



FEDERATED FARMERS

SUBMISSION ON:
Electricity Industry Bill

SUBMISSION

TELEPHONE 0800 327 646 | **WEBSITE** WWW.FEDFARM.ORG.NZ

TO: Committee Secretariat
Finance & Expenditure Committee
Parliament Buildings
Wellington 6140

SUBMISSION ON: Electricity Industry Bill

FROM: Federated Farmers of New Zealand

DATE: 26 February 2010

CONTACT: Nick Clark
Manager General Policy

Federated Farmers of New Zealand
PO Box 1992
Christchurch 8140

P 03 357 9459
F 03 357 9451
E nclark@fedfarm.org.nz

1. INTRODUCTION

- 1.1 Federated Farmers welcomes the opportunity to submit to the Electricity Industry Bill.
- 1.2 Federated Farmers has had significant concerns about the performance of the electricity market, with farmers and other consumers being subjected to substantial price increases over recent years. Overall, the Federation supported the findings and recommendations of the Ministerial Review of Electricity Market Performance and the Government's subsequent decisions. We support the Electricity Industry Bill and we submit that it should proceed.
- 1.3 The Federation will be monitoring the market with the expectation that the changes to the market will arrest the sharp increases in electricity prices that have been imposed on farmers and other consumers. If not, more aggressive regulatory actions may have to be considered.
- 1.4 The Federation is also keen to ensure that progress is made on the resolution of issues concerning landowners with respect to the presence of transmission infrastructure (as set out in paragraphs 4.3 to 4.9 below).

2. SUMMARY OF RECOMMENDATIONS

- 2.1 Federated Farmers recommends that the Electricity Industry Bill should proceed.
- 2.2 Notwithstanding the Federation's primary recommendation that the Bill should proceed, Federated Farmers recommends that, in its new role of approving transmission grid upgrade plans, the Commerce Commission should be required to take consideration of the issues of concern to landowners with respect to the presence of transmission infrastructure.
- 2.3 The Federation recommends that the Bill should be amended to provide for the Security and Reliability Council to include representation of rural consumers.
- 2.4 The Federation also recommends that the Bill should provide that the terms of the Waitaki Catchment Water Allocation Regional Plan for minimum flows and reliability of supply form the basis of any water supply agreement between Meridian and Genesis.

3. ELECTRICITY AND FARMING

- 3.1 According to Statistics New Zealand's *Energy Use Survey: Primary Industries 2008*, in 2008 the primary sector used 2,390 million kWh of electricity, around 6% of New Zealand's total electricity use. Of that amount, 1,026 million kWh was used by dairy farming and 504 million kWh was used by sheep, beef and grain farming. The balance was taken up mainly by mining (530 million kWh), horticulture and fruit growing (151 million kWh), and poultry, deer and other livestock farming (90 million kWh)^{1,2}.
- 3.2 Electricity is a very important on-farm input. According to MAF's 2009 National Dairy Model, an 'average' dairy farm will spend \$21,000 on electricity over the coming year, but there is regional variation depending on the need to irrigate, with the Canterbury Dairy Model's electricity spend being \$66,300³. Dairy farms are therefore particularly conscious of the need to conserve energy, with the *Energy Use Survey* revealing that they have the highest uptake of energy management practices of the primary sector.
- 3.3 Electricity is not just a dairying story though. The MAF 2009 Canterbury Arable Model forecasts that the average Canterbury arable farm will spend \$27,300 on electricity over the coming year⁴. The MAF 2009 National Sheep and Beef Model forecast that the 'average' sheep and beef farm would be spending around \$3,400 over the coming year⁵.
- 3.4 Electricity is an input that is difficult to cut back during tough times. According to MAF, the 'average' dairy farm's expenditure on electricity will rise 7% this year compared to last year even as total on-farm expenditure is forecast to be cut by 13%. Indeed, electricity is the only working expense forecast to rise in the coming year.
- 3.5 The rise in spending on energy is a reflection of ever increasing electricity prices. According to Statistics New Zealand's Farm Expenses Price Index, electricity prices for 'all farms' have increased by 64% since the start of 2003, with particularly large price increases in some years (e.g., double digit increases in 2002-03, 2005-06, and 2008). One has to go back to 2000-01 to find any annualised drops in electricity prices for farms⁶.
- 3.6 Security of supply is also very important for farming. Power outages can be extremely disruptive and costly and they can have serious health and safety implications, especially when many modern farm activities are reliant on technology and machinery. For example, dairy and arable farming uses its large amounts of electricity for irrigation; dairy farmers require a particularly secure electricity supply for milking and milk storage; modern shearing practice requires electricity; all farm businesses are becoming increasingly reliant on information and communication technology, powered of by electricity; and farming families, like all New Zealanders, are reliant on a secure electricity supply for their social well-being.
- 3.7 Hence the importance of the need for the electricity market to be working in a way that ensures security of supply at prices that promotes rather than impedes agricultural productivity and competitiveness. Given the importance of agriculture to exports and a

¹ *Energy Use Survey: Primary Industries 2008*, Statistics New Zealand, July 2009.

² On-farm electricity use excludes the electricity used in the processing of primary products by dairy companies, meat companies, etc. This processing is highly energy-intensive and electricity is a significant cost for such manufacturers, a cost which is passed back to farmers through lower farm-gate returns.

³ *Pastoral Monitoring 2009, Dairy and Deer*, Ministry of Agriculture and Forestry, 2009.

⁴ *Horticulture Monitoring 2009*, Ministry of Agriculture and Forestry, 2009.

⁵ *Pastoral Monitoring 2009, Sheep and Beef*, Ministry of Agriculture and Forestry, 2009.

⁶ *Farm Expenses Price Index*, Statistics New Zealand (time-series data on website).

sustainable economic recovery, an electricity market that fails agriculture will fail New Zealand.

3.8 Federated Farmers agreed with the Ministerial Review that the performance of the electricity market has fallen short of the objectives of providing reliable supply at competitive prices (i.e., prices low as possible consistent with ensuring reliable supply over the long-term). We therefore strongly supported the Government's decision to review the electricity market with a view to ensuring that it better meets these objectives.

3.9 The Federation supported the overall thrust of the direction set out in the Ministerial Review's recommendations and the Government's subsequent decisions. In general, we

support the use of market mechanisms, competition and light-handed regulation to provide the right incentives and to drive the best outcomes, but we also recognise that the electricity market requires well-designed regulation and governance arrangements to address market failure in the areas of market power, information asymmetry and the mispricing of resources.

3.10 The remainder of this submission comments on the key aspects of the Electricity Industry Bill.

2. ELECTRICITY INDUSTRY GOVERNANCE (PART 2 OF THE BILL)

4.1 Part 2 of the Bill relates to governance of the electricity industry. Federated Farmers agrees with the problems with the current governance arrangements raised by the Ministerial Review and we support the changes set out in the Bill.

Disestablishment of Electricity Commission

4.2 The Federation supports the disestablishment of the Electricity Commission (EC) and its replacement with a more tightly focused and more politically independent Electricity Authority (EA). We agree that the EC has too many objectives and as a Crown Agent it has not been sufficiently independent. The EA will be an Independent Crown Entity and as such the Minister of Energy will not be able to direct the EA and it will be harder for him or her to dismiss board members. Both of these happened to the EC after it rejected Transpower's proposed new transmission line between Whakamaru-Otahuhu, which was (and remains) controversial to affected landowners.

Approval of Transpower Grid Upgrades

4.3 The Bill provides for the Commerce Commission (CC) to take over the EC's current function of approving grid upgrade plans proposed by Transpower. The Federation agrees that it makes sense for all Transpower's capital expenditure to be considered in an integrated manner by one entity (the CC as part of the regulation of Transpower's revenue requirements and costs).

4.4 Federated Farmers considers it very important for there to be careful scrutiny of Transpower's proposed projects and costs. The CC should be able to provide independent, countervailing power to Transpower which should help avoid the construction of a costly, potentially 'gold-plated' transmission network and ensure that other options, such as building generation closer to demand, are properly considered. Just as important though is to ensure that the CC grid upgrade approval process picks up a particular important issue for farming not adequately considered by the EC: the

implications for landowners arising from the presence of transmission infrastructure. This is important as in our view they have not previously been considered in grid upgrade proposals but all the same contribute to costs of projects.

4.5 As stated in its submission to the Ministerial Review, Federated Farmers agrees that the transmission grid is critical for the operation of the electricity market and we accept the need for increased investment in improving transmission infrastructure after many years of under-investment. However, this acceptance is tempered by the fact that our members are often directly impacted by projects that require existing transmission infrastructure to be upgraded and/or new infrastructure erected on private land.

4.6 There are a number of issues regarding access, compensation, liability for outages, restrictions on use of surrounding land and or its injurious affect on a farming business. These issues have caused a great deal of controversy around the country and the Federation and its constituent provinces are currently working with Transpower at a national and a local level respectively to reach satisfactory resolutions. If the CC grid upgrade approval process is to be truly robust then it needs to properly factor in these issues, something the EC failed to do adequately.

4.7 As a consequence of this failure, the Federation believes there has been an underpricing of the easements Transpower has been negotiating with landowners for transmission infrastructure on private land. A recent study undertaken by NZIER on behalf of Federated Farmers (copy attached) confirms this and found that easements run the risk of being inefficient if compensation does not at least fully cover the costs imposed on landowners. The NZIER study recommended that understating easement prices and the associated inefficiency issues may be addressed by providing a margin over estimated costs or providing for periodic adjustable payments – as is often the

case overseas⁷. We look forward to the CC investigating this issue.

4.8 Recommendation: Federated Farmers recommends that the Commerce Commission should be required to take consideration of the issues of concern to landowners with respect to the presence of transmission infrastructure.

4.9 The Federation is also promoting a Private Members Bill to amend the Public Works Act to make it clear that compensation for interests in land taken under the Public Works Act may be made by way of annualised payments.

Security and Reliability Council

4.10 The Federation supports the establishment Security and Reliability Council, and that it should include representatives of consumers. However, we believe that the Council must specifically include representation of rural consumers because the issues of security and reliability faced by rural consumers are often different to those faced by commercial and industrial users and urban consumers.

4.11 Recommendation: Federated Farmers recommends that the Security and Reliability Council should include representation of rural consumers.

4.12 For such a Council to be of value it will also be essential for consumer representatives to have access to adequate resources so they may provide an effective countervailing view to the highly resourced technical expertise available to the electricity industry representatives. This comment also applies to advisory groups.

System Operator

4.13 Federated Farmers agrees that Transpower should continue to be the system operator.

Industry Participation Code

4.14 Federated Farmers supports the replacement of the Electricity Governance Rules with an Industry Participation Code and that the Code will not require the approval of the Minister of Energy, instead being approved by the EA. This approach maintains the independence of the EA and is consistent with practice in the UK and Australia. Also, by their nature electricity rules are very detailed and highly technical (with the current rulebook running to more than 1,400 pages), which means the Minister is probably not in the best position to approve them.

4.15 The Federation also supports the specific new matters to be covered in the Code as they reflect the changes recommended by the Ministerial Review (which we generally supported). That said, we will be monitoring the situation to ensure that these changes do arrest the large increases in electricity prices that have been seen over recent years. The EA should closely monitoring market practice and enforce behaviour if necessary.

⁷ *Compensation for Transmission Infrastructure*, NZIER, 30 November 2009.

5. SEPARATION OF DISTRIBUTION FROM CERTAIN GENERATION AND RETAILING (PART 3)

5.1 Federated Farmers has previously expressed cautious support for changes to the Electricity Industry Reform Act 1998 to make it easier for lines companies to invest in generation capacity. The Federation agrees that making it easier for lines companies to invest in generation might provide for greater contestability in the market for electricity generation.

5.2 However, this support has always been subject to the important caveat that investment in generation must continue to be

clearly ring-fenced from lines-related activities to prevent anti-competitive behaviour and cross-subsidisation. We would be concerned if relaxing the restrictions would encourage lines companies to discriminate against competing retailers so pushing existing retailers out of the market and potentially reducing competition. The restrictions in the Bill are needed to retain safeguards to prevent such behaviours.

6. INDUSTRY PARTICIPANTS AND CONSUMERS (PART 4)

Dispute Resolution

- 6.1 Federated Farmers supports carrying over the Electricity Act 1992's consumer dispute resolution scheme in this Bill. The Federation welcomed the recent approval of the Electricity and Gas Complaints Commission (EGCC) as a single nationwide disputes resolution scheme. This means most consumers (both business and residential) will have access to a free and independent complaint resolution service.

Financial Statements of Customer and Community Trusts

- 6.2 Federated Farmers supports carrying over the Electricity Act 1992's power to make regulations to promote accountability of customer trusts and community trusts to their beneficiaries.

Continuance of Supply

- 6.3 Federated Farmers supports incorporating the provisions of the Electricity (Continuance of Supply) Amendment Bill into this Bill. The Federation has long called for the change to section 62 of the Electricity Act 1992 to require lines businesses to continue to ensure the supply of line function services (or arrange alternative electricity supply) to places which received lines services prior to 1993 beyond the current expiry of 2013.
- 6.4 When section 62 was considered by Parliament in 1992 it was thought that by 2013 cost-effective alternative supply options would be widely available making supply less reliant on lines. Alternative supply options are available and in some circumstances they are attractive. However, as 2013 has approached it has become evident that, generally speaking, alternatives are still very expensive (especially in terms of capital costs), they are not as reliable as supply by lines, and individually they often do not have enough generating capacity to supply an average

household, let alone a farm. As a result a number of our members, particularly those in remote rural areas, became increasingly concerned about the uncertainty of electricity supply beyond 2013.

- 6.5 While strongly supporting the passage of the provisions on continuance of supply we note that some lines businesses with small, thinly spread populations are struggling to recover sufficient revenue from their customers (many of whom have low incomes) to upgrade or replace their extensive and ageing networks. Prior to 1997 electricity lines businesses with „uneconomic“ lines were able to access funding from the Rural Electricity Reticulation Council, recovered by a levy on all electricity supply authorities. We think the Government may need to consider whether it should re-establish such a funding source.

Price Restraint for Line Charges for Domestic & Rural Consumers

- 6.6 Federated Farmers supports carrying-over of the Electricity Industry Reform Act 1998's power to make regulations to restrain the rate of increase in line charges for domestic and rural consumers. The Federation is concerned that remote rural consumers would be exposed to severe price shocks if lines businesses implemented fully-allocated costings for line services. The Federation therefore strongly supports the Government Policy Statement's direction that "Government expects distribution companies to keep any changes to rural line charges in line with changes to urban line charges" and we agree with the retention of this and other fairness-related regulation-making powers to ensure that the policy objectives continue to be met in practice.

7. MISCELLANEOUS (PART 5)

SOE Asset Reconfiguration

7.1 In its submission to the Ministerial Review, Federated Farmers was cautious about asset reconfiguration and wanted to ensure that further work was done on the costs and benefits. Although we agree that the SOE generating assets are not well-balanced geographically and while we do not necessarily oppose the sale of Meridian's Tekapo A and B stations to Genesis, it is unclear to us whether this further work has happened. We also note that there will be implications, such as those for water consents, which will need to be carefully considered.

7.2 Water is a great competitive advantage for New Zealand and members of this Committee will be aware that Federated Farmers is a strong proponent of making greater use of water storage and irrigation to facilitate economic growth. Irrigation has become particularly important in South Canterbury and North Otago both in terms of improving productivity and providing farmers with insurance against drought.

7.3 A potential concern we have over the proposed sale of Tekapo A and B is the implication for users of water downstream from having two competing generators operating in the upper catchment where most of the river's water is stored. Water users must continue to have certainty over river flows and we consider it very important that the terms of the Waitaki Catchment Water Allocation Regional Plan for minimum flows

and reliability of supply form the basis of any water supply agreement between Meridian and Genesis. The Federation submits that this should be explicitly set out in the Bill. We understand that the Waitaki Irrigation Collective, representing irrigators in the area, has made a more detailed submission on this issue.

7.4 Recommendation: Federated Farmers recommends that the Bill should provide that the terms of the Waitaki Catchment Water Allocation Regional Plan for minimum flows and reliability of supply form the basis of any water supply agreement between Meridian and Genesis.

7.5 Federated Farmers agrees with the sale of Whirinaki. The Ministerial Review found that the reserve energy scheme is 'unlikely to have assisted in managing dry-year risk' and we agreed that relying on the Whirinaki station during a dry spell reduces the incentives on market participants to manage their own risks. The Federation submitted that Whirinaki should be sold, albeit to the highest bidder rather than selling it to Meridian (although we understand the rationale for providing Meridian with a North Island power station).

7.6 Federated Farmers supports the concept of SOEs being required to enter into 'virtual asset swaps' through financial hedges if it will help encourage the SOEs to be more active in retailing nationwide.

8. CONCLUSION

8.1 Overall, Federated Farmers supports the Electricity Industry Bill and recommend that it should proceed. The Federation will be monitoring the market with the expectation that the changes to the market will arrest the sharp increases in electricity prices that have been imposed on farmers and other consumers. If not, more aggressive regulatory actions may have to be considered.

8.2 The Federation is also keen to ensure that progress is made on the resolution of issues concerning landowners with respect to transmission infrastructure.