CONSUMER COALITION ON ENERGY (CC93)

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The Coalition: Business New Zealand Inc.
Consumers' Institute
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Mr Bill Naik
Investigator
Commerce Commission
PO Box 2351
WELLINGTON

Dear Mr Naik

Submission in response to the Draft Determination issued by the Commerce Commission on the application lodged by the Electricity Governance Board Limited.

1.General Commentary

The members of CC93 endorse the preliminary view reached by the Commerce Commission that it should decline to authorise the application lodged by the Electricity Governance Board Limited (EGBL).

CC93 strongly believe that the rulebook as submitted for authorisation by the EGBL will result in consumer interests being disregarded or over-ruled and that pro-competitive initiatives will be delayed or deferred indefinitely.

As per CC93's earlier submission its representatives on EGEC and the Governance, Rationalisation and Transport working groups were consistently out-voted by the greater number of suppliers on each of those groups. The voting system proposed by EGBL entrenches the control of the rule making and rule changing processes by generator/retailers. CC93 does not believe that authorisation of a rulebook which in practical effect disenfranchises consumers can be contemplated by the Commission.

CC93 participated in the previous authorisation processes relating to the Wholesale Electricity Market (NZEM-1996) and the Multi-Lateral Agreement on Common Quality (MACQS-1998 & 1999) and has reviewed the legal arguments and commentaries relating to these cases.

In respect of the NZEM case the outcome whereby "no authorisation was necessary because jurisdiction was declined" meant that consumer interests were not jeopardised. At any stage consumers or a class of consumer could take a case, i.e. lodge proceedings under the Act, if they believed that parties within NZEM were engaging in anti-competitive behaviour or restrictive trade practices were being undertaken. The fact that NZEM was claimed to be voluntary and that by-pass could be achieved turned out to be the reality.

The two applications in respect of MACQS warrant specific attention. The first application lodged in October 1998 was strongly opposed by consumers. This application was withdrawn. An amended application was lodged in May 1999 and this application was fully supported by consumers. A key difference in the two applications was the involvement of consumers in the governance of the Grid Security Committee and the voting rights. In its Draft Determination dated 30th June 1999 the Commerce Commission observed, (quite rightly in CC93's opinion) that:

> "the changes (between the first and second application) appear to have met many of the concerns about the potential for quality levels being determined, or costs being allocated, in a way which reflects the interests of those with decision rights at the expense of those without." (refer para.144 of Draft Determination)

It should be noted that the MACQS authorisation did not encompass any element of pricing or the methodologies for the allocation of costs. It was envisaged that such decisions would be the subject of specific applications to the Commission. CC93 believe this point is particularly relevant given the "blanket authorisation" sought by EGBL.

CC93 raise these previous cases to highlight its concern that the Commission appears to have accepted the general premise of the applicants case that a combined rulebook can satisfactorily deal with what was a voluntary wholesale and spot electricity market, obligatory metering and reconciliation arrangements and mandatory common quality and security arrangements.

CC93 may have misinterpreted the draft determination but it appears that the principal concerns expressed by the Commission relate to the potential of pro-competitive rules being delayed or being deferred because of the voting structures and arrangements within the rulebook. CC93 identified this issue in its submission and shares the concern of the Commission. However CC93 has many other concerns with the proposed arrangements set out in the rulebook and believe that authorisation would prevent action being taken in the future by it, or any other consumer group, to protect its interests from anti-competitive behaviour.

CC93 has a major concern with the concept of "**possible conditions on an authorisation**" outlined in paragraphs 451-453 of the Draft determination. It is acknowledged that Section 61 subsection 2 authorises the Commission to grant conditions for such periods of time that the Commission may think fit subject only to the requirement that such conditions shall be "not inconsistent with this Act".

CC93 has some difficulty in reconciling the suggestion by the Commission that it may be prepared to authorise the proposed arrangements subject to the imposition of conditions with its past approach to "incomplete applications" or where applicants wished " to amend post application the basis of the application". CC93 also expresses its concern that given the opposition by consumers and a number of other stakeholders in the electricity industry to the proposed arrangements the "concept of authorisation subject to conditions" would appear to undermine their position.

If any new proposals are lodged by the applicant in response to the concerns expressed by the Commission then CC93 believe that such proposals should be considered as a "new application". CC93 would be particularly concerned if new proposals were lodged at the time of the Conference.

2. Specific Issues raised in the Draft Determination:

CC93 does not have the resources to respond to each of the 64 questions raised by the Commission. However there are a number of questions, which require comment.

CC93 has carefully considered paragraphs 106 to 133, which deal with the wholesale pricing mechanisms inherent in the rulebook and the application of S30 of the Act. In CC93's view the pricing mechanisms are in breach of S30 and should not be authorised as this will indemnify or immunise the mechanisms from any future challenge. The answer to Question 3 is yes. The desired outcome by CC93 is for the Commission to decline authorisation.

CC93 has also examined paragraphs 134 to 145 and believe that the pricing of services for non members, the transmission pricing methodology and the allocation of costs all involve processes or outcomes which breach S30 of the Act. The answers to Question 4,5, and 6 is Yes. The desired outcome by CC93 is for the Commission to decline authorisation.

The strong view of CC93 is that the pricing arrangements outlined in the rulebook potentially impact adversely on consumers. However the major problem is once authorised they will be impossible to challenge. Also it will be difficult to ever mount a case for alteration or amendments to the rules or the underlying basis of the methodologies if that meant that a new case to the Commission would have to be lodged. Authorisation at this point of time will in effect prevent any further debate over the pricing arrangements.

For the purposes of this application CC93 is prepared to accept the counterfactual as outlined by the Commission. However as stated in our first submission, we believe the likely outcome when the Commission declines to authorise the application is as follows (refer bullet point 3 of CC93 submission 22 February 2002):

> "It is highly unlikely that in an election year the Government will regulate an EGB, not just because of the political risk but the fact is the Parliamentary calendar and legislative drafting resources will not permit it. We believe this provides a window for EGEC to negotiate with consumers and others a better set of arrangements. There is already a precedent for this with MACQS when the applicant withdrew the first application for authorisation to change the governance to provide greater consumer participation."

CC93 is prepared to negotiate a more consumer-oriented rulebook but such negotiations would have to address more than the rule-making and rule-changing processes. In any event CC93 considers that a Crown EGB (as the counterfactual) would lead to more even-handed, objective working group and rule-making/rule-changing processes.

In respect of Question 8 CC93 believes the Guiding Principles prescribed in any new rulebook should replicate the Guiding Principles outlined in the GPS. The differences between the text of the GPS and the Guiding Principles submitted by EGBL reflect the desires of the supply side of the industry to eliminate from the Guiding Principles (to the maximum extent possible) the concept of "electricity being delivered in an efficient, fair and environmentally sustainable manner to all classes of consumers". Therefore the Guiding Principles contained in the rulebook are not designed to optimise consumer welfare or achieve the least cost delivered electricity to all classes of consumers.

In paragraphs 223 to 243 the Commission comments on the voting arrangements. Questions 9 to 14 highlight the very concern of CC93. A rulebook that does not provide consumers with any say in rule making and rule changing processes should be rejected. The EGBL rulebook as proposed entrenches the supply side dominance of the rule change process with its system of chapter votes. The EGB can make decisions but in all instances such decisions can be over turned, struck down, vetoed by the supply side. This type of governance and decision making process is unsustainable because competing suppliers and monopoly transport providers will never act in the best interests of consumers. Consumers need to be directly involved just as they already are in MACQS. The EGB must have executive powers, i.e. the ability to make decisions that cannot be then struck down by the supply side.

It appears to CC93 that the Commission may have misinterpreted the Transitional Dispensation arrangements given the comments in paragraphs 351 and 352. CC93 understands that dispensations can be given to asset owners for the life of the plant and that the costs of procuring ancillary services to cover the non-compliant plant will be allocated to all parties to the arrangement. This means that consumers will end up paying for any existing non-compliant plant that is granted dispensation. The rules for new entrant asset owners, such as generators, make it quite clear that the costs of non-compliant plant are a charge on that asset owner. There appears to be at least an arguable case if not a prima facie case that a barrier to entry has been created. It may be appropriate for the Commission to review its position on this issue.

CC93 has briefly examined the quantitative assessment of benefits and detriments. It remains convinced that the detriments inherent in the proposed arrangements significantly outweigh any alleged benefits.

In paragraphs 433 to 444 the issues of "strike-down of pro-competitive rules" and "under investment in the grid" are canvassed by the Commission thus leading to Questions 44, 45, 46 and 47. It is clear to consumers that there is less competition in the electricity generation and electricity retail markets than is desirable. However for as long as the NZEM remains unauthorised it is possible for an action to be commenced under the Commerce Act if an aggrieved party believed that anti-competitive behaviour was occurring. The fact that the MSC found that market participants could exercise market power from time to time but that no breach of the NZEM rules had occurred did not prevent an aggrieved party or for that matter a group of consumers from seeking redress through the Commission.

The authorisation of the new arrangements, i.e. the Rulebook, will eliminate this course of action being available to aggrieved parties. The objective functions of the wholesale electricity market will be immunised from challenge. This has enormous consequences for consumers.

CC93 believe that the authorisation will lock in "higher electricity prices" and that the ability of an industry EGB to review the pricing and cost allocation methodologies will be severely impaired by any voting structure which leaves a right of veto with generator/retailers. Relative to the counterfactual consumers would be worse off.

In CC93"s opinion the preliminary view reached by the Commission, namely that it "would decline to grant authorisation pursuant to S61(1)(b) of the Act" is the correct outcome and should be become its final determination. CC93 commented earlier on conditions. In respect of Questions 49, 50 and 51 CC93 views the concept of "conditions" as exceedingly dangerous.

It is clearly acknowledged that "conditions" have been imposed in authorisation cases relating to takeovers and mergers and this approach is endorsed. Furthermore it is consistent with overseas practice.

However in terms of authorisation of arrangements pursuant to S58 of the Act CC93 is unaware of any precedent since this statute was introduced in 1986. The concept puts the applicant in an advantageous position of being able to trail a series of options, or ifs, or maybes, in front of the Commission without having to formally amend its application. The opportunity for "opponents of authorisation" to subject such options to full cost/benefit analysis will be limited.

The Commission should withdraw the "offer of imposing conditions" and require any options or amendments that are lodged by the applicant to be subject to the full scrutiny of the process outlined in the Act.

The answers to Question 49 is that the issue of pro-competitive rule changes is so fundamental to the optimal working of the new arrangements that it cannot and should not be dealt with by way of conditions, i.e. an add-on to the application.

The answer to Question 50 is that there are significant detriments associated with the "use of conditions", and while it is provided for in the Act it is noteworthy that the provisions have not previously been used in respect of S58 applications.

The answer to Question 51 is that CC93 has serious concerns about the use of conditions per se.

It is likely that some members of CC93 will make separate submissions on the draft determination also, but all four members of CC93 confirm that those submissions will not be in conflict with this submission.

Yours sincerely

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Spokesman