfully protected a very narrow vested interest.

39 **MR ADAM:** Can you give me any reason why the view that Comalco --  
40 in the approach that Comalco has adopted in looking after the  
41 wider public interest wouldn't also apply to the way that  
42 generators approach the market Rules?

43 **MR McDONALD:** Well, one would expect that would be similar, in fact  
44 one would expect that our view would be out at the boundary and  
45 the view of state owned generators would be more aligning to the  
46 national interest. Now, I've read the MEUG submission, I  
47 haven't seen the CC 93 submission. CC 93 is a broadly based  
48 coalition of consumer interests, and yet their views for some  
49 10 years have been strongly opposed to the generator views.

1 This isn't just the big consumers, it ranges down to the  
2 Consumer's Institute, for example.

3 So I am very surprised there is not an alignment of views,  
4 but I've come to accept that there isn't and, therefore, we  
5 can't rely on an alignment from the supply side with the  
6 interests of the consumers. It simply -- there is such a solid  
7 history of non-alignment.

8 **CHAIR:** Just a follow-up question. Why do you think the MACQS  
9 process, in essence, was something of a circuit breaker?

10 **MR McDONALD:** One member of the group standing around the table,  
11 who's in a position of leadership in the industry, went to a  
12 visit to the United States, spoke at some length to a number of  
13 the industry leaders there and came back with the message that,  
14 "Unless you are aligned with your consumers, you haven't got a  
15 business".

16 This person recounted to an assembled IGSC meeting this  
17 view with great passion, to the point where he pulled out his  
18 resignation from his pocket from the IGSC and said, "Unless we  
19 start taking consumers on board, I'm off, and this process is  
20 going nowhere."

21 That was a circuit breaker, it ended up with four people,  
22 of whom I was one, and each represented a different quadrant of  
23 the industry from generation to transmission to retail/line  
24 companies to consumers, and we effectively operated as a group  
25 of four and hammered out an agreement and then put it on the  
26 table, and the last thing was to force the group generally to  
27 accept that the Government Policy Statement and the guiding  
28 principles inherent in it were appropriate.

29 Now, without that unusual set of circumstances I think it  
30 would have been just the same as had gone on before and the same  
31 as we're seeing now.

32 **MS REBSTOCK:** Some people suggest that it's because of the issues  
33 that MACQS deals with, that they are issues that are most  
34 appropriately dealt with involving directly consumers, but that  
35 it should stop there.

36 **MR McDONALD:** I don't agree. I think there are critical things  
37 like the price formation process, where consumers, if they don't  
38 have a seat at the table and influencing the price day-by-day,  
39 should have a role in the -- at least agreeing in the design of  
40 the market process and the way it works. I don't actually think  
41 they -- unless you get a consumer interaction bidding into the  
42 market and so on, then -- you know, consumers generally  
43 shouldn't be in there on a day-to-day basis, but the Rules of  
44 the market should be such that they are fair, equitable and  
45 balanced to both sides. It's a very unusual market that doesn't  
46 provide that.

47 **MS REBSTOCK:** Just one final thing. We've been told that if this  
48 is not authorised that it's the end of the line, basically, and  
49 it reverts to the Crown EGB model that's in the legislation,  
50 which is with the Minister making the decisions, and you may be

1 familiar but in the past -- and I think it was the MACQS case --  
2 we did not authorise, or we put out a Draft Determination which  
3 indicated concerns; it was withdrawn, I believe, and a new  
4 application came forward that addressed some of these concerns.

5 The bit that you have spoken about, we have been told that  
6 that's not a possible outcome in this case in response to an  
7 application if we were to decline it.

8 Do you think that the industry has done everything it can  
9 do to find a model that can take the majority of the players  
10 along with it?

11 **MR McDONALD:** By no means. I think it's a very resourceful  
12 industry and the necessity will be the mother of invention, and  
13 if they need to find a way, that they will do so.

14 But on the risk that if this falls over, it did evolve back  
15 to the Crown, we have already stated directly to the Minister  
16 that we have a clear preference for the Ministerial solution in  
17 comparison with what's proposed now. So, if an alternative  
18 can't be found, we believe that the industry would be better off  
19 under the fallback option rather than what's proposed.

20 **MS REBSTOCK:** So you wouldn't support another round of trying to  
21 find an industry led approach?

22 **MR McDONALD:** Yes, we would, definitely. I mean, we've been at  
23 this since 1985, and not much along the way has been of a  
24 positive outcome, but we've always been there to go another  
25 round, and we would be a strong supporter of another round of  
26 process.

27 **MS REBSTOCK:** Do you think that's a real likelihood of that  
28 happening? I mean, it's important for the counterfactual, for  
29 instance.

30 **MR McDONALD:** The key issue around a further round of process would  
31 be the governance arrangements around the Working Group. For  
32 example, Jason has been intensively involved this time round in  
33 various aspects of the process, and it's been very frustrating  
34 that when things come to the vote, the consumer vote is either  
35 one or two; but it's swamped in the process, so there's not much  
36 notice taken of it.

37 In spite of that, we would engage in another round. For  
38 the further round to be genuinely effective you would want the  
39 working party or the decision process to be a rather more  
40 balanced one.

41 So, if there was any basis for giving guidance on that,  
42 whether it's for the Minister or however, that would be useful.

43 **MS BATES:** By which you mean you would have more voting rights or  
44 representation on the working group?

45 **MR McDONALD:** Or you would have -- personally I'd be happy with a  
46 decision by consensus if it was a more balanced process, if  
47 people had a sense that they had to get to an outcome that was  
48 more middle of the road and not favouring one particular group  
49 or another.

1           The MACQS process demonstrated it was possible, and there  
2           are other processes going on in the industry that do get to a  
3           satisfactory outcome.

4   **CHAIR:** Right. Well, thank you very much, and also for answering  
5           questions extensively because it will be of help to the  
6           Commission.

7           If there's anything else you want to put in, as I said, if  
8           we could have it first thing tomorrow so that other parties  
9           could have a chance to look at it. So, thanks indeed.

10 **MR McDONALD:** Thanks. Thank you very much and thanks for hearing  
11           our views.

12 **CHAIR:** Thank you. Well look, we'll break for 10 minutes and at  
13           3 o'clock sharp we'll have Meridian.

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**Adjournment taken from 2.50 pm to 3.01 pm**

**\*\*\***

1 **CHAIR:** We'll reconvene and just welcome Meridian, who are the next  
2 submitters. I'll stop at quarter past four for 10 minutes to  
3 give the transcriber a chance to catch her breath, otherwise  
4 thanks for also delaying your presentation to suit the way  
5 things are going. So, over to you, please.

6  
7 **PRESENTATION BY MERIDIAN ENERGY**

8  
9 **DR TURNER:** Thank you, Mr Chairman. You have our written  
10 submission, but if I may take a few minutes to make a broad  
11 introduction and then we will work our way through that  
12 submission as you desire.

13 If I could introduce the Meridian people. I'm Keith  
14 Turner, Chief Executive of Meridian. I participated in setting  
15 up many of the market institutions that have appeared before you  
16 in the set of Rules. I was a Founding Director of M-Co in 1993.  
17 I was a member of the Contact Establishment Group and had a role  
18 in setting up the market in 1995 and 1996. I negotiated the  
19 Service Provider Agreements for that market in 1996. I was a  
20 member of the Market Surveillance Committee from 1996 to late  
21 1998. I have been a Grid Security Committee member and I have  
22 been a member of the EGENC Applicant Committee.

23 If I could introduce Gillian Blythe from Meridian. She has  
24 been a participant in the Wholesale Electricity Market  
25 Development Group setting up in the early 90s; an ECNZ  
26 participant in the rule development of NZEM; a member of the  
27 Rules Structure Working Group and, more recently, a member of  
28 the Transport Working Group of EGENC.

29 If I could introduce Ari Sargent on my left. Ari also has  
30 a long history in setting up the markets that we have here. He  
31 was a member of the Dispatch Rules Working Group of NZEM in  
32 1995-1996; a member of the Wholesale Market Development Team at  
33 ECNZ; ECNZ's Wholesale Market Manager; he directs Meridian's  
34 trading functions; he has been a member of the NZEM Rules  
35 Committee for three years, and has been a member of the  
36 Rationalisation Working Group for EGENC.

37 If I could introduce James Hay on my far right. James is  
38 Meridian's General Counsel. He has been a member of the EGENC  
39 Governance Working Group and our legal advisor to CCMAU.

40 On my immediate right, Forrie Miller, is a partner of  
41 Chapman Tripp.

42 I introduce those people by way of outline of the  
43 substantial experience you have in these people, who have  
44 participated not just in the EGENC process but in the whole  
45 reform of the electricity industry starting back in 1990. So I  
46 hope you will take advantage of that experience.

47 I will give some high level comments; Gillian will talk  
48 about Part F and the distinctions between the Crown owned and  
49 industry owned EGB; Ari will talk about NZEM and its track  
50 record; and Forrie Miller will discuss jurisdictional issues.

1           This application essentially combines NZEM, MARIA and MACQS  
2 under a single governance structure. NZEM came out of an  
3 electricity supply shortage in 1992. It was derived from an  
4 inquiry into that shortage led by Sir Ronald Davidson and  
5 Sir Ronald Carter. One of the key recommendations from that  
6 inquiry was that price discovery be externalised from ECNZ and  
7 that price caps be removed. It was an inquiry that had to  
8 preside over a loss of 0.6% of GDP and the shut down of a  
9 Comalco pot line.

10           M-Co was the vehicle that was set up in 1993 following that  
11 inquiry as a joint industry initiative. I was a member of the  
12 board and I remember well the very first board meeting of M-Co.  
13 It consisted of two members from the generation side and two  
14 members from the power company side and an independent chairman  
15 by the name of Graham Scott.

16           NZEM was fully developed in 1996 when Contact Energy was  
17 split away from ECNZ, but that was the real impetus to put  
18 together Rules that would create competitive price discovery.

19           If I look at the events of last year, of which you have  
20 heard much, in my view NZEM worked extremely well in exposing  
21 the supply tightness that occurred because of lack of hydro  
22 power supply.

23           The price discovery that came from last year, I believe,  
24 replicated internal signals which I have seen at least three  
25 times in my prior career inside the NZED and in ECNZ; for  
26 example, price signals that justified burning distilled oil that  
27 cost 25 cents a kilowatt hour to consume.

28           MARIA was born out of the establishment of M-Co. It  
29 provided the means for competition by enabling reconciliation of  
30 metering data. It is absolutely essential that mechanisms for  
31 reconciling electricity production and consumption to all  
32 participants across the total system is efficient if we are to  
33 have competition. It is in effect an essential service to  
34 competition.

35           MARIA had a huge challenge in 1999 when the Government  
36 decided to undertake comprehensive reform of both ECNZ and the  
37 power company environment. Retail competition emerged almost  
38 overnight in the timescale of most reforms. In Australia retail  
39 competition has been three years in the planning and been  
40 deferred twice. So MARIA was an institution set up but not  
41 prepared for the wholesale reform that took place early in 1999.

42           MACQS, on the other hand, has actually yet to come into  
43 operation. It has been five years in the planning. MACQS is  
44 designed to provide a forum to establish power system quality  
45 standards that are common to all participants in the industry;  
46 and by participants I include producers and consumers.

47           I venture to suggest that the only true common service in  
48 this industry is actually frequency. It is the only  
49 characteristic about electricity that everyone who consumes  
50 electricity must take.

1           The concept of multilateral agreement under MACQS, I think,  
2 is good. It is certainly good where consumers and producers can  
3 debate the standard of quality to which they both want to  
4 participate and contract to.

5           However, in my observation of MACQS -- and I have been on  
6 the GSC now for three years -- one of the real difficulties has  
7 been getting adequate input from the small consumer sector --  
8 the small consumers, I mean the residential and the smaller  
9 enterprise sector.

10          I have found that the consumer influence in MACQS has  
11 largely been derived from major users who have the greatest  
12 interest and the technical knowledge and the understanding of  
13 the implications of common quality issues on their business.  
14 That is not to say that the small consumers have not been  
15 represented, but I suspect that the complexity of this industry  
16 has been difficult to assimilate and to identify the  
17 implications for small consumers from.

18          We have an additional part to this Rulebook that was not in  
19 existence before we started the consolidation process; Part F.  
20 Part F introduces a new set of arrangements for transmission  
21 decision-making. New Zealand's decisions in transmission  
22 investment over the past 10 years have been almost non-existent,  
23 and I venture to suggest they will be shown to impede the rate  
24 at which New Zealand can grow in the very near future.

25          In my view, Part F is by far the most important element of  
26 this application before you and will have by far the most  
27 implication for the way the industry is run, how efficient  
28 electricity supply is deemed to be, and how effective it is in  
29 supplying consumers.

30          Meridian has put most of its effort into the review of  
31 Part F and I hope that Gillian and my team can demonstrate that  
32 to you as we go through our submission.

33          I would say this about Part F. Part F is untried, it is  
34 untested and it has no equivalent anywhere in the world. That  
35 is not a surprise. Transmission investment, contracting for  
36 transmission, identification of transmission services,  
37 establishment of transmission pricing, is the most difficult  
38 aspect all around the world in electricity deregulation. It is  
39 a global problem and there are no outstanding global solutions  
40 to the problem.

41 **MS BATES:** Could I just interrupt, just for a moment, to ask you  
42 why you think it is that there has been so little investment in  
43 transmission over the last 10 years; what stopped it?

44 **DR TURNER:** Several elements. One is that Transpower has not had a  
45 secure revenue stream and has been pre-occupied with obtaining a  
46 secure revenue stream because it is profit motivated; it is a  
47 company like any other SOE.

48          The second is that Transpower has had difficulty with  
49 contracting with its consumers. That difficulty comes from its



1 monopoly characteristic, its perceived arbitrary price setting  
2 capacity, and its unilateral setting of conditions.

3 A third is that Transpower utilises an optimised deprival  
4 value method for valuing its assets, and its assets when built  
5 are large and lumpy, and invariably have to be greater in  
6 capacity than the service immediately provided by them and,  
7 therefore, the minute they come to book cannot be fully valued  
8 at their cost.

9 Those are profound complexities for transmission. However,  
10 I have to say, we cannot carry on in New Zealand with those  
11 impediments. You have a big duty on your shoulders.

12 **MS BATES:** You would have heard the last speakers. The CEO of  
13 Comalco says that he thought there had been a fundamental change  
14 in the operation of Transpower over the last five years. Would  
15 you agree with that view?

16 **DR TURNER:** I can't say that I've experienced Transpower's  
17 behaviour for five years, I've only been in the role in Meridian  
18 for three and a half; but I wouldn't class the change as  
19 profound or fundamental. Certainly their willingness to engage  
20 in MACQS has been, I think, a breath of fresh air to the  
21 industry, but if you look at the timeframe it has taken to bring  
22 MACQS to a point where it is ready for implementation, breath of  
23 fresh air but not fast enough.

24 **MR CURTIN:** Just before leaving that topic, if we could, the whole  
25 issue of transmission under-investment or over-investment has  
26 been cropping up fairly regularly. Now, in your explanation of  
27 why inadequate investment has taken place you have slotted it  
28 home fairly squarely to Transpower, but we've had a variety of  
29 submissions that suggest it's freeloading, unwilling to sign up  
30 for their fair share of the costs on the part of the users of  
31 transmission services that seemed to be part of the problem in  
32 the inability to sign a contract as well.

33 Would you care to comment on that line of evidence?

34 **DR TURNER:** I wouldn't want you to take my comments as a criticism  
35 of Transpower, the company. I think it is an acknowledgment of  
36 the difficulties that the company Transpower has been operating  
37 under arising from, I think, global issues about how do you  
38 define and price the services of transmission? I think those  
39 global complexities are an example of why it has been very  
40 difficult to contract; whether it's Transpower's desire to  
41 contract for revenue certainty or the users of transmission to  
42 satisfy themselves that the price and the terms are fair and  
43 reasonable.

44 **MR CURTIN:** Thank you.

45 **DR TURNER:** I would refer to Professor Hogan who I think made a  
46 comment that New Zealand's market design has been at the  
47 forefront of best practice. I've worked with Professor Hogan  
48 for just about the whole time that he's been involved in the New  
49 Zealand market, and he has had a strong influence in the way in  
50 which New Zealanders have thought about their market, and I

1 would agree with him that much of what we have done in New  
2 Zealand has been at the leading edge of industry reform.

3 I think that the core aspects of the New Zealand market  
4 design are close to best practice. However, he particularly  
5 refers to the basic building blocks of our market, particularly  
6 NZEM and MARIA. That's different from the culmination of NZEM,  
7 MARIA, MACQS and Part F; that's a very different package which  
8 is yet untested and untried.

9 **MS REBSTOCK:** Just before you go on. I'd just like to come back to  
10 some comments that Professor Hogan made here, even about the  
11 current arrangements.

12 In that context he said, while he thought we were at the  
13 forefront in terms of detailed Rules, he had always had concern  
14 about the governance arrangements around them, and continues to.  
15 So, I just -- before we get on to the difference between that  
16 proposal and this one, I'd welcome your view on his concerns  
17 about the governance arrangements, even around the existing  
18 Rules.

19 **DR TURNER:** Yes, I interpret his concerns around governance to be  
20 derived largely from his primary experience of regulated  
21 industries in the US. I think New Zealand is a unique country  
22 with a unique culture where we can do things quickly and  
23 informally, and I think he has never subscribed to the theory of  
24 threat of regulation, for example.

25 So, I do see his concerns about governance driven largely  
26 from his US experience rather than an acknowledgment that New  
27 Zealand can do things a little more co-operatively and  
28 differently.

29 **MS REBSTOCK:** He actually put it to us that his concern related to  
30 his experience in watching certain American States dabble with  
31 the idea of industry led and industry controlled processes.

32 So, I think he did address that issue.

33 **DR TURNER:** Although if you engage with him on the California  
34 experience then he will, I think, readily acknowledge that the  
35 Regulator had a big hand in the destruction of the market, if  
36 you like, and he's been closely involved with trying to  
37 resurrect some arrangements there that are actually not terribly  
38 dissimilar to what we do in New Zealand.

39 **MS REBSTOCK:** I mean, I think it's fine to quote -- everyone quotes  
40 Professor Hogan, the business that they like, but I do take the  
41 point that he has been involved here since very early times. I  
42 mean, the Commission itself sees many overseas experts come in  
43 here for a few days and then they're gone and never come back.  
44 He doesn't appear to be one of those people who do not  
45 understand the uniqueness of New Zealand, nor our ability to do  
46 things differently.

47 So, I wonder about so quickly dismissing his -- the bit he  
48 did have concerns about due to him being familiar with the US  
49 approach to regulation. I have some difficulty sort of marrying  
50 up the idea that he's been involved here since the beginning,

1 spent a lot of time here, been very influential but doesn't  
2 understand our uniqueness.

3 **MS BATES:** I took his objection to the Regulators in California,  
4 and I questioned him on this specific topic, as being related to  
5 their failure to act as he considered Regulators ought properly  
6 to act, is his concern; it appeared to be their failure to act  
7 rather than positive actions on their part.

8 **DR TURNER:** Yes, I think what I'll -- I'll deal with the California  
9 one first and come back to Commissioner Rebstock's question.

10 Although he will acknowledge in California that the  
11 Regulator imposed certain conditions on generators, that they  
12 had to buy off the spot market, or -- sorry, sell to the spot  
13 market and the Regulator did impose price controls on the end  
14 price and, you know, those two features of the market were a  
15 significant influence on the difficulties that market  
16 experienced.

17 Coming back to Professor Hogan's comments on governance; I  
18 don't wish to dismiss his concerns about our governance because  
19 I have exactly those concerns myself, and I think that they are  
20 warranted concerns. However, I guess in looking at this  
21 application we are making a comparison between an industry  
22 sponsored governance process and a Government directive  
23 sponsored governance process, and I don't mean to dismiss --

24 **MS REBSTOCK:** In light of some of the conditions that we have  
25 discussed as possibly being applied to any authorisation, should  
26 it happen, I think we'd still be interested in how you would  
27 summarise those governance concerns with the current  
28 arrangements.

29 **CHAIR:** I think it is picked up, at least in 1.3 in your overview  
30 you refer to it and I assume it's covered further on in your  
31 presentation?

32 **DR TURNER:** I will get there, Mr Chairman.

33 If I can perhaps just finish my broader comments. I want  
34 to get down to some very real practical issues. New Zealand is  
35 facing a looming electricity supply shortage, not because we're  
36 short of water but because New Zealand is rapidly becoming short  
37 of supply capacity. The imminent decline in gas supply, the  
38 lack of long-term gas contracts to support new gas fired power  
39 stations, has in the very short space of time reduced  
40 New Zealand's supply options. Combined with that we have a  
41 Government Environmental Policy under development and should  
42 this Government be returned I suspect will be prosecuted; that  
43 will put substantial emphasis on renewable and sustainable  
44 options.

45 On top of that the rates of return on capital in this  
46 industry, particularly in the energy production side of the  
47 industry, are well below the weighted average cost of capital  
48 for this industry. If you look around at all of the asset  
49 owning companies in this industry there is only one that is  
50 returning above its cost of capital, and that is Transpower --

1 and I accept lines companies because I understand the role you  
2 are intending to play in the lines companies.

3 That is not an environment which is conducive to investment  
4 in supply; it is not an environment that suggests that  
5 institutional arrangements like the NZEM Rulebook allow  
6 generators to obtain a price well above the competitive cost of  
7 supplying consumers; it is not an arrangement that is going to  
8 serve consumers well, if capital does not flow into this market  
9 to meet consumers' expectations.

10 Meridian is proposing major development on the lower  
11 Waitaki River. It's a project that will cost well in excess of  
12 one billion dollars; that's half the asset value of Comalco in  
13 one project. Investments of this nature require a much greater  
14 degree of certainty than we have had in the past. Such  
15 certainty is unlikely unless the industry arrangements can be  
16 finalised, and soon.

17 Furthermore, such certainty is very difficult to achieve if  
18 other parties have decision rights over the value of such an  
19 asset.

20 I want to conclude with setting out Meridian Energy's  
21 position on this application. Meridian Energy, if faced with  
22 the option of an electricity Governance Board with the powers  
23 presently defined under the Electricity Amendment Act of 2001,  
24 or with a self-governance regime as this application proposes,  
25 would favour this application on the basis that those who have  
26 assets at risk and value at stake, and have the knowledge and  
27 the incentives to increase or improve efficiency and customer  
28 utility, are those best placed to make decisions affecting those  
29 assets.

30 However, in making that preference we wish to draw the  
31 Commissioners' attention to the novelty, the unusual precedent  
32 that this multilateral proposal represents, particularly in  
33 regard to Part C and Part F, and we remain suitably cautious as  
34 to whether those parts justifiably form a common bond with the  
35 NZEM and MARIA Rulebooks.

36 If it suits you, we will work our way through the  
37 submissions, and I'll call on Gillian Blythe to talk about  
38 Part F.

39 **MS BLYTHE:** Good afternoon, Commissioners. I'll first make some  
40 introductory remarks and then will focus on a number of aspects  
41 in terms of Part F in terms of the investment issues and in  
42 terms of pricing.

43 Meridian Energy is generally supportive of Part F but we do  
44 have a number of important qualifications. We accept that there  
45 is a need to consider what services customers are currently  
46 getting and what services customers want, and we recognise that  
47 there has already been considerable value extracted within the  
48 industry in the Working Group process working on transmission  
49 service definitions and measures, which is a fundamental part of

1 Section 1 of Part F. We clearly see there's a need for  
2 investment in the grid.

3 We see that there is a need to ensure that there is a  
4 framework through which new investments are paid for in a way  
5 that reflects the benefits that all users gain from such  
6 investments and where there is, you know, you don't have a  
7 problem of free-riding.

8 We see that parties who are ultimately going to pay for  
9 those assets should have the opportunity to have a say in  
10 whether those investments are actually constructed, in terms of  
11 voting.

12 We also see that there is a need for those parties who  
13 currently benefit from transmission constraints should not be  
14 entitled to veto those new investments that are intended to  
15 relieve those constraints.

16 We also see that Part F offers something that we don't  
17 often think about, which is that at the moment when there is a  
18 need for investment you typically are having generators making a  
19 generation investment or the consumers having to do some sort of  
20 load management opportunity because there has been this problem  
21 for Transpower in investing, and so really Part F offers the  
22 opportunity for Transpower and any other transmission providers  
23 to actually compete with generation and with the demand side,  
24 and that clearly is a benefit that's offered by Part F.

25 However, as Keith has said, Part F is new, it is novel, it  
26 hasn't been tried elsewhere in the world. There are also a  
27 number of aspects of Part F which are fundamentally different to  
28 the rest of the Rulebook.

29 I think it would be fair to say the other aspects of the  
30 Rules and different parts are self-contained. There are Working  
31 Group processes that govern or would work within the wholesale  
32 market section in Part G or in the common quality aspects of  
33 Part C.

34 Part F, though, in its Section 3 requires Transpower to  
35 propose its pricing methodology having initially proposed a  
36 process within which it will follow and then ultimately a set of  
37 pricing principles from which it will develop its methodology.  
38 There is no ability or there's is no provision, certainly in the  
39 process that Transpower has proposed to date, to have a Working  
40 Group process.

41 I acknowledge that in the process that they are conducting  
42 outside of the Rulebook they are holding consultation forums,  
43 but there's a very fundamental difference between consultation  
44 in a hearing process relative to a Working Group.

45 There's no voting that takes place. There's no check  
46 against the guiding principles of the Rulebook which reflect the  
47 guiding principles of the Government Policy Statement. It is  
48 simply a process where Transpower's methodology must be  
49 approved, if it passes the pass mark associated with the pricing  
50 principles of Part F.

1           In many ways it's quite analogous to the current situation;  
2       choose a Crown EGB or choose an industry EGB. It's a yes or no;  
3       it's a pass or a fail.

4   **MS REBSTOCK:** Can I just clarify something you just said. You said  
5       that the guiding principles in the Rulebook were consistent with  
6       the GPS.

7           I thought it was Meridian's position with respect to Part F  
8       that that wasn't the case.

9   **MS BLYTHE:** I think if we go to some of the annexures, in Annexure  
10       2 there's a Government Policy Statement; and we will cover this  
11       later on in our discussion.

12           There's an Attachment 1 which is about the objectives and  
13       principles for transmission pricing. Part F includes some of  
14       the pricing principles that are in there, but it doesn't include  
15       some of the important aspects that are contained in the pages 1  
16       and page 2 of the Government Policy Statement, where delivered  
17       electricity costs and prices are subject to a sustained downward  
18       pressure, and the promotion of enhanced competition wherever  
19       possible, and the mirroring of activities that would apply in a  
20       competitive market.

21           So that is the point that we have been making in relation  
22       to Part F, that because there is no relationship to the guiding  
23       principles that are contained in Part A of the Rulebook, it only  
24       has a small subset. So, if you asked us the question, are the  
25       guiding principles in Part A consistent with the Policy  
26       Government Statement, Meridian would agree and would support the  
27       guiding principles that are contained in Part A. We're just  
28       saying there's been some forgotten because there's no need for  
29       the governance body in Part F to consider the guiding principles  
30       in Part A when it's making its decision to confirm that the  
31       pricing methodology conforms to the pricing principles.

32   **MS REBSTOCK:** But Part F must still be subject to the Governments  
33       or the GPS, whether it's specifically brought in or not; is that  
34       not the case?

35   **MR MILLER:** The question for the board in looking at a particular  
36       Transpower pricing methodology under Part F is whether it  
37       complies with the principles that are set out in Part F.

38   **MS REBSTOCK:** Yeah, I do understand that, but the board,  
39       nevertheless, is accountable to the Minister to meet the GPS,  
40       isn't that -- and in that sense it applies equally to Part F, or  
41       would seem to me, but...

42   **MR MILLER:** That's right, at a very general level, but what it  
43       perhaps overlooks is that it only applies to the extent that  
44       Part F allows the board to -- the board has a specific function  
45       in relation to Part F and a specific set of criteria that it  
46       looks at when it approves a methodology --

47   **MS REBSTOCK:** You seem to almost be suggesting Part F over-rides --  
48       the first obligation of the board is to the Rules and Part F or  
49       any other part rather than to the GPS.

- 1 **MR MILLER:** No, the first obligation for the board is to set up a  
2 set of Rules that comply with the GPS, including the guiding  
3 principles, and we absolutely agree with that, and we're asking  
4 the Commission to look at the set of Rules from that  
5 perspective, to make sure they do. What we're saying is,  
6 "There's a gap." the concern that we have is that when it comes  
7 to a particular methodology Transpower will say to the board,  
8 "Your function is a very limited function. It is simply one of  
9 approving it against the specific criteria that are in Part F,"  
10 which don't include some of the guiding principles.
- 11 **MS REBSTOCK:** Do you accept, if they did that, they would be not  
12 meeting the GPS?
- 13 **MR MILLER:** They would be not, sorry?
- 14 **MS REBSTOCK:** Not meeting the Government's Policy Statement.
- 15 **MR MILLER:** Yes, I do, but --
- 16 **MS REBSTOCK:** Is that a matter for the Commission to consider or  
17 would it simply be a matter for the Government to hold the  
18 industry board accountable for in its assessment of whether the  
19 industry board has met the GPS?
- 20 **MR MILLER:** It is for the Commission very much because you are  
21 looking at the question whether the Rules that are being set  
22 up -- you are being asked to authorise them after all -- you are  
23 looking at the question whether those Rules are aligned with the  
24 GPS as one of your considerations, and we're saying that they're  
25 not.
- 26 **MS REBSTOCK:** I just want to stop you there. Is that what we  
27 actually are meant to decide? Is it for us to decide whether  
28 the Rules -- does an authorisation under the Commerce Act  
29 require us to decide whether the Rules meet the Government  
30 Policy Statement? It doesn't seem to me that it does.
- 31 **MR MILLER:** As a general proposition, of course the Act doesn't say  
32 that. But you have chosen a counterfactual under which there's  
33 a Crown EGB and it's a proper supposition, indeed the Act really  
34 provides for this, that the Crown EGB will comply with the GPS.
- 35 **MS REBSTOCK:** But there's nothing in Part F that suggests -- while  
36 it may not positively restate the Government Policy Statement,  
37 there is nothing in it that is inherently inconsistent with the  
38 Government Policy Statement. In other words, why would we  
39 presume that they would not be bound by the GPS in Part F,  
40 unless there's something explicitly there that is in direct  
41 contradiction to it?
- 42 **MR MILLER:** Well, if I understand -- well, I understand the point  
43 you are making there, but I would suggest, and the evidence  
44 actually supports this, that what Transpower proposes to do is  
45 to put up a methodology in which it regards some of these  
46 guiding principles as not relevant; that's what its draft  
47 pricing methodology says, and it can only be doing so on the  
48 basis that the methodology doesn't need to meet those principles  
49 in order to be ticked off under Part F.

1 **MS REBSTOCK:** I mean, all kinds of things can happen from hereon  
2 with respect to what people put up relative to the Government  
3 Policy Statement. I mean, the whole chapter that's missing on  
4 consumers, who knows what might be put into that chapter when  
5 it's finally written? But we can't be asked, I don't think, to  
6 make presumptions about what Transpower or anyone else may or  
7 may not put forward in terms of whether it's consistent with the  
8 Government Policy Statement.

9 The reason I'm pursuing this is because it's an issue of  
10 the role of the Commission; is it our role really to make that  
11 comparison? Or is it just part of this package that the  
12 Government will give you a Government Policy Statement, the  
13 industry may or may not meet its obligations under that, but  
14 then that is for the Crown afterwards to decide what its going  
15 to do about it.

16 **MR MILLER:** I agree with that point generally, and the reason that  
17 we have pointed to what Transpower has put up is simply to  
18 illustrate the proposition that the Rules which you are being  
19 asked to authorise are deficient because they don't specify  
20 these matters.

21 **MS REBSTOCK:** But it seems to me that what I'm putting to you is  
22 that this is an issue about the governance of the two regimes.  
23 This regime has a process that says the Government gives the  
24 industry a Government Policy Statement, the industry has an  
25 opportunity to either comply with it or not, and afterwards the  
26 Government will hold it accountable and then decide what its  
27 response will be. That is the governance arrangement inherent  
28 in this.

29 It's different under the counterfactual and it's that bit  
30 that seems relevant, not necessarily whether we think or don't  
31 think whether the Rules currently reflect that Government Policy  
32 Statement 100%.

33 So, the question I'm putting to you really, if there is a  
34 problem with this aspect isn't it a reflection of the governance  
35 issue rather than an issue of whether the Commission should  
36 directly make a comparison between the Government Policy  
37 Statement and the principles that are set down in Part F?

38 **MR MILLER:** Well, we're here to consider whether you should  
39 authorise these Rules.

40 **MS REBSTOCK:** Sure.

41 **MR MILLER:** And it's against that context that we've asked the  
42 Commission to consider making its authorisation conditional on  
43 some things that are compliant with two quite separate things.  
44 One is the purposes of the Commerce Act itself, because they're  
45 talking about promoting outcomes that would mimic those in a  
46 competitive market, and the other is with the GPS which is  
47 relevant, of course, as you say, because of the counterfactual.

48 **CHAIR:** Well, I wonder if we go back to Mrs Blythe's presentation  
49 because where you've got to you are talking primarily about the  
50 rent seeking approach of Transpower that's possible under



1 Part F, and I think you are arguing that some of those  
2 objectives should be widened. However, you will come to the  
3 point of GPS looking at your submission a little further on.

4 **MS BLYTHE:** Yes, I probably should have delayed my comments for a  
5 few minutes.

6 Just to conclude on some of the differences that we see in  
7 Part F. I commented that there wasn't a Working Group  
8 framework. It's also -- I mean it's concerned with the delivery  
9 of a monopoly service. In contrast, other parts of the  
10 arrangements have a horizontal nature or character. The  
11 wholesale market rules, for example, involve all wholesale  
12 market participants and no one participant has the power to  
13 dictate terms. In terms of Part F Section 3, Transpower is  
14 putting up its transmission pricing methodology to the board; in  
15 that sense we can make submissions, and they will consider them,  
16 but they don't necessarily have to take them into account.

17 As the Chair said, we see within Part F there's a strong  
18 need to safeguard against the potential for Transpower to  
19 extract monopoly rents. It has been a principal concern and  
20 remains a principal concern of Meridian Energy's, that Part F  
21 could licence monopoly pricing by Transpower and, I think, we  
22 made quite extensive submissions earlier in the process on that  
23 matter.

24 **MS REBSTOCK:** I really want to stop you there because, how could  
25 monopoly pricing by Transpower not be caught by the Government  
26 Policy Statement?

27 **MR MILLER:** We're coming back, aren't we, to the question where the  
28 Rules themselves actually are apt to ensure that pricing doesn't  
29 have those features.

30 **MS REBSTOCK:** What I'm really putting to you is if there is a  
31 problem here, if you are picking up a problem, it comes back to  
32 a Government regime that says the Government is going to give  
33 you a Policy Statement. The industry may do something  
34 inconsistent with it and it may take the Government a year or so  
35 to pick it up, but that's the overall arrangement.

36 Now, you're picking up one instance where you don't want to  
37 wear the risk of that possibility happening, but the whole  
38 proposal that has been put to us is based on that governance  
39 arrangement that says the Government will give a Policy  
40 Statement, the industry may or may not do what is consistent  
41 with it. But that is fundamentally the whole process here, and  
42 it's only -- from what I can see -- it's primarily in this  
43 instance that you are concerned about, the outcome of that  
44 governance arrangement. But that same governance issue applies  
45 to the entire Rulebook, it seems to me. [pause]

46 **CHAIR:** I wonder whether we should go back to finish -- do you want  
47 to reply, Mr Turner?

48 **DR TURNER:** Yeah. I think what's at the heart of this is our  
49 argument that is the governance set out in Part A an appropriate  
50 governance for Part F, given that Part F is a completely

1 different process from the other parts of this Rulebook. I  
2 think that goes to the heart of our earlier submissions that,  
3 you know, you could consider authorising all but Part F.

4 Now, we understand the practical implications of the  
5 Commission with that. But maybe we haven't got our message  
6 across clearly and we perhaps would like the opportunity to  
7 submit a further note on this point.

8 **CHAIR:** Could I just add, because you need to put it in fairly  
9 quickly, but as I see the argument on Part F as you got so far,  
10 it's the prospect of Part F enabling a purely monopolistic  
11 approach to transmission pricing. That's one leg of it.

12 Then you said earlier that Part F nevertheless, I think,  
13 was an improvement. I think what you are telling us now is it  
14 needs to be operated in a certain way, and I would assume that  
15 the impact of the governance arrangements on the way Part F  
16 will operate is the nub of what you are talking about.

17 **DR TURNER:** I think that's a fair comment, Mr Chairman.

18 **CHAIR:** Okay, well look, let's move through and if you would like  
19 to put something else in, as long as we can have it very early  
20 tomorrow so that other parties can have a chance to look at it.

21 **MS BLYTHE:** To continue. There's also -- just turning to paragraph  
22 2.5, we probably covered some of those issues and will cover  
23 them shortly as well.

24 We're also concerned that in terms of Part F, and as was  
25 foreshadowed by Comalco earlier, that Part A and Part C, there  
26 is the potential to over-ride some of the existing long-term  
27 contractual obligations. We acknowledge in the latest EGENC  
28 meeting there was a commitment given that there would be  
29 conversations with the three parties; being ourselves, Comalco  
30 and Transpower in the next few weeks, and we see that whilst the  
31 Rules at the moment have the ability to over-ride our  
32 contractual obligations, that there is every intent to move  
33 towards a situation where we are able to enter the Rulebook  
34 without suffering loss as a consequence.

35 **MR CURTIN:** Could I just ask -- did you want to follow-up on that?

36 **DR TURNER:** I would like to say a little more about that aspect,  
37 and it's prompted by Comalco's own submissions. It is fair to  
38 say that options for dealing with the historical long-term  
39 Comalco contracts which still have some 20 years to run have  
40 been discussed, and I'm not sure that Comalco fairly reflected  
41 the fact that options for dealing with those contracts are on  
42 the table and are under discussion.

43 **CHAIR:** I think they said they hadn't seen them or something like  
44 that.

45 **DR TURNER:** I suspect that that applies to the particular  
46 commentator but not to Comalco as a company, because I have been  
47 party to some of the discussions on the options.

48 **CHAIR:** That's an inter-company -- intra-company communication  
49 issue, I assume.

1 **DR TURNER:** However the Comalco company are of a special nature and  
2 Comalco is right, that they are the only long-term fixed price,  
3 fixed delivery obligations that include a long-term transmission  
4 contract.

5 Comalco itself is not affected by these arrangements. It  
6 is Meridian that has the entire obligation to deliver power  
7 under the contractual rights and obligations that exist. It is  
8 Meridian that is the counter-party to Comalco, and in that light  
9 we don't think it is essential that Comalco join these  
10 arrangements in order to ensure that all the obligations are  
11 discharged; it's certainly a case that Meridian would take on  
12 risk, and probably risk we're unwilling to take on, if  
13 unilateral changes could be made to our transmission contract to  
14 deliver to Comalco the power that they have a right to.

15 So, I think that's a crucial point, that it is Meridian  
16 with the counter-party obligation at the smelter.

17 **CHAIR:** I think that's a point fair made. It's the ECNZ contract  
18 you took over, presumably, yes?

19 **DR TURNER:** However, there is a more general issue which I think  
20 Mr McDonald did identify, but which remains a real concern to us  
21 in a more general sense, and that is not as he put it the  
22 ability to contract for electricity at fixed price but the  
23 ability to contract for transmission service long-term, without  
24 the capacity of other parties to multilaterally over-ride the  
25 conditions of that transmission contract.

26 I think Mr McDonald characterised the long-term contracting  
27 for the forestry industry as an energy certainty issue. That is  
28 not correct. Meridian has been offering long-term electricity  
29 prices to new industries wishing to set up in New Zealand. They  
30 have gone away because they cannot get long-term certainty  
31 around transmission, and therein is the nub of the issue of the  
32 Comalco contract; it is a specific historical issue. But Part F  
33 creates a situation where long-term new transmission contracts  
34 can be altered multilaterally, and that I think is an impediment  
35 on large fixed investments in the New Zealand economy.

36 **MS REBSTOCK:** So, even if you fix the Comalco problem, you don't  
37 necessarily fix the forward-looking problem?

38 **DR TURNER:** I can assure you, Meridian has had four or five large  
39 investors looking for long-term fixed price contracts delivered  
40 at their door and we have not been able to assure them of the  
41 terms of the transmission component of that contract.

42 **MS REBSTOCK:** But the Part F provisions, do they fix that problem  
43 in the future?

44 **DR TURNER:** No, they don't. They leave the risk that some  
45 multilateral discussion could over-ride the basis of a contract  
46 that could be struck tomorrow.

47 **MS REBSTOCK:** And are you addressing this with the applicant?

48 **DR TURNER:** We have raised that issue with the applicant.

49 **MS REBSTOCK:** But there's no agreement to deal with the issue?

1 **DR TURNER:** I think there is a debate as to exactly how serious  
2 this problem may be, but I'm certainly not yet assured that, you  
3 know, large industries can get long-term fixed priced contracts.  
4 I mean, you are basically saying can we have a bilateral  
5 agreement in a multilateral context, and by definition Part C  
6 over-rides bilateral arrangements. In fact Part C has already  
7 overwritten one of the conditions of the Comalco contract.

8 **MS BATES:** Could I just clarify that with you. Are you saying that  
9 where there is in existence -- in existence a long-term contract  
10 for transmission between two parties, that it can somehow be  
11 overwritten by other parties?

12 **DR TURNER:** No, the Comalco contract is the only case in point.

13 **MS BATES:** That has a long-term --

14 **DR TURNER:** It is a long-term transmission contract.

15 **MS BATES:** Are you saying that can or can't be overwritten?

16 **DR TURNER:** Well, it can be overwritten and it has already been  
17 overwritten in one sense by Part C.

18 You recall that Comalco indicated that Part C -- which is  
19 the MACQS origin -- was a section that they agreed with,  
20 belonged to, but there has been a debate about frequency under  
21 Part C and there has been a change or a proposed change to the  
22 frequency standard.

23 **CHAIR:** That relates to new generation or what; frequency?

24 **DR TURNER:** Well, it's to allow a higher level of -- sorry, a  
25 higher minimum frequency standard by which the generators must  
26 remain connected.

27 **MS BATES:** But presumably Comalco goes along with that, if it's --  
28 nobody can alter your contract, unless by regulation or  
29 something, without you agreeing to it?

30 **MS BLYTHE:** Can I perhaps explain by way of an example, in terms of  
31 how within Part F there is the potential at the moment, without  
32 an amendment, as to how our contract could be overwritten?

33 **MS BATES:** Yes, but could you just answer me about the Comalco one  
34 first. You are saying that the Comalco one could be or has been  
35 altered without Comalco's consent?

36 **DR TURNER:** It is in the process -- it is under discussion, I'm not  
37 sure that it has yet been implemented, but there certainly has  
38 been discussion that there be a change to the frequency  
39 standard, and at this point in time I'm not aware of an  
40 objection by Comalco to that change.

41 **MS BATES:** But that's a different thing from it being over-written  
42 without its consent.

43 **DR TURNER:** However, Comalco has not said to Meridian, "We will  
44 relieve you of any obligations under your bilateral agreement  
45 for energy supply in relation to frequency." so for the  
46 frequency standard to be adopted there must be a relief to  
47 Meridian from Comalco for any consequence.

48 **MS BATES:** I understand what you are saying.

1 **DR TURNER:** They have said quite clearly to you today they do not  
2 expect any change to the bilateral obligations that exist  
3 between Meridian and Comalco.

4 So, I think it's an example of why it's quite important to  
5 split out and deal with the Comalco contracts quite separately,  
6 but it is also an example of the implication for anyone who  
7 might place a new contract in the future.

8 **MS BATES:** And, Ms Blythe, that's what you are going to address us  
9 on?

10 **CHAIR:** Without holding you up, I'd like you to comment as you work  
11 through. There's a Working Group process in relation to the  
12 current obligation we have to Comalco, and one assumes that that  
13 may or may not set a precedent for future long-term contracts,  
14 one doesn't know. The applicant made the point though, among  
15 others, about Part F, that they saw it providing the platform or  
16 the opportunity for a real getting hold of these transmission  
17 issues.

18 Now, what I think the Commission's hearing from you is that  
19 that in principle may make sense, there's a lot of water to go  
20 under the bridge yet before it can be achieved.

21 So I think if you can comment on some of those implications  
22 as you work through it would help anyway.

23 **DR TURNER:** I think we are saying, Mr Chairman, that they are  
24 untried and untested, and there are quite a lot of wrinkles to  
25 be ironed out before you can be assured that they will work as  
26 intended.

27 **CHAIR:** I think we've got to make a judgment as to how large are  
28 those wrinkles as you work through your presentation.

29 **DR TURNER:** Maybe Gillian's example will help you understand how  
30 big the wrinkle is.

31 **MS BLYTHE:** I'll try and shed some light on matters.

32 The concept behind Part F in terms of Section 2 is that, if  
33 a party is affected by a change to a service level or by a  
34 change -- by the creation of a new service, that that party  
35 should be entitled to vote. The mechanism for deciding votes is  
36 dependent on the pricing methodology which is to be confirmed  
37 through Section 3. The only assumption that I think we can make  
38 at the moment, unless you are Transpower, is that the current  
39 pricing methodology would continue and that the current contract  
40 counterparts would continue.

41 So, if you are to think about a situation where there might  
42 be a need to strengthen a link somewhere in the South Island,  
43 the concept in terms of the electricity system is that what you  
44 do to one part of the grid has an impact on everything else.

45 At the moment if you do any -- if it was an existing piece  
46 of the grid it's charged to all distributors and to all direct  
47 connected customers, with the exception, obviously, of the HVDC  
48 which is charged to South Island generators, but if you ignore  
49 the DC for a moment.

1           If you are saying that there's a need to have a change in  
2 the investments that have some -- would have some ability on  
3 affecting Comalco, perhaps if it was a removal of some capacity,  
4 which would then have a impact on our ability to deliver the  
5 service that we get partly from Transpower and partly through  
6 the general spot market, unless we have 26% of the votes we are  
7 unable to veto that investment.

8           When you follow through the processes in Section 2, once  
9 the vote has taken place and the outcome is that you don't have  
10 the 26% to prevent it going through, there's an automatic  
11 requirement that all contracts are amended. So our contract  
12 with Transpower would be amended to the extent that we were  
13 affected by the investment change without any ability for us to  
14 pass on that change to Comalco. So our difference -- there's a  
15 mismatch.

16 **MS BATES:** Yes, I can understand that, thank you, that's quite  
17 clear when you take it through like that.

18 **MS BLYTHE:** Just in terms of -- one of the concerns, I think, that  
19 was expressed in the Draft Determination by the Commission was  
20 that generator/retailers may be able to veto future investment  
21 changes.

22           If you follow it through, at the moment we don't have any  
23 voting -- because it's on the basis of Transpower's pricing  
24 methodology, we wouldn't get any votes as a generator/retailer  
25 other than as a Comalco -- you know, standing in their shoes at  
26 Tiwai and paying for their portion of the direct connect  
27 payments, generator/retailers wouldn't get any votes to veto  
28 through or strike-down investment in this situation.

29 **MS REBSTOCK:** Is it right to make the assumption that the  
30 Transpower pricing methodology would continue, and isn't it  
31 reasonable to assume that you are going to have another  
32 opportunity to address this issue when that methodology is  
33 developed? I mean, that methodology won't be set by Transpower  
34 on their own, they don't have the ability to unilaterally set  
35 it.

36 **MS BLYTHE:** Transpower has in terms of Section 3 to propose a  
37 methodology to the Commission -- sorry, to the EGB -- get my  
38 counter-parts mixed up.

39 **MS REBSTOCK:** You're trying to scare us, aren't you?

40 **MS BLYTHE:** There is a bit later on, as you say. You might get it.

41           Transpower proposes it to the EGB. Sure, parties can make  
42 submissions but at the end of the day it's Transpower's board  
43 that need to decide what its transmission pricing methodology --  
44 the final version of it -- is, which it then hands to the EGB  
45 for confirmation.

46 **MS REBSTOCK:** Well, no, it doesn't hand it for confirmation does  
47 it, it hands it to the EGB board for a decision?

48 **MS BLYTHE:** It's a "yes" or a "no".

49 **MS REBSTOCK:** It's a yes or a no, that's right, but presumably  
50 Transpower will want whatever methodology it puts to the board

1 to be accepted, and why would the board, given the Government  
2 Policy Statement, allow a methodology to proceed that had  
3 significant economic detriments, because that's what I hear  
4 coming out of this; is that there would be significant economic  
5 detriments from it?

6 **MR MILLER:** It goes back to the question, what are criteria by  
7 which the board must make that decision?

8 **MS REBSTOCK:** Yes. Please don't take me back to that point,  
9 because I'll say to you in the end you are supporting a proposal  
10 that includes a certain governance procedure, and that's part of  
11 it; that's the Rules.

12 **DR TURNER:** I think, if I look at our historical debate on this  
13 issue, you pose a very good question, and it has very much been  
14 our view that the Commerce Commission would be a better body to  
15 address that pricing methodology proposal than the board.

16 **CHAIR:** We thought we'd better be neutral on that in the Draft  
17 Determination, but one will see.

18 **MS REBSTOCK:** I mean, let's pursue this, because why is it that you  
19 cannot rely on the very mechanism in this proposal that is there  
20 for the whole of the proposal, not just Part F, but the tension  
21 created by the Government Policy Statement and the fact that the  
22 industry board will be held accountable for making it; why is  
23 there not enough leverage out of that to ensure an economically  
24 sound outcome in this instance, but there is in the hundreds of  
25 other bits that are supposedly reliant on that same constraint?

26 I mean, this is where I have the difficulty with, and this  
27 is really what I was trying to get at, what I asked the original  
28 question on, the governance issue, because the whole Rulebook  
29 relies on that tension, and yet in this case you are very  
30 reluctant to think that it's going to come through for you?

31 **DR TURNER:** You touch on an absolutely critical issue and that is  
32 that for whom is the Governance Board acting when it makes this  
33 decision? And you asked during my presentation what were some  
34 of our concerns about this application?

35 One of my concerns, driven by desire to see good  
36 governance; good governance requires clear accountability. When  
37 the EGB faces this decision on transmission pricing methodology  
38 is it acting for the industry or is it acting for the  
39 Government; and it is certainly not clear exactly what its  
40 accountability is when it makes that decision?

41 **MS REBSTOCK:** It's been suggested to us that there's a coincidence  
42 of those interests, but you seem to be doubting whether that's  
43 the case; is that fair to say?

44 **DR TURNER:** Well, I think we have some reasonably sharp experience  
45 that it's not necessarily a coincidence of interest, and that  
46 experience relates to our debate on the HVDC charges. We've  
47 amassed, I think, an unbelievable collection of analyses that  
48 suggests Transpower's methodology on HVDC, whichever way you  
49 test it -- whether you test it on equity or on economic  
50 efficiency -- would not meet the current guiding principles. Do

1 you think we could get that changed? Instead we got legislative  
2 action to guarantee transmission revenue following a Court case.

3 So I think that's a reasonably sharp example of the  
4 concerns that we feel.

5 **MS REBSTOCK:** The question that begs is, despite these concerns  
6 with Part F -- Part F is part of this proposal, despite these  
7 concerns which sound to me like they have very high potential  
8 detriments, not just to this industry but economy wide, you are  
9 supporting this proposal in comparison to the counterfactual,  
10 and that is a little bit surprising given the nature of the  
11 current concerns you have expressed.

12 **DR TURNER:** And I think we have to -- sorry, just a moment.

13 [Confers with Mr Miller]

14 I think we do come to the conclusion we've come to because  
15 we've looked very closely at the counterfactual, and the  
16 counterfactual is not the equivalent of a regulatory body. We  
17 see the counterfactual under the legislation as a Ministerial  
18 directive powers which are, I think, under any political system  
19 extraordinary and broad. And when we look at the potential for  
20 that sort of influence on the industry compared to the  
21 possibility that our concerns can be debated and can ultimately  
22 modify Rules, I guess we'd prefer to try and work with the  
23 industry to modify the Rules and get a better outcome than we  
24 are facing.

25 I'd have to say that either option is not an ideal option,  
26 but the industry's opportunity to improve these Rules, I think,  
27 is better than Ministerial directive opportunity to improve  
28 these Rules.

29 **CHAIR:** Well, look, in the interests of keeping going, if we come  
30 back to where Ms Blythe is at, I see at Chapter 3 we get right  
31 into the governance issues. So maybe, I suggest, that Ms Blythe  
32 carries on with her presentation, Keith, and then we come back  
33 to -- I think Chapter 3 is right on the point. I'm just anxious  
34 to keep the process moving.

35 **MS BLYTHE:** Before, perhaps, we leave Part F there's been a  
36 question at various times during the hearings in relation to the  
37 75% threshold level. Clearly we've expressed considerable  
38 concerns about the Meridian contract with Transpower for  
39 Comalco. Thinking about future investments there needs to be a  
40 balance. At the moment Transpower requires 100% consent before  
41 it would proceed with an investment. That appears too high, and  
42 there needs to be -- there does need to be a balance. Can you  
43 bear with me a moment? [Pause].

44 Thank you. Turning to Chapter 3 on the governance issues -

45 -

46 **MR CURTIN:** Very quickly, just coming back to the issue about "the  
47 overseas investors come down and would like to cut a long-term  
48 deal". I just want to understand exactly what it is that  
49 constitutes the barrier to you sitting down and doing the deal.



1 Presumably part of it is the inability of members of the  
2 Rulebook in normal circumstances to trade bilaterally outside  
3 the market, part of it is that any arrangements you might come  
4 to could be unpicked by subsequent rule changes.

5 I'm presuming that you and Transpower are both willing to  
6 enter into long-term services, both for generation and  
7 transmission, with the new potential investor.

8 I'd just like to tease out, where is it that the Rulebook  
9 is preventing the meeting of minds? Is it principally the  
10 unpicking of changes, the retrospective, the ban on bilateral  
11 trading? Because, if the Rulebook is operating in that way,  
12 it's potentially a very significant public detriment.

13 **DR TURNER:** There is no problem in bilateral contracting for the  
14 electricity. That is not an impediment. I can offer a new  
15 customer a 20 year contract for 20 megawatts at a fixed price or  
16 whatever price I deem, or that we can mutually agree. That is  
17 not a problem from this Rulebook.

18 **MR CURTIN:** Explain to me how you are able to do that when in  
19 theory electricity is supposed to go through the spot market?

20 **DR TURNER:** I can choose to take whatever risk I like on what the  
21 future price might be in the spot market.

22 As I have right now with Comalco, I have a fixed price  
23 obligation that arose some 40-odd years ago, and it's never  
24 contemplated the current market arrangements. But I don't have  
25 any relief from that obligation; I have to supply, you know, X  
26 hundred megawatts at a fixed price irrespective.

27 Like, last winter, we kept supplying electricity to that  
28 smelter and we were buying it off the spot market for \$250 a  
29 megawatt hour.

30 So, the energy side is not an issue; that's a matter of  
31 risk between ourselves and the customer.

32 **MR CURTIN:** So you are happy to buy it through the spot market?

33 **DR TURNER:** Well, if I am unable to generate it and I have  
34 committed an obligation, then I do buy it. We are buying it  
35 right now, to be honest. That's not the problem. The problem  
36 is the transmission element of the cost to deliver to that new  
37 customer.

38 Firstly, the multilateral environment of this Rulebook  
39 over-rules bilateral transmission arrangements in both Part C  
40 and Part F. As Gillian has outlined, if there is a multilateral  
41 agreement in Part F to dis-invest in the grid, that dis-  
42 investment can over-rule any bilateral contract that I might  
43 craft in the future with a major industry, even if they're  
44 affected, unless we get more than 26% of the voting capacity on  
45 that issue.

46 Now, if it's an issue associated just with the direct  
47 connection, in other words, we're the only party affected by the  
48 change, it's very likely we'll have absolute control over that  
49 element of the grid. But the problem with the grid is it's  
50 actually a common service, it's a common good. The minute you

1 go back from a specific connection you have a whole lot of users  
2 all of whom are deemed to have a say under a multilateral  
3 arrangement.

4 What I'm actually saying is you have a fundamental conflict  
5 between bilateral contracting long-term and multilateral  
6 decision-making environment.

7 **MR CURTIN:** Okay, and just my follow up to that -- and then we will  
8 move on to governance -- is, how big an issue is this? You have  
9 instanced people coming down and fossicking around to see if  
10 they can cut a deal and, secondly, if it is an issue, do you  
11 have any proposed solution as to how it might be addressed?

12 **DR TURNER:** It is a significant issue in that we will have four or  
13 five major investors talk to us about long-term electricity  
14 supply where they are seeking price and supply certainty, and we  
15 have been unable to give them the certainty around the  
16 transmission component.

17 I think that uncertainty is exacerbated by the current  
18 climate where the multilateral agreement is not yet in place,  
19 but may be coming. So it would be fair to say that part of the  
20 uncertainty is the current reform process. But, when you start  
21 talking to investors about what the multilateral environment is  
22 like, it is so novel, they have no precedent or experience in  
23 it, and they're not worrying about how you supply electricity;  
24 they just want the price certainty in the contract. But they  
25 say, "Well, this is all getting a bit complex for me. I can  
26 contract in South Australia much easier than this," and away  
27 they go.

28 So it's a very real issue.

29 **MR CURTIN:** And the answer to it?

30 **DR TURNER:** I'm loathed to suggest that you apply some threshold at  
31 which below you can have a multilateral environment and above  
32 you have a bilateral environment, because the minute you provide  
33 a bilateral environment you will have a rush of all parties to  
34 contract bilaterally if there is an advantage to doing so; and  
35 as you heard from Comalco, risk is a very real issue in a big  
36 business.

37 I don't know the answer. It strikes at the core of this  
38 multilateral structure. Perhaps the answer is that Part F is  
39 not part of this Rulebook, and I think that's a submission we've  
40 made before, but I'm not sure the Commission has the option to  
41 decide which parts it will authorise and which parts it won't.

42 **MS REBSTOCK:** Isn't it at least possible that the problem is  
43 actually caused by the voting right approach to this, and if you  
44 had an independent board who could make a decision you could --  
45 the problem can at least be addressed on its merits rather than  
46 on a vote-by-vote basis?

47 **DR TURNER:** I think what you do find internationally is that  
48 transmission is acknowledged as a monopoly and you generally  
49 find a Regulator provides the decision-making powers that you

1 refer to. However, I would caution that that is not the same  
2 institutional structure as the proposed counterfactual, and --

3 **MS REBSTOCK:** I do very clearly understand that, but leaving aside  
4 the counterfactual, within this proposal you had an independent  
5 board or you have a board, an EGB board; with respect to Part F,  
6 if that board had executive decision rights you'd fix this  
7 problem -- at least there's the possibility of it being  
8 considered on its merits rather than getting into capture by the  
9 voting structure.

10 In the case of Part F, are you accepting that that may be a  
11 solution?

12 **MS BLYTHE:** In terms of the current drafting of Part F there are  
13 some limited circumstances where the board is able to hear  
14 appeals. Now, we've got a number of concerns, in fact, that  
15 they're quite narrow at the moment, and we're in discussions  
16 with the applicant on some of those as to whether the intent of  
17 the Working Group is actually being reflected in the rule  
18 drafting.

19 But assuming that you are able to move to have an appeal  
20 heard, there is the provision for the board to consider a net  
21 public benefits test to whether actually some investment should  
22 go through, and that is one option that could be considered, and  
23 if the appeal -- the parties who are allowed to go to an appeal  
24 were sufficiently broad you might be able to use that.

25 **MS REBSTOCK:** So that provision wouldn't apply in the circumstances  
26 under the Rules as they are currently proposed, but you are  
27 saying they could?

28 **MS BLYTHE:** I don't believe that if you were taking, say, the  
29 Meridian/Comalco situation that we would ever take an appeal.  
30 We could make an appeal but I don't think as drafted the board  
31 can hear the appeal.

32 **DR TURNER:** I think that what Gillian has said, though, is  
33 suggesting at least one option to consider to resolve  
34 Commissioner Curtin's concern, what solution do we have here?  
35 Maybe there is a solution to put in front of the board an  
36 opportunity to argue for a bilateral as distinct from a  
37 multilateral, and rather than, say, trying to discover a fixed  
38 threshold for bilateral contracting, that they be made on a  
39 case-by-case basis and the board have the power to make that  
40 decision, which would effectively give them the exception that  
41 we will probably seek for the Comalco arrangements.

42 **MS BATES:** So that would be like a dispensation for Part C in  
43 particular cases?

44 **DR TURNER:** Exactly.

45 **MS BATES:** Because as it stands, what you said to us is that by  
46 joining up you are at risk because of Part C of putting yourself  
47 into -- I don't know how --

48 **DR TURNER:** Part C and Part F.

49 **MS BATES:** I don't know how severe the trouble would be, but  
50 considerable trouble with Comalco in your contract, and yet

1 you've said that you'd prefer to go for that risk than to go for  
2 the Crown EGB model.

3 **CHAIR:** Shall we come back. We need to break now because our  
4 transcriber needs a break.

5 If we come back under item 3 to some of these issues, then  
6 I think it will logically follow. So, we'll come back at about  
7 just after 4.30. Thank you.

8

9

**Adjournment taken from 4.20 pm to 4.34 pm**

10

11 **CHAIR:** All right, we'll resume.

12 A couple of Commissioners have to leave at 5.25, so if you  
13 are not finished, and I don't want to hurry you, we'll  
14 reschedule to complete the submission, because the Commission  
15 has been conscious of not trying to cage anybody's presentation,  
16 so we may have a bit of reshuffling. So, don't hurry because  
17 5.25 is closure tonight. Okay, back to you, Mr Turner.

18 **DR TURNER:** Right. I think Gillian will carry on on Section 3 of  
19 governance.

20 **MS BLYTHE:** I'll try to balance my speed with the need for talking  
21 a bit slower.

22 In terms of the governance side of things, so in terms of  
23 chapter 3 of the book, we see that there is a significant  
24 difference between the Crown entity EGB and the proposed  
25 industry version, and essentially that that lies in the  
26 incentives with respect to the industry EGB. Essentially the  
27 decisions are made by participants voting, but there are a  
28 number of constraints. I've sat on a number of Working Groups  
29 where the guiding principles have been a fundamental part of  
30 those Working Group discussions about whether appropriate rule  
31 changes should occur.

32 Certainly, we see it as appropriate, given that we are  
33 talking about investments of \$1 billion, that we should have the  
34 ability to have some voting decisions on those.

35 **MS BATES:** Can I stop you there and quickly take you back to  
36 something you said at the beginning which was, "parties who pay  
37 for new assets are entitled to determine whether it's  
38 constructed". Do you remember saying that?

39 **MS BLYTHE:** Yes.

40 **MS BATES:** I put it to you that, if you pass those costs on to  
41 consumers, that the consumers are actually paying, so why  
42 shouldn't they be represented in the equation?

43 **MS BLYTHE:** There is the intent under the Part F Rules -- let's  
44 take the assumption that the current pricing methodology would  
45 continue, and if it was an increase of investment in terms of  
46 the AC network distributors, and direct connect customers have  
47 the final say in the matter, that distributors would be required  
48 to consult under the concept of the model distribution contract  
49 with their customers. And so, in that sense, they have the  
50 consultation on that.

1           Certainly the Rules need to be able to respond quickly to  
2 changes in the sector and to take on board new technology etc.

3           In terms of the consumer influence and ability to impact on  
4 the decisions there's clearly, through the governance side of  
5 Part A and the fact that we're going through and developing  
6 Rules to be consistent with the Government Policy Statement,  
7 there is that ability for us all to influence the direction of  
8 that.

9           In terms of whether there should be over-ride powers,  
10 that's a question that the Commission has asked a number of  
11 parties. Meridian believes that the design of this industry  
12 version, given that it is within the context of a self-  
13 regulatory environment does not necessitate the need for that  
14 over-ride accountability; perhaps with the exception of Part F,  
15 given the discussions that we've just had.

16           In terms of the Crown entity EGB, I think -- we've set out  
17 in Annexure 5 some of the key functions and duties of that Crown  
18 EGB, and whilst we probably all have some degree of uncertainty  
19 of how it's going to work in practise, the only thing we can  
20 really hold on to is what's in the legislation.

21           And taking that as the brief, the Crown entity EGB is  
22 certainly going to be incentivised to give particular weight to  
23 the consumer interests. I note in Section 172T(c) that the  
24 Crown entity has a particular duty to act consistently with the  
25 spirit of service to the public, that the Crown entity EGB has a  
26 duty not to contravene the Act and, in particular, that there  
27 should be -- that there's a prohibition against promoting the  
28 interests of particular market participants or industry  
29 participants, and the definition of that includes directly  
30 connected users; so effectively it's the mums and dads in the  
31 small/medium enterprises that are left in that mix.

32 **MS BATES:** What page are you at?

33 **MS BLYTHE:** Page 15.

34 **MS REBSTOCK:** Given what you have just said, why do you think  
35 consumers are sort of universally opposed to this proposal?

36 **MS BLYTHE:** I think they are -- different people have got different  
37 views of looking at the Crown EGB and many people see it as a  
38 Regulator, they don't see it as a body that has particular  
39 duties to the Minister, and if those board members aren't doing  
40 as the Minister bids that they can be removed at will. So, I  
41 think that the --

42 **MS REBSTOCK:** With respect, we put that issue directly to Comalco  
43 and to MEUG, and I haven't talked to CC 93 yet, but they did  
44 seem to understand that, but nevertheless they do not support  
45 this proposal, and I think for any player in this industry, such  
46 as Meridian, if your consumers are saying clearly, universally,  
47 "We don't like this," it does not promote the long-term  
48 interests of consumers; does that cause you concern?

1 **DR TURNER:** I think that's quite a broad question, and beyond the  
2 aspect that Gillian's just dealing with, but I think it needs to  
3 be answered.

4 I think there's a lot of elements to the answer. I think  
5 one is that the process by which we have brought this  
6 application to the Commission, the industry I mean, has not  
7 necessarily been a process of resolution of issues but of common  
8 denominator, and --

9 **MS REBSTOCK:** Lowest common denominator or...?

10 **DR TURNER:** I think we've got to a Rulebook that can just get  
11 through the dissent and debate that's occurred without  
12 necessarily resolving that dissent and debate. So, I think  
13 that's why you're getting quite a spectrum of views from the  
14 industry on this application. Much of the debate that has taken  
15 place to bring this Rulebook has not been resolved.

16 **MS REBSTOCK:** But isn't it the case that we're not getting a  
17 spectrum of views from consumers, we're getting a pretty  
18 consistent view?

19 **DR TURNER:** Absolutely, and I think consumers are saying they don't  
20 like this approach. If you listen to the consumers, though, you  
21 will find that there are various reasons why they don't like  
22 this approach; either they don't participate in the governance  
23 enough or they don't believe that Part G the NZEM Rules should  
24 be authorised, or they don't like the idea of voting structures  
25 to decide outcomes in the various parts of the Rules, they want  
26 a Regulator.

27 So there's quite a spectrum of views even from the consumer  
28 side as to why they don't like this set of arrangements.

29 **CHAIR:** I think it would be fair to say that the consumer side has  
30 not dismissed the industry EGB, it comes back in essence to  
31 where the governance issue ends up. Although, maybe Comalco was  
32 a little more strongly inclined towards Ministerial driven  
33 structures.

34 I followed from him and from you that, given there are --  
35 they have governance issues they have raised and you're aware of  
36 them, that if they were capable of solution -- and I'm not sure  
37 of what the solution is, obviously -- they're not necessarily  
38 opposed to the concept of an industry EGB.

39 **DR TURNER:** Well, I did hear Comalco say that they would be willing  
40 to give this another round if there was another opportunity to  
41 have another go.

42 **CHAIR:** And MEUG said roughly the same thing this morning --  
43 Mr Currie.

44 **DR TURNER:** However, Comalco has a very long history in this  
45 industry and up until 1996 they were supplied by a Government  
46 entity, and they carry with them the experience of the years  
47 prior to that; experiences like 1975 where prices were adjusted  
48 unilaterally, and they have learnt to adjust to Government  
49 control of this industry, and it may be that they have a

1 preference for that environment than the environment we have  
2 today.

3 **CHAIR:** Yes, I think people have different perspectives on that  
4 depending on their experiences. All I'm saying is it seemed to  
5 me that certainly MEUG and Comalco hadn't shut the door  
6 completely on an industry EGB depending on where the governance  
7 issue ends up, of course.

8 **DR TURNER:** That is, though, the crucial nexus in this application,  
9 whether we talk about a Regulator as distinct from the current  
10 Electricity Amendment Act mechanism, as distinct from a  
11 multilateral agreement between the industry. I think that one  
12 of the complex tasks you have is to distinguish between the sort  
13 of Regulator that various parties are talking about versus the  
14 role of Government under the 2001 Amendment Act, and I think  
15 what Gillian is trying to do is to show that the powers under  
16 the Amendment Act are very different from the powers you might  
17 expect a Regulator to have as distinct from this multilateral  
18 package.

19 **CHAIR:** I think there's been -- without making a judgment -- the  
20 comments of Professor Hogan, for one, seem to be premised on the  
21 basis that everybody has an Electricity Regulator, and everybody  
22 has a Telecommunications Regulator and so on. But I think to my  
23 mind that doesn't necessarily fit with economic regulation  
24 principles here.

25 So there is a fundamental disconnect in the middle of that,  
26 and I think if Gillian can explain how you see the Crown EGB --  
27 and I don't think you see it as a Regulator, as I understand  
28 you?

29 **MS BLYTHE:** We see it as the next thing along the spectrum, going  
30 further and further away from a Regulator. It is far more --  
31 there is a body that can do the Minister's bidding.

32 I mean, one of the issues in the last bullet point on  
33 page 15 is we've talked about there would be the need for  
34 working parties, and that would occur under the Crown entity as  
35 well as under the industry body, and I agree that that would be  
36 likely. But there are certainly certain circumstances where the  
37 Minister and the Crown entity can make decisions without the  
38 need to consult, and simply waiving that obligation if it's  
39 necessary or desirable or in the public interests that proposed  
40 regulations are made urgently.

41 That is a very different situation from a --

42 **MS BATES:** Which provision is that, Ms Blythe?

43 **MS BLYTHE:** It's section 172E.

44 **MS BATES:** Yes, thank you.

45 **MS BLYTHE:** 172E, subsection 3; the subsection 2 where requiring --  
46 the consultation is not required if the EGB or the Minister, as  
47 the case may be, consider that it's necessary.

48 Just to continue. Another key difference is the -- from a  
49 process perspective the Crown entity is likely to be -- to  
50 consider a very wide range of issues and have a far more sort of

1 quasi judicial way of processing forward which to the extent --  
2 you know, again as another layer of uncertainty for industry  
3 participants.

4 **MS BATES:** Can I just come back to that section that you talked  
5 about, that subsection 3. It seems that that is only -- the  
6 regulations are made on the basis that they are to be reviewed  
7 by the EGB six months afterwards.

8 **MS BLYTHE:** But to the extent that that was to impact something  
9 that was going to happen tomorrow and that there were impacts on  
10 market participants in terms of revenue consequences, that could  
11 have quite a major impact on parties.

12 **MS BATES:** I agree with that, but I think that provision is  
13 intended to be used in very special circumstances.

14 **MS BLYTHE:** And one would all hope that we're never in those  
15 circumstances, but the provision still exists.

16 **MS BATES:** It may be in situations where somebody has to move very  
17 quickly.

18 **DR TURNER:** Although last year is a good example where  
19 circumstances existed where initiatives were taken on  
20 transmission that fundamentally changed all the generators'  
21 planning for energy supply, changed the value of that planning.  
22 I mean, the basic Rules for security of supply were altered and,  
23 for example, in Taranaki changes were made to relieve generation  
24 constraints at the expense of security of supply to Taranaki  
25 residents.

26 That's a profound change when you think about it, and I  
27 think that's a big value shift as well.

28 **MS BATES:** And who made that decision?

29 **DR TURNER:** That was a decision ultimately made by Transpower. But  
30 in the context of an extreme condition, and I think it was  
31 accepted as a logical decision to make, given the circumstances  
32 of supply, but it was also made, I think, at the -- with some  
33 support from an industry forum chaired by the Minister. So,  
34 there was, I think, outside of the Rules governing the industry  
35 at the time a decision made that had a profound shift in value  
36 between generators.

37 **CHAIR:** Certainly the point was made by an earlier submitter that  
38 in that company's view -- and I'm not taking a position on it,  
39 but that the system operator under a Crown EGB would have a lot  
40 of say, to put it bluntly -- and I'm not aware of the issue you  
41 mentioned; I mean, it might have been a grid issue that required  
42 that to happen, I don't know. Your point is that there needs to  
43 be a process whereby people affected by it have some say as  
44 well?

45 **DR TURNER:** Yes.

46 **CHAIR:** It's only a small point, your first bullet point about  
47 acting consistently with the spirit of service to the public,  
48 that's an exultation to Crown entities generally these days, so  
49 I wouldn't see that as being a Trojan horse, I don't think.



1 **MS BLYTHE:** If the Commissioners are happy we'll move to TAB 4 and  
2 Ari Sargent will continue.

3 **MR SARGENT:** I'll cover some of the history of market development  
4 in New Zealand, which I'm sure the Commissioners will feel is  
5 well trodden ground over the last couple of weeks, but I think  
6 it would be useful to have another perspective on it.

7 **MS REBSTOCK:** We've heard 10 versions already, we might as well  
8 have another one.

9 **MR SARGENT:** The first point I make is that Meridian  
10 representatives collectively have extensive experience in  
11 Working Groups in NZEM and other market forum. I make that  
12 point not to advertise Meridian's credentials, and indeed many  
13 other submitters have made similar claims. The point is that  
14 it's an important part of the decision-making process and in  
15 Meridian's case it is very relevant to how we might exercise our  
16 voting rights in various rule change proposals.

17 We see the Working Group process not only offering a forum  
18 for debate for extremely complex issues, but we also see them as  
19 a forum to enlighten Meridian on other's perspectives and allow  
20 us to make complex trade-offs and, I guess, assess in a sense  
21 what or where Meridian's commercial interests might lie, and I  
22 think on that front we don't hide behind the fact that in  
23 exercising our votes our commercial interest is high on the  
24 priority list in terms of how we exercise that vote, and we  
25 won't try and convince the Commission any other way.

26 What we will say, though, is that the process of  
27 enlightenment through the Working Groups actually makes us  
28 challenge what is in our commercial interests, and clearly a  
29 stable market environment is a relevant factor and involvement  
30 in Working Groups allows us to assess other people's  
31 perspectives and the level of controversy etc that might be  
32 around any particular proposal.

33 That's probably a useful point to launch into the second  
34 bullet here. Commenting on Professor Hogan's submission last  
35 week, I don't intend to cherry pick the good bits that support  
36 our case, but rather challenge his view on how the market was  
37 developed in New Zealand.

38 I don't question that the Government of the day had a hand  
39 in certainly the policy level setting the direction for market  
40 development in New Zealand, but at the detail level in terms of  
41 the Rulebook development, from bitter experience I can say that  
42 that was a very hard fought commercial negotiation, and I think  
43 that the involvement of commercial interests in that process  
44 is -- has contributed to the quality of the Rulebook and the  
45 market arrangements that we have today.

46 I think, to cite a couple of examples of that, you would  
47 acknowledge, and most people do, that at the time the market was  
48 involved -- developed in 1995 in terms of it first processed to  
49 develop the Rules, I think ECNZ and probably Transpower were  
50 viewed with quite a degree of suspicion at that time. Their

1 views were probably discounted because they were coming from a  
2 position of perceived self-interest, and there was a number of  
3 negotiations that had to be, I guess, fought harder than would  
4 otherwise be the case.

5 I think if you look at the development of the Rules in  
6 detail, prior to the interim market which started in February  
7 1995, the process for dispatch was one of Transpower as grid  
8 operator at that time effectively operating to detailed river  
9 chain models and generators had no discretion over how they  
10 would operate their own plant.

11 There was a hard fought battle to move to convince the grid  
12 operator that an inter-temporal price quantity offer process  
13 would actually deliver outcomes and maintain security. Clearly  
14 that was at that time in ECNZ and, I guess, Contact's interest  
15 to -- not only for financial reasons -- but also to allow them  
16 to manage risks around their own operations that weren't  
17 possible under the previous arrangements.

18 Similarly, what we now know is the two hour rule.  
19 Transpower at the time -- I think it was Mr Stevenson from  
20 Contact, suggested their original proposal was for 11 hours and  
21 I think, again, there is a continual hard battle to bring those  
22 limits down.

23 I don't think Transpower had any mal-intent. I think, in  
24 fact, they had good intentions in trying to maintain grid  
25 security under a market environment.

26 I guess the point, though, is that they lacked incentives  
27 to innovate and it was those commercial pressures borne, I  
28 guess, pushed on to Transpower the need to innovate, and you  
29 might argue that maybe that was the trigger for the improvement  
30 that Mr McDonald perhaps perceived in the last five years in  
31 terms of the changes in Transpower.

32 So, I guess I have to summarise that point, we don't  
33 necessarily think that operating in commercial interest is the  
34 evil that some would describe it as, and also I think it's not  
35 always obvious necessarily what is in the parties' commercial  
36 interest.

37 **MS REBSTOCK:** Can I just stop you there. I don't -- certainly  
38 wouldn't want you to have a view that the Commission takes the  
39 view that commercial interests are somehow evil, and I don't  
40 think that's, with respect, the issue. The issue is,  
41 undoubtedly, and I think every participant here has accepted in  
42 many cases those commercial interests and the interplay between  
43 the parties can lead to very good outcomes.

44 But, do you accept that there are times when they can  
45 diverge from what would be a wider public interest, and that is  
46 the issue; it's not whether one is good or bad or always right  
47 or always wrong. There's a finer discussion going on here about  
48 when interests coincide and when they don't, and Meridian itself  
49 has acknowledged, at least with respect to the issue that we're  
50 talking about when we discuss Part F, that there can be very

1 sizeable diversions that can have serious net costs and  
2 detriments to the economy as a whole.

3 So, I think that's the issue here, not whether commercial -  
4 - someone pursuing a commercial interest represents a sort of  
5 evil deed.

6 **MR SARGENT:** Except in theory that you know there may be a  
7 misalignment of public good and commercial interests. I think  
8 the history of the market development, that's not borne out in  
9 practise, and I think the track record shows that the industry  
10 has delivered, I guess, public good type solutions, particularly  
11 in the area -- I mean, Part F, as we've sort of outlined, the  
12 new and novel part of the Rulebook, and I think this  
13 particular --

14 **MS REBSTOCK:** Can I stop you there. I mean, the point I'm trying  
15 to make is, it may have delivered many, many net public benefits  
16 but we've also seen many examples where there's been the  
17 inability to move forward.

18 So, for instance, when we hear from virtually everyone that  
19 there's been under-investment in the grid for the last decade,  
20 that comes out of the same environment. So, I think it's -- you  
21 know, we take your point, but we have to move beyond this strict  
22 dichotomy between two extremes position as there's something in  
23 between here that we're all debating, it seems to me.

24 **MR SARGENT:** I understand. I think there is a fundamental  
25 difference between the inter-plays in the competitive market; as  
26 in energy versus a monopoly provision, as in transmission, so I  
27 don't think it's necessarily to apply the same tests.

28 **MS REBSTOCK:** What happens when you're in an oligopoly? What is  
29 your decision-making -- I mean, what does your analysis lead to  
30 in that context?

31 **MR SARGENT:** I think the issue is whether there's competition. I  
32 don't think it's a question necessarily of degree or whether  
33 you've got high levels of competition or minimal levels. The  
34 NZEM was developed in an environment of basically ECNZ and  
35 Contact on the generation side, and I think clearly the degree  
36 of competition at that stage, it was less than it is now. So I  
37 don't think it's a question of degree of competition, I think  
38 the market environment dictates those sorts of outcomes.

39 **MS REBSTOCK:** It must be to some extent the degree because you said  
40 in a monopoly environment you get a different result. So what  
41 I'm asking you is, leaving aside the particulars in theory, what  
42 does an oligopoly theory tell you about, just in theory, what  
43 does it tell you about the possible coincidence of public  
44 interest with commercial interest?

45 **DR TURNER:** I wonder if I could tackle your question this way,  
46 Commissioner. There is a distinction between the behaviour of  
47 competitors in the competitive part of this industry and the  
48 behaviour of the monopoly. If you are in the competitive part  
49 of the industry and you have very long life assets with high  
50 fixed costs you ignore the public benefit to your peril.

1 Because eventually, if you keep acting in contradiction to the  
2 public good, you will eventually suffer commercial loss.

3 So, there is a very strong discipline on companies with  
4 long life assets, as you see with Comalco -- I mean Comalco's  
5 efforts on Kakapo is a great example of their desire to create  
6 the impression of the public that they do good beyond making  
7 money and employing people.

8 I think that is the same in the electricity industry in the  
9 competitive sector. However, in the monopoly part of this  
10 industry you don't have the same incentives because there's  
11 always the protection that if you are a monopoly and you fail,  
12 the cost to the economy is huge and, therefore, you --

13 **MS REBSTOCK:** I understand the deference between the competitive  
14 market and monopoly and why you get different results, but you  
15 may recall that the -- my understanding is, in the Market  
16 Surveillance report, in what happened over the winter, it  
17 acknowledged that this market -- and what I think you are  
18 referring to as competitive -- had some characteristics of an  
19 oligopoly market, and I'm asking you -- I mean, I'll ask you  
20 whether you agree with that view, but leaving that aside, if a  
21 market has oligopoly characteristics, what can we take to be the  
22 standard theory on whether commercial and public interest is  
23 likely to coincide?

24 **DR TURNER:** I don't agree that the market had oligopoly  
25 characteristics last year. It is not a surprise when a market  
26 gets short in supply that prices will rise to unexpected  
27 extremes and that you cannot get a hedge when -- sorry, you  
28 can't get a hedge at prices that may have prevailed six months  
29 earlier in the circumstances of short supply. It's sort of like  
30 trying to buy insurance for your house when it's burning; it's  
31 too late.

32 And I think it's quite wrong to call that oligopoly  
33 behaviour given the long life asset cycle of this industry.  
34 You've got to look at the behaviour over a much longer period  
35 than just the short run shortage of supply. So I don't accept  
36 oligopoly behaviour in this industry.

37 **MS REBSTOCK:** Let's talk in theory then, second part of the  
38 question; if you did, if that's what we had, what would be the  
39 analysis of -- under what circumstances you had this coincidence  
40 of commercial and public interest? Because we do have to form a  
41 view on what we think the nature of this market is, and it has  
42 clearly been put to us that it is not competitive, that it  
43 actually has some other characteristics. So that's why I'm  
44 putting the question -- I mean, I accept that your position is  
45 that it doesn't have those characteristics, but if it did?

46 **DR TURNER:** I think, then, I revert back to my more general view,  
47 that even in an oligopoly if you pursue commercial strategy that  
48 is not in the public interest, eventually you will suffer loss.

49 I think there you invite -- if you are part of an oligopoly  
50 and you abuse that position, you invite intervention in some

1 form. You will start to see it with your customers objecting,  
2 but eventually customers revert to the means that they have at  
3 their disposal; they approach the political environment to try  
4 and get change.

5 **MS REBSTOCK:** So they go to the Minister and say, "We'd prefer a  
6 Crown EGB".

7 **DR TURNER:** Yes, absolutely. That's certainly, I think, the logic  
8 of misbehaving under an oligopoly environment.

9 **MS REBSTOCK:** We're kind of doing that right now, aren't we?

10 **DR TURNER:** I think this is not dissimilar to the environment New  
11 Zealand has operated under, where there's been no direct price  
12 control but the threat of regulation. You know, those who have  
13 been under direct regulation would say it never works. Those  
14 who live in New Zealand have actually been very exposed to  
15 threat of regulation and our own view on, do we like this  
16 arrangement or an Electricity Amendment Act 2001 arrangement; on  
17 balance, we would pick this arrangement because we think we  
18 could do more to improve it than we would under the Government  
19 EGB.

20 **CHAIR:** I mean, I think -- without getting into the Government  
21 policy issue -- that that's not the Commission's concern; given  
22 that the Government's had inquiries in telecommunications and  
23 this industry, and statutes have come out of those inquiries,  
24 then the option of a Crown EGB as a default situation is pretty  
25 real.

26 **DR TURNER:** I think it's been put there to stimulate the industry  
27 into getting its act together, if you like.

28 **CHAIR:** This has come through over the last couple of days, I can  
29 assure you anyway, back to you please.

30 **MR SARGENT:** It's probably a useful point to move on in the sense  
31 that it's useful to look at the nature of the rule changes we're  
32 talking about here as well, and it may give some comfort on the  
33 oligopoly issues in the sense that it's, whether you have got  
34 two or 10 or 100 competitors in a competitive market, it's in  
35 the participants' interest to have a low cost infrastructure and  
36 a friction free infrastructure to transact. I think that aligns  
37 pretty well with the public interest and it's our submission, by  
38 and large, that's the nature of the rule change we're talking  
39 about anyway; improvement of the dispatch algorithm, refining  
40 pricing signals and enhancing information flows is really the  
41 nature of the rule changes we're talking about in practise, and  
42 I think there's examples that we include in the annexure of  
43 changes that are pro-competitive which we don't need to go  
44 through, you can read them at your leisure.

45 In terms of -- the Commission has asked a number of  
46 submitters whether they have accepted or rejected rule changes  
47 to their financial disadvantage. I guess our submission is that  
48 in theory there's probably three generic areas where we might  
49 have some commercial disadvantage as a result of rule changes.  
50 The first is as to rule changes that might impact on market

1 prices. Our submission is that the Rules are of a nature that  
 2 there's no constraints on pricing outcomes and, therefore, the  
 3 market -- changes to the Rules won't deliver different pricing  
 4 outcomes and there won't be rule changes that Meridian is  
 5 required to vote on that will have a material disadvantage to us  
 6 in that respect.

7 The other generic area is in relation to changes that might  
 8 impact on Meridian's ability to compete and, therefore, our  
 9 market share. There is a good example where Meridian has  
 10 supported, not necessarily a formal rule change, but supported a  
 11 proposal for a new under frequency standard which arguably  
 12 allows combined cycle technology to compete against Meridian  
 13 generation in a sense.

14 And its specific sense is a disadvantage to Meridian but  
 15 again, taking the wider view, it's our view that -- coming back  
 16 to market stability -- it's a good thing; promotion of new  
 17 technology, a good thing which we ultimately may benefit from as  
 18 well.

19 And also, I guess, through the involvement in the Working  
 20 Group process, it became apparent to us that without that  
 21 change, you know, there would be no new arrangements and,  
 22 therefore, it was a necessary compromise. So, while on the face  
 23 of it --

24 **CHAIR:** But being realistic, one of these days you may want to  
 25 build a CCGT plant yourself; I mean...

26 **MR SARGENT:** Probably not a CCGT, but there may be other technology  
 27 advancements that we want to pursue. I guess, reiterating the  
 28 point that it's not immediately apparent where commercial  
 29 interests lie. If you get down to specifics you may find a  
 30 disadvantage but if you take a more holistic view there may be a  
 31 different outcome.

32 The third, I guess, generic area where we might see  
 33 commercial disadvantage in promoting rule changes is in the area  
 34 of cost of the arrangements, and I think there's a number of  
 35 examples where both Meridian and the wider market has supported  
 36 rule change proposals that have increased the cost of market  
 37 arrangements without any real benefit; and I think the examples  
 38 of that are free-to-air prices, publication of spill  
 39 information, hedge indexes, those sorts of things, largely  
 40 around information flows.

41 **MS REBSTOCK:** Why would you do it if there was no real benefit?

42 **MR SARGENT:** I think it's an important point to take into account  
 43 that -- and I think the Commission's acknowledged -- that the  
 44 Rulebook even in the existing structure -- the existing  
 45 arrangements don't operate in isolation of other policy issues,  
 46 and I think that the incentives on the industry -- policy  
 47 objectives were made clear and, therefore, they were delivered,  
 48 and I think you need to look wider than the Rulebook in terms of  
 49 meeting policy objectives. In particular, the Government Policy

1 Statement referred to those specific outcomes they were looking  
2 for.

3 Moving on, I guess, now to a number of submitters have made  
4 submissions that there's been pro-competitive rule changes  
5 blocked. Two instances have been cited in particular, one in  
6 relation --

7 **MS REBSTOCK:** Sorry, I'm just thinking about this statement that  
8 the industry agreed to some rule changes that had no real  
9 benefit, and I take that to be no public benefit or industry  
10 benefit?

11 **MR SARGENT:** Certainly no obvious industry benefit. The public  
12 benefit, I guess the policy makers had made that decision and  
13 formulated the policy.

14 **MS REBSTOCK:** So you are not making the comment that there was no  
15 public benefit? Because otherwise I'd have to think that there  
16 was a detriment to this business of Minister giving a push to  
17 the industry to do things without a transparent process to look  
18 at its merits.

19 **MR SARGENT:** I think that is -- you point to a very real risk under  
20 the Crown EGB structure that --

21 **MS REBSTOCK:** Excuse me, but isn't that something that's happened  
22 under the current context, which is more like the industry EGB?

23 **MR SARGENT:** That's a possibility. I guess my submission is that  
24 it becomes even easier or more likely under a Crown EGB  
25 structure where if the Minister issues a directive --

26 **MS REBSTOCK:** I think the Act actually puts some requirements on  
27 the Minister when he acts under the Crown EGB, in terms of the  
28 circumstances under which he can make certain decisions and give  
29 certain instructions, which he would not have to do under an  
30 industry EGB in terms of the ongoing dialogue in the CEO forums  
31 that he has with industry participants.

32 **DR TURNER:** Perhaps if I can just illuminate this a little. I  
33 think some of the initiatives that have been taken have no  
34 commercial benefit to Meridian but may have perceived public  
35 benefits relating to transparency or better information flows or  
36 whatever; I guess we're not in a position to assess the wider  
37 public benefits, we just don't see the commercial benefit.

38 The disclosure of spill is a good example. I mean,  
39 disclosing spill doesn't change how much we use water or spill  
40 water. A good example was last week; we spilt a lot of water in  
41 the Waiau, we couldn't not spill it because the lakes were full  
42 and we were running flat out. The disclosure of that  
43 information doesn't the commercial position of Meridian; it may  
44 inform a whole lot of other people about what's happening. I'm  
45 not sure we can see immediately what the commercial benefit or  
46 the public benefit might be from that.

47 **MS REBSTOCK:** I guess the question I was really asking is whether  
48 it's an industry EGB or a Crown EGB. The Government or the  
49 Minister may -- and we see this happening, we've been told it's  
50 happening -- push the industry to make certain concessions,

1 which as you've stated you make; you haven't done the assessment  
2 on even whether there is net public benefits.

3 I mean, there must be the potential for detriment from --  
4 particularly the stuff that happens in the in-between periods,  
5 when GPSs are negotiated, where real detriment could occur under  
6 either scenario in terms of untested proposals being put to the  
7 industry which it feels, for whatever reason, it must adopt.

8 **DR TURNER:** I think we're referring though to elements in the  
9 Government Policy Statement that didn't seem to have any direct  
10 mechanism for implementation until the EGB, whatever form it  
11 might have, was established and the Ministers desire to see  
12 action on the Government Policy Statement, and I guess as an  
13 industry we're in no position to contravene the law.

14 What debate we had on what might go into the Policy  
15 Statement is, I think, an interesting question you raise. I can  
16 tell you that we had very little influence other than to submit  
17 to the inquiry that was run prior to the formulation of that  
18 Policy Statement, and I don't think we could be held to account  
19 for the public benefits that might flow from that Policy  
20 Statement.

21 **MS REBSTOCK:** No, I'm just -- because I thought that the comment  
22 referred to public benefits I wondered about -- I mean, one of  
23 the things that it seems to me happens currently, even with the  
24 body that's been set up to look at this, is that there's an  
25 issue about the transparency to which the Government signals to  
26 the industry what it wants in between the setting of a GPS, and  
27 whether you get the testing of -- and even an industry's input  
28 into whether the benefits in a public sense outweigh whatever  
29 costs there are to the changes, and that's the thought that was  
30 triggered by the comment that was made.

31 **DR TURNER:** Well, I can assure you, there was no test on the public  
32 benefit of disclosing spill. However, we didn't see it as a  
33 particularly major issue for us to do either, so the cost is  
34 relatively small. In the context of the stress the system was  
35 under last winter, a relatively minor issue to deal with  
36 compared to trying to manage water.

37 **CHAIR:** All right, getting back to the point that we're trying to  
38 work through, there were some comments made by the applicant, I  
39 think on the first day, as to what issues of a GPS had not yet  
40 been picked up in the guiding principles, and one can assume  
41 that they are being progressed or further worked on right now.  
42 Perhaps back to you.

43 **MR SARGENT:** Coming back to the specific rule changes that some  
44 submitters have suggested have been blocked; financial  
45 transmission rights and disclosure of bid and offer information.  
46 With respect to financial transmission rights, I think that the  
47 nub of the issue there is that the industry and Transpower had  
48 quite a different view on both at the detailed level and at the  
49 generic level as to whether there was actually any net public  
50 benefit.



1           There's an e-mail from myself, as a member of the Rules  
2 Committee, to some members of the Transpower group that were to  
3 present to the Rules Committee on the FTR design issues. A  
4 number of issues raised there were genuine concerns with the  
5 proposal; specifically we saw a desire to have incentives placed  
6 on the grid owner to operate their assets in an efficient way  
7 and saw financial transmission rights as one of the possible  
8 mechanisms to deliver that. Transpower's design didn't deliver  
9 on that.

10           We felt that the nature of the arrangements didn't give us  
11 a lot of certainty as to what we were actually procuring and,  
12 therefore, didn't offer a lot in terms of a risk management  
13 instrument.

14           I won't go through them all, but there's a range of other  
15 issues associated with financial transmission rights.

16 **CHAIR:** I think the point was made by another submitter similar to  
17 what you have just said, that it was the nature of the issue  
18 rather than anti-competitiveness.

19 **MR SARGENT:** So, there are specific design issues, but there's a  
20 wider issue too, in that, there was genuine concerns that in  
21 fact, while Transpower saw the arrangements as pro-competitive,  
22 that they could actually have anti-competitive impacts, and  
23 there is quite a degree of subsequent debate which resulted in a  
24 small but significant modification to the design to deal with  
25 those concerns. So, I think the point here is there is genuine  
26 concerns, there was nothing vexatious about it and there wasn't  
27 any attempt to block anything that was pro-competitive. There  
28 was genuine debate as to whether it was pro-competitive.

29           With respect to disclosure of bids and offers, similar  
30 issue really. I think Mr Stevenson last week some time  
31 described the history of the bid and offer disclosure under NZEM  
32 and the Commission's obviously aware that that's a separate  
33 issue for them to consider, but it wasn't immediately obvious  
34 that that was a pro-competitive change in the way that the rule  
35 change proposal was submitted.

36           So I guess, to sort of sum up this. A number of people  
37 have alluded to the so-called industry inertia in the rule  
38 change proposals. I guess my submission is that's actually  
39 quite the contrary. If you look at the efficiency and the  
40 expediency with which the market now deals with rule changes,  
41 it's a significant improvement on when the market originally  
42 came into being, which I think is largely driven by the members'  
43 experience, and I would suggest that issues being debated in the  
44 industry now are issues of real substance; whereas three or four  
45 years ago there was a lot of industry debate on issues of  
46 detail, and I think the expediency with which issues of detail  
47 are being resolved is a lot better than historically, and that  
48 in fact there is no industry inertia, there's just genuine  
49 debate on complex issues.

1 I can understand why people perceive issues of blocking,  
2 but at the end of the day there is genuine complexity which  
3 needs to be resolved.

4 I guess one final issue, in terms of the Crown EGB versus  
5 industry EGB, I think the Commission has been probing some  
6 parties as to whether there is any difference in information  
7 asymmetry between the two, and I don't proffer a view on that,  
8 but I think it's not just a matter of looking at the information  
9 available, it's also looking at the incentives, and also I think  
10 the FTRs is a good example of, Transpower, I expect, had a  
11 genuine public benefit approach to issuing financial  
12 transmission rights, but at the end of the day it was only the  
13 industry participants who knew how to operate with those Rules  
14 and could proffer a -- you know, describe a different view and,  
15 I guess, point to potential detriments in the arrangements. It  
16 wasn't a question of information asymmetry, it was a question  
17 of, the real users of those Rules have the best knowledge as to  
18 how they will be applied.

19 And I think that's all I've got to say on market rule  
20 changes and the like.

21 **CHAIR:** Well, I wonder, given that two Commissioners have to leave  
22 imminently, if we broke it there and then reconvened, if you  
23 could make it on Tuesday morning.

24 **DR TURNER:** I think I may be absent.

25 **CHAIR:** We could reschedule, and it's your call as to -- we can  
26 change it with someone else.

27 **DR TURNER:** I think the material we've got to cover is largely in  
28 Mr Miller's domain, and I mean my absence shouldn't impede the  
29 Commission.

30 **CHAIR:** If you are comfortable with that we obviously will take  
31 submissions from whoever's representing, that's your call.

32 So, we'll probably confirm it tomorrow anyway, but at the  
33 moment we'll put you on first and then follow with the others as  
34 scheduled. But I'm very conscious of giving people on both  
35 sides of the house full opportunity to put their points of view.

36 So thank you very much for where we've got to and Tuesday  
37 morning, if Mr Turner isn't here, Mr Miller will be in the seat.

38 All right, thank you, we'll adjourn.  
39  
40

41 **Hearing adjourned at 5.25 pm**  
42 **Resuming on Tuesday, 25 June 2001**  
43  
44

45 \*\*\*

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