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# Electricity Price Review Options Paper

Submission to the EPR Panel

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## At a glance – ENA Views on Options.

■ We favour    
 ■ We have no strong view    
 ■ We do not favour

### A STRENGTHENING THE CONSUMER VOICE

- A1 ■ Establish a consumer advisory council.
- A2 ■ Ensure regulators listen to consumers.

### B REDUCING ENERGY HARDSHIP

- B1 ■ Establish a cross-sector energy hardship group.
- B2 ■ Define energy hardship.
- B3 ■ Establish network of community-level support services to help consumers in hardship.
- B4 ■ Set up a fund to help households in energy hardship become more energy efficient.
- B5 ■ Offer extra financial support for households in energy hardship.
- B6 ■ Mandatory minimum standards to protect vulnerable, medically dependent consumers.
- B7 ■ Prohibit prompt payment discounts but allow reasonable late payment fees.
- B8 ■ Explore bulk deals for social housing and/or Work and Income clients.

### C INCREASING RETAIL COMPETITION

- C1 ■ Make it easier for consumers to shop around.
- C2 ■ Include information on bills to help consumers switch retailer or resolve billing disputes.
- C3 ■ Make it easier to access electricity usage data.
- C4 ■ Make distributors offer retailers standard terms for network access.
- C5 ■ Prohibit win-backs.
- C6 ■ Help non-switching consumers find better deals.
- C7 ■ Introduce retail price caps (*like the Panel, we don't support this option*).

### D REINFORCING WHOLESALE MARKET COMPETITION

- D1 ■ Toughen rules on disclosing wholesale market information.
- D2 ■ Introduce mandatory market-making obligations.
- D3 ■ Make generator-retailers release information about profitability of retailing activities.
- D4 ■ Monitor contract prices and generation costs more closely.
- D5 ■ Prohibit vertically integrated companies.

### E IMPROVING TRANSMISSION AND DISTRIBUTION

- E1 ■ Issue a government policy statement on transmission pricing.
- E2 ■ Issue a government policy statement on distribution pricing.
- E3 ■ Regulate distribution cost allocation principles.
- E4 ■ Limit price shocks from distribution price increases.
- E5 ■ Phase out low fixed charge tariff regulations.
- E6 ■ Ensure access to smart meter data on reasonable terms.
- E7 ■ Strengthen ComCom's powers to regulate distributors' performance.
- E8 ■ Require small distributors to amalgamate.

E9  Lower Transpower and distributors' asset values and rates of return.

F IMPROVING THE REGULATORY SYSTEM

F1  Give the EA clearer, more flexible powers to regulate network access for DER.

F2  Transfer the EA's transmission and distribution regulatory functions to the ComCom.

F3   Give regulators environmental and fairness goals.

F4  Allow Electricity Authority decisions to be appealed on their merits.

F5  Update EA's compliance framework and strengthen its information-gathering powers.

F6  Establish an electricity and gas regulator.

G PREPARING FOR A LOW-CARBON FUTURE

G1  Set up a fund to encourage more innovation.

G2  Examine security and resilience of electricity supply.

G3  Encourage more co-ordination among agencies.

G4  Improve the energy efficiency of new and existing buildings.

# Introduction

The Electricity Networks Association (ENA) welcomes the opportunity to submit on the Electricity Price Review Panel's Options Paper (For Discussion).

The ENA represents all New Zealand's 27<sup>1</sup> electricity distribution businesses (EDBs) or lines companies, which provide critical infrastructure to New Zealand residential and business customers.

Nearly all electricity consumers are connected to a network operated by an ENA member, distributing power to and from consumers through overhead wires and underground cables.

Together, EDB networks total 150,000 km of lines. Some of the largest distribution network companies are partially publicly listed or privately owned, or owned by local government, but most are owned by consumer or community trusts.

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<sup>1</sup> Powernet is one member and comprises three individual businesses: Electricity Invercargill, The Power Co, and OtagoNet.

## Executive Summary

The Electricity Networks Association congratulates the Electricity Price Review Panel on its options paper. ENA is supporting about three-quarters of the Panel's recommendations.

At a high level, ENA agrees with the Panel's goal of addressing the need for electricity prices to be fair and affordable, in addition to being efficient and competitive, and focusing on options for supporting vulnerable and disadvantaged consumers. We commend a focus on all consumers benefitting from competition and improving elements of the wholesale electricity market.

To be concise, ENA comments only briefly about options on which both us and the Panel agree. We offer fuller discussion in this submission on those options which we believe are not in the best interests of consumers or industry or are unnecessary and therefore add cost for little gain and put forward reasoning on why these options need reconsideration.

Arguably the most important recommendation for ENA, and possibly for the entire electricity sector, is the removal, or transitioning out of, the low-fixed charge regulations. This is a matter of urgency, as ENA members would like to start – or, at least have the option of starting – the transition out of the regulations on 1 April 2020, at the beginning of a regulatory reset which will adjust down regulated rates of return. All things being equal, this will lower prices paid by consumers for network services and reduce any possible price increases as a result of transitioning away from imposed fixed price caps.

Another key area on which we comment – and agree with the Panel – is the benefit of a Government Policy Statement (GPS) on distribution pricing. ENA believes a GPS will give direction to regulators and industry and inform consumers on the importance and long-term benefit of moving to cost-reflective pricing for the long-term interests of consumers. Such a GPS could include guidance on minimising price shocks, customer engagement, and reviewing allocation principles. As requested by the Panel, ENA has provided what we believe a GPS should contain in a concise suggested text in appendix two.

ENA also supports the Panel proposing a high-level review three years after the adoption of proposals that the Government implements. We have heard your message that, if there hasn't been improvement as a result of the selected options, government would consider taking stronger action, including structural and regulatory changes.

Finally, ENA was frustrated by the absence of a recommendation on the tree regulations. Yes, a major government department plans to review the regulations, but we would prefer that this was included as an option in your final report to ensure that this work maintains momentum through to conclusion. Trees add significant cost to network operation, and the regulations are not fit-for-purpose for minimising these costs which are passed to consumers.

ENA emphasises that members will continue to collaborate and cooperate to gain efficiencies and better outcomes for consumers through shared thinking and effective asset management. We also frequently collaborate with stakeholders such as the Electricity Retailers' Association of New Zealand, and indeed ENA and ERANZ lodged a short joint submission highlighting areas on which we agree with the Panel. ENA is ready to engage on any of the material in this and the joint submission.

## A. Strengthening the consumer voice

### A1 Establish a consumer advisory council

We support the Panel's view, which favours this option.

As discussed in our October submission to the Panel, ENA would embrace the concept of some type of consumer advocacy representative organisation which would have the capability to coherently present the views of consumers' long-term interests.

To be effective, a consumer advocate must be strongly informed by actual consumer behavior and trends. In addition to consultation this should include actively advocating for consumer interests, as informed by robust data analytics, and have the capability to:

- Be fully independent from industry and regulators.
- Establish itself as an entity, including writing a constitution and terms of reference that is in the long-term interests of consumers. Establishment might be enacted after government legislation or regulation, accompanied by a Budget funding vote.
- Assemble a governance board that has powers to appoint a secretariat to manage the affairs of the council.
- Engage with consumers or consumer groups through methods such as workshops, focus groups, surveys, data analytics, or a consumer panel, and refine their feedback into concise views.
- Assemble data and carry out analysis to help inform a work programme and decision making.
- Employ the intellectual capability to review and respond to the mostly technical or complex consultations issued by regulators and government departments.
- Engage with stakeholders and government departments to help implement the Panel's recommendations contained in section B and C of the options paper (especially B2, B3, B4, B8, C1, C2).
- Potentially fund legal action for judicial and merits reviews, as done in Australia by Energy Consumers Australia (though this could be expensive).

Establishing such an agency (assuming it is a final recommendation and one which is adopted by the government), is time-consuming. It also requires funding, which the ENA estimates would be at least \$500,000 a year.

Until the council is established, ENA is prepared to support a smaller, interim consumer representative council, but only until decisions on a permanent entity are implemented, and provided it is independent of regulators.

ENA financial support would depend on equivalent contributions from other industry stakeholders in the energy sector – including generators, retailers, and Transpower.

The interim council could implement some of the more urgent recommendations on which the government wants to focus, and help craft the terms of reference, strategy, and work programme of a permanent body.

ENA proposes that the interim council could take one of the following forms:

- A standalone entity which carries out its own consumer engagement.
- A contracting model – outsourced to an independent economic or public policy research institute such as Motu, which might outsource consumer engagement to a research company (eg. UMR).
- Use of an existing consumer panel, such as the ENA’s or Transpower’s reference panels.

In considering the implementation of the above models, it is important that the independence of the council from industry and regulatory capture is maintained.

ENA is ready to facilitate the best outcome within the resources available to help bring a consumer voice to the tables of decisionmakers.

## A2 Ensure regulators listen to consumers

We note that the Panel is undecided on this option. We flagged concerns in our first submission about the ability of regulators to effectively engage with consumers, and stated:

- The Electricity Authority occasionally undertakes consumer research, but this is typically based around on-line surveys rather than personal, face-to-face engagement. Typically, its consultations are high-level and technical, with feedback mostly from industry participants and business consumer representatives, rather than small consumers.
- The Commerce Commission similarly does not appear to have the resources to engage successfully with small consumers. It does, however, expect industry associations and individual EDBs to carry out increasing consumer engagement.

Ensuring regulators engage with consumers is an easy statement to make, and hard to disagree with, but the reality is difficult. As we have noted<sup>2</sup>, customer engagement is expensive and time-consuming, and can deliver inconclusive results. That said, some government agencies (e.g. local government) have invested in talking to their end customers with some success. We also note that the core role of regulators is to protect consumer interests – executing this role effectively is at best difficult (and at worst impossible), without listening to consumers.

In preference to enforced consultation, ENA suggests that a consumer advisory council with the capability of giving feedback to regulators would nullify the need for recommendation A2.

A consumer council should be resourced to engage with consumers and make submissions on the at-times highly technical consultations run by regulators.

As option A2 can be achieved through a consumer council, ENA does not support option A2.

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<sup>2</sup> Electricity Networks Association, Submission on EPR Issues Paper, October 2018, p5

## B. Reducing Energy Hardship

ENA submits that the most important recommendation in this group is B2, Define Energy Hardship. This should be completed first – defining hardship is a key requirement for progressing other options.

### B1 Establish a cross-sector energy hardship group

We support the Panel, which favours this option.

ENA agrees that there is no magic bullet for tackling energy hardship, which is due to a combination of factors including a household's financial situation, standard of accommodation, energy needs, and awareness of energy and efficiency options. A cross-sector group should first do a stock take to see what is already offered by government agencies and support groups, looking for gaps and improvements. The group should include government agencies that have accountabilities for policies that impact energy hardship, including the Ministry of Social Development, Ministry of Business Innovation and Employment, and the Ministry of Housing and Urban Development.

### B2 Define energy hardship

We strongly support the Panel, which favours this option as a matter of priority.

ENA agrees that the meaning of 'vulnerable consumer' or 'energy hardship' must be clearly defined by government in consultation with the electricity sector and other stakeholders, including the proposed consumer advisory council.

ENA supports further social welfare measures such as refinements to the winter energy payment. The payment does benefit many people on low incomes but could be better targeted as it also benefits some consumers who might not be in energy hardship.

### B3 Establish a network of community-level support services to help consumers in energy hardship

We support the Panel, which favours this option as a matter of priority.

We recommend that this work is closely aligned with the establishment of a cross-sector energy hardship group (B1), and a consumer advisory council (A1).

## B4 Set up a fund to help households in energy hardship become more energy efficient

We support the Panel, which favours this option.

A fund administered by the Electricity Efficiency and Conservation Authority is the logical extension to option B3.

## B5 Offer extra financial support for households in energy hardship

We support the Panel, which favours this option.

We would note, however, that the Government has committed over \$2.1 billion to its Winter Energy Payment over five years.<sup>3</sup>

### Direct fiscal costs associated with the Winter Energy Payment (\$m)

2017/18	2018/19	2019/20	2020/21	2021/22	Out Years	5-yr total
185.8	470.9	484.4	501.9	523.3	523.3	2166.3

Funding for the payment, which could be better targeted, is already a \$2.1 billion impost on taxpayers. Any further financial support must be aimed at helping those in genuine need. It should also be seen as a social welfare benefit funded from general taxation, rather than be a cross subsidy from other electricity consumers.

## B6 Set mandatory minimum standards to protect vulnerable and medically-dependent consumers

We support the Panel, which favours this option.

ENA acknowledges the work of the Electricity Authority and the Electricity Retailers' Association of New Zealand (ERANZ) in publishing voluntary guidelines and benchmarks.

<sup>3</sup> <https://treasury.govt.nz/sites/default/files/2018-04/fp-3903009.pdf>

Some retailers are not following these precepts, so we support a formal, consistent and enforceable regime for dealing with vulnerable and medically-dependent consumers.

## B7 Prohibit prompt payment discounts but allow reasonable late payment fees

We support the Panel, which favours this option. Prompt payment discounts are misleading and have been shown to have a disproportionate impact on those least able to pay. ENA supports a late payment fee that directly reflects the costs associated with late payment (likely to be similar to fees charged in other industries).

We note that the Credit Contracts and Consumer Finance Act works well in limiting default fees charged by banks and finance companies to a reasonable level, preventing them using fees to generate profit. ENA supports a similar approach for electricity late-payment fees.

## B8 Explore bulk deals for social housing and/or Work and Income clients

We express cautious support for this option.

ENA supports further evaluation of the government establishing a retail option for those consumers who would otherwise struggle to find a competitively-priced electricity retailer – such as those in energy hardship or with sub-prime credit ratings.

This would not require the government to set up a stand-alone electricity retailer. But it would involve aggregating the households at risk of experiencing energy hardship or exploring options for “credit wrapping” (providing a guarantee or security to ensure that this group of customers are able to pay their electricity bills).

Caution would need to apply in how this option is developed, as it might reduce incentives on retailers to manage customer credit issues before they get to the point of default, or simply raise the cost to the government of social support for households in energy hardship.

## C. Increasing Retail Competition

ENA is supportive in principle of these recommendations, but we note that we aren't in a position to provide robust analysis on their likely impacts and success rates, or any unintended consequences.

ENA favours an experimental, holistic approach to discover what works and what doesn't to fix an identified problem, rather than policy-makers or regulators making final decisions on what will work at the outset.

### C1 Make it easier for consumers to shop around

We support the Panel, which favours this option.

It makes sense to merge the two price-comparison websites into one, enhanced version. This website must be well promoted, especially to those consumers who are not switching.

### C2 Include information on power bills to help consumers switch retailer or resolve billing disputes

We support the Panel, which favours this option.

Inclusion of prominently-placed, easy-to-understand information in the most-effective channels about how to switch retailers would be a great help for consumers – especially those unaware of benefits of shopping around. Printed power bills are just one of the options for channeling information, and electronic methods should be increasingly employed.

### C3 Make it easier to access electricity usage data

We support the Panel, which favours this option.

Timely consumer access to usage data is more important for informed decisions as new technologies and services become available.

Quick, easy access to historical data held by retailers will help streamline decision making by consumers and their agents and encourage switching.

### C4 Make distributors offer retailers standard terms for network access

Though ENA hasn't supported regulated default terms, and we do not consider that this issue

represents a significant barrier to retail competition, we acknowledge that the Electricity Authority is likely to have the legal ability to impose a default distributor agreement (DDA).

A recent Court of Appeal decision (CA481/2017) has helpfully clarified what is and what is not lawful, and that the Authority may not regulate or mandate quality standards.

We note that the Electricity Authority is progressing default terms by publishing these in a consultation.

We will work in good faith through the consultation process to establish the default terms and any relevant code amendments.

## C5 Prohibit win-backs

We support the Panel, which favours this option.

## C6 Help non-switching consumers find better deals

We support the Panel, which favours this option.

ENA agrees that New Zealand should mirror a British trial<sup>4</sup> which successfully increased switching rates and substantially lowered power bills.

## C7 Introduce retail price caps

We support the Panel, which does not favour this option.

Regulated prices in a competitive sector sound attractive, but usually lead to poorer outcomes for consumers, and it would be difficult to set price caps for different businesses without stifling innovation.

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<sup>4</sup> See <https://www.ofgem.gov.uk/consumers/household-gas-and-electricity-guide/how-switch-energy-supplier-and-shop-better-deal/ofgem-disengaged-customer-database>

## D. Reinforcing Wholesale Market Competition

As with the recommendations on retail competition, ENA is supportive in principle of these recommendations, but aren't expert in reinforcing wholesale market competition, and which solutions will and won't work.

That said, ENA strongly supports greater transparency in the market, especially for option D3 and D4. EDBs know and understand how disclosure aids transparency, as they are required to provide large amounts of data to the Commerce Commission.

We're also aware that some individual members have investigated these options more fully and will provide their own comments and evidence.

### D1 Toughen rules on disclosing wholesale market information

We support the Panel, which favours this option.

As the Panel pointed out, there have been gaps in disclosure, and the Authority should enforce the rules as they currently stand and identify any gaps.

ENA also supports extension of disclosure rules to include information on available generation fuel. Information on 'water' fuel is already publicised and analysed – a similar level of disclosure is appropriate for other fuels.

### D2 Introduce mandatory market-making obligations

We support the Panel, which favours this option.

We agree that mandatory market making would reduce the fragility of the wholesale contract market.

If the Panel allows the industry to enhance voluntary market-making, we suggest the government establish the criteria for success – spread and volume traded indicate liquidity (not open interest).

ENA's submission on the first EPR paper included information about Britain's market spreads – which were tracking below two percent before a change to mandating, and are now less than 0.6 percent<sup>5</sup>, compared with New Zealand's five percent<sup>6</sup>.

### D3 Make generator-retailers release information about the profitability of their retailing activities

We support the Panel, which favours this option.

All electricity distribution companies adhere to a comprehensive information disclosure regime. However, information disclosed by the competitive sector is less transparent or uniform. This was pointed out in the ENA's submission on the Panel's first report.

It is currently difficult to assess generator and retail profitability given the current lack of transparency and disclosure by vertically-integrated incumbents. New information disclosure rules should require generator-retailers to report separately.

### D4 Monitor contract prices and generation costs more closely

We support the Panel, which favours this option. It is important to ensure government and consumers are confident in the integrity of electricity prices.

### D5 Prohibit vertically integrated companies

We note that the Panel does not support splitting generation and retailing businesses.

We do not have a view on this recommendation.

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<sup>5</sup> ENA submission on EPR's first report, p27.

<sup>6</sup> The actual spread amount is contained in confidential agreements between four New Zealand gentailers and ASX. ENA understands from public commentary that the spread in the New Zealand hedge market is 5 percent under normal circumstances.

## E. Improving transmission and distribution.

### E1 Issue a government policy statement on transmission pricing<sup>7</sup>

ENA cautiously supports the Panel, which favours this option.

ENA is keen for the Transmission Pricing Methodology (TPM) to be resolved as soon as practicable for a variety of reasons, not least of which is that TPM is an influence on pricing decisions by EDBs.

Transmission pricing is one of the factors which members must take into account and manage as the distribution sector changes its own pricing methods.

While a GPS could be useful, it might also make the task of completing the TPM more complex and time-consuming if the government introduces concepts outside the Electricity Authority's statutory objectives.

Consequently, a transmission-pricing GPS will be useful only if it helps narrow the interpretation of what the government sees as most important under the Authority's objectives.

### E2 Issue a government policy statement on distribution pricing

ENA supports the Panel's view, which favours this option.

Members are already considering, trialing or implementing new pricing methods which move from volumetric charging to greater time-of-use tariffs, capacity or demand charging, and, when allowable, higher fixed charges which are more reflective of network costs.

Stakeholders and the Electricity Authority are championing progress, and keen for EDBs to move sooner rather than later.

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<sup>7</sup> Under the Electricity Act 2010, the Electricity Authority "must have regard to" any statements of government policy concerning the electricity industry issued by the Energy and Resources Minister. This language is similar to Section 26 of the Commerce Act 1986, which says the Commerce Commission "shall have regard to" the economic policies of the government through the relevant Minister. The Minister of Commerce and Consumer Affairs issued a government policy or "economic" statement on September 21, 2017 in relation to resilience of lifeline utility services in Wellington.

A Government Policy Statement (GPS) would provide support to members' work and align the expectations and timelines of industry, regulators, and stakeholders.

A GPS could also be supportive of a transition plan which attempts to manage price shocks, and takes into account consumer preferences, the transitioning out of the low-fixed charge regulations, and probable changes in transmission pricing.

A well-worded GPS would be an enabling document for transition and implementation, helpful for members and the Electricity Authority.

A GPS must be focused on the long-term interests of consumers, the sector's sustainability, and the government's decarbonisation agenda.

Importantly, a GPS should give members flexibility to set realistic time frames to manage a transition (from mainly variable charges; to mainly fixed, kilowatt-based, or time-of-use charges which are more reflective of network cost drivers). These timeframes need to be flexible to allow members to manage the impacts on their customers.

Though there are differences between the methods for setting transmission and distribution prices, a GPS for distribution should be aligned where practicable with a GPS for transmission.

We note the Panel's request for suggestions on the content of a policy statement that would offer clear and enduring policy guidance for distribution pricing.

The ENA has prepared a draft GPS on distribution pricing, which is in appendix two. This captures points of importance and ENA looks forward to providing input into a GPS on distribution pricing during its further development by government.

### E3 Regulate distribution cost-allocation principles

The Panel is undecided on this recommendation and would prefer options that exclude heavy-handed regulation.

We don't support regulation of cost-allocation principles, but ENA members are prepared to collaborate on industry guidelines on cost allocation that would standardize the various approaches. These could be developed in a way similar to that in Britain.<sup>8</sup>

ENA's position is that individual EDBs should individually review their cost allocation as part of their move to new pricing methods, and then publish their findings as part of consultation on new pricing.

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<sup>8</sup> Britain's Common Distribution Charging Methodology are used across Great Britain by all EDBs. The methodologies were developed through joint collaboration between Distribution Network Operators, Ofgem and interested stakeholders. The methodology was implemented in April 2010 for both demand and generation users connected at low and high voltage.

ENA proposes that the Government Policy Statement on distribution pricing directs industry to prepare guidelines on cost allocation within two years.

Finally, it's important that the focus on cost allocation does not distract the government, regulators and ENA members from more important issues which are in the long-term interests of consumers. These include distribution pricing reform and the removal of the low-fixed charge regulations.

## E4 Limit price shocks from distribution price increases

We note that the Panel is undecided on this recommendation.

We do not support the recommendation, which says that the Electricity Authority would approve distributors' proposed changes to "ensure they were consistent with a previously approved pricing plan" which would be similar to tariff structure statements in Australia.

ENA members are putting considerable effort into a smooth transition to new pricing methodologies. We know that changes in pricing methods will result in some customers facing higher network charges – especially if it coincides with removal of the low-fixed charge regulations.

While wanting their prices to be more cost reflective, members will be seeking also to minimise the impact on consumers as much as practicable or reducing price shocks through transitions. To do otherwise would risk hundreds or thousands of dissatisfied consumers writing to their local MP or newspaper, which could derail pricing reform.

EDBs are sharply focused on their consumers and will be concerned that as a result of reform some consumers might end up paying higher network charges due to new ways of charging for a connection to the network. Most EDBs are owned by their communities and all are connected to their consumers through trusts, councils, or structured consumer engagement.

EDBs are also required to consult with consumers as part of changes in their pricing<sup>9</sup>.

EDBs would prefer to make their own judgments on suitable transitions, based on their own circumstances and data analysis. Electricity Authority approval of pricing plans and changes to pricing plans is unnecessary and would likely require the Authority to build significant new capability to provide an effective role in this area. The Authority has strong theories on efficient network prices, but is short on practical, customer-focused pricing practitioners.

In summary, ENA doesn't favour centrally-imposed obligations on how to implement new pricing. ENA members are best placed to develop pricing which reflects the cost structure of their networks and manage the impact of price changes on their consumers.

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<sup>9</sup> [https://comcom.govt.nz/\\_\\_data/assets/pdf\\_file/0015/60081/Electricity-Distribution-Information-Disclosure-Determination-2012-consolidated-in-2015-24-March-2015.PDF](https://comcom.govt.nz/__data/assets/pdf_file/0015/60081/Electricity-Distribution-Information-Disclosure-Determination-2012-consolidated-in-2015-24-March-2015.PDF)

We believe a better option is to include language about managing price shocks in the Government Policy Statement on distribution pricing (option E2).

## E5 Phase out low fixed charge tariff regulations

ENA supports the Panel's view, which favours this option.

ENA and, indeed, the entire electricity sector, has been calling for removal of the LFC regulations for many years, so we are heartened to see this recommendation and congratulate the Panel.

While ENA would prefer that the regulations were removed as soon as possible, the industry is ready to work with government on an orderly transition which gradually diminishes the impact of the regulations on consumers.

In this regard, the ENA's preference for a transition is for the regulated cap on daily fixed charges (currently 30 cents a day, split between retailer and distributor) to be increased over three or four steps before being removed. As network fixed prices increase, there would be reductions in the variable components of network prices. So, at an aggregate level, distribution revenues would not increase.

In terms of a start date for transitioning out of the regulations, April 2020 might be overly ambitious, given that government decisions on the Panel's recommendations aren't due until late 2019. However, an April 2020 start date would coincide with the reset of the Default Price Path and consequent reduction in regulated rates of returns, which will blunt price increases for some consumers due to removal of the low-fixed charge.

ENA doesn't support the other obvious option for transitioning out of the regulations, which involves lowering the qualifying energy threshold from the current 8,000 kWh/year<sup>10</sup>.

Lowering the threshold could lead to perverse outcomes; it will incentivise consumers to use less power – turning heaters off to reduce load and stay under the threshold. It will also create a greater incentive for consumers to purchase distributed energy resources (albeit only during the transition out of the regulations) to qualify for the low-fixed charge.

Lowering the threshold will similarly not address the problem of second or holiday-home owners paying less than the cost of their network connection. While second homes are supposed to be exempt from the regulations, the practicality is that many bach owners do access the low-fixed charge.

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<sup>10</sup> 9,000 kWh in the lower South Island

While the ENA supports a transition in the fixed charge, we strongly encourage the Panel to support the immediate removal of a clause in the regulations which impedes progress toward new pricing options; this prohibition on stepped and tiered pricing is included in the regulations under Part 10.

New, efficient approaches to distribution pricing can be divided into two types – kWh-based time of use pricing, and kW-based charging. Effective kilowatt-based charging requires stepped and tiered pricing. For example, customers on 8kW capacity could be billed a certain amount per kilowatt per time period while larger consumers who want 15 kW capacity will be charged a higher total amount (but a lower price *per kilowatt*).

These charges would appear to not conform with the LFC regulations. The ENA and Electricity Authority have been working on this problem together over the past two years, with the Authority putting forward the view that there is a work around to the regulations. This bypass involves describing the separate steps and tiers as “different energy packages”.

ENA has concerns about whether “different energy packages” approach is legally robust and note that it appears to be against the intent of the regulations in preventing stepped and tiered pricing.

So, in summary, ENA supports the Panel’s recommendation, is ready to work on a transition by raising the cents/per day threshold over a maximum of four (or possibly three) years and seeks the immediate removal of restrictions on stepped and tiered pricing.

## E6 Ensure access to smart meter data on reasonable terms

ENA supports the Panel’s view, which favours this option as a matter of priority.

ENA notes that there has been progress in removing roadblocks to accessing smart meter data over the past year, thanks to a joint distributor and retailer working group which sought to improve data transfer. The Electricity Authority has also been supportive of solutions-thinking.

Following the success of the ENA-ERANZ working group, two meter-access solutions are being explored – a Part 12 code amendment as part of the introduction of a default distributor agreement (DDA), and a joint industry initiative to remove barriers. However, the draft DDA is not an effective solution, as it provides retailers the option but not the obligation to provide data to EDBs.

Another area of progress is clarification that retailers have no issue with distributors obtaining voltage data to improve visibility of their low-voltage networks. <sup>11</sup>

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<sup>11</sup> Electricity Retailers’ Association Data Working Group letter to Commerce Commission, 16 August 2018.

Though progress is being made, we would remind the Panel that the roll out of smart meters needs attention in some parts of New Zealand. For example, there is only 55 percent smart meter penetration in Eastland Network against a national average of 80 percent<sup>12</sup>.

ENA sees this as unacceptable, as higher penetration will facilitate a number of other important objectives identified by the Panel, such as distribution pricing reform (E2), and easier access to electricity usage data (C3).

Finally, a comment on future updates to meters. The Panel should recommend that the Electricity Authority be required to increase EDBs' ability to influence the functional specifications of meters. Meter selection is currently the sole domain of electricity retailers, which creates a risk that improvements in meter functionality that would benefit the provision of network services are not included.

## E7 Strengthen the Commerce Commission's powers to regulate distributors' performance

### Introduction

The ENA opposes all aspects of this option, which we respond to in good faith below, because it is not clear what issue the panel is seeking to solve through the recommendations.

We are comfortable with the panel seeking to strengthen regulatory governance over the sector but advance that improvement should be focused on how existing regulatory powers are enforced, rather than expanding existing powers.

The distribution section of the Panel's options paper said: "Given the immense challenges worldwide facing electricity sectors, including the introduction of de-carbonisation policies and the rapid pace of technology changes in generation and storage, there is little room for poor governance."<sup>13</sup>

The ENA agrees with this statement but does not see how strengthening the already comprehensive powers of the Commerce Commission to regulate distributors' performance will achieve the desired outcome.

The Commission has existing wide-ranging powers to investigate and address distributors performance. It has legislative as well as influencing mechanisms to "improve distributors' efficiency, particularly their management of assets, their operational performance, and their investment in infrastructure and business systems"<sup>14</sup>.

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<sup>12</sup> Data provided by Eastland Network.

<sup>13</sup> Electricity Price Review First Report, p59.

<sup>14</sup> Page 26 of Electricity Price Review Options Paper

ENA has prepared a list of the Commission's existing oversight mechanisms. For space reasons, we have listed these in appendix three.

While the Commission's powers are comprehensive, they cannot be effective in incentivising improved quality practices among EDBs if they are not applied consistently, or transparently.

In some instances, price-quality breaches are outside the control of EDB practices (resulting from climate change, vegetation management regulation, legislative change). In this context, we do not recommend expanding the regulatory response as a means of improving EDB performance. We instead recommend an examination of the consistency, transparency and effectiveness of existing regulatory levers and how they are applied – including, for example, the urgent introduction of enforcement guidelines.

We also believe that a regular, independent, review of current regulatory practice and how strongly it relates to EDB practice which strengthens quality for consumers, would affect more positive change in this area than, say, increasing penalties.

#### **The Four Bullet Points**

Our response to the four bullet points is below.

**Bullet Point 1: The Commission would have the power to advise the Minister of Commerce and Consumer Affairs to remove a distributor's exempt status if an investigation found this would be better for consumers.**

ENA doesn't support this recommendation, as the Commission already has sufficient oversight mechanisms.

**Bullet Point 2: The Commission would have the power to require a distributor to move from compliance with default price-quality regulations to more stringent customised price-quality (CPP) regulations if an investigation found this would be better for consumers.**

ENA doesn't support this recommendation as the Commission already has sufficient oversight mechanisms.

If the Panel were to progress this recommendation, we would suggest it adopt an amendment which was discussed at the EPR industry workshop on March 13.

There it was suggested that it would be more appropriate to require a distributor to move to an Individual Price Path, rather than a CPP. A CPP is seen as an extraordinary situation involving significant investment and price changes, whereas an IPP is more a "business-as-usual" path that is closer to an individualised version of the default regime.

**Bullet Point 3: The Commission would have the power to apply higher maximum penalties to deter big distributors from breaching price-quality regulations (to align with maximum penalties under Part 2 of the Commerce Act 1986).**

ENA disagrees with this recommendation, as we do not think it would result in the intended outcome of strengthening distribution quality, but rather create perverse incentives that have a good chance of achieving the opposite.

Under section 86 of the Commerce Act 1986, a breach of a price-quality requirement or order, or of an information disclosure requirement, is an offence if done intentionally and can be punished with pecuniary penalties of up to \$500,000 for an individual, and up to \$5 million for a body corporate.

Breaching Part 2 of the Act requires that the maximum penalty for each breach not exceed the greater of \$10 million, three times the commercial gain obtained by the defendant (if it can be readily ascertained), or 10 per cent of the defendant's turnover (if commercial gain cannot be readily ascertained).

We would note that penalties for contravening section 47 of the Act, which covers business acquisitions, is the same as contravening Part 4 - up to \$500,000 for an individual and up to \$5 million for a body corporate.

Greater fines will lead to EDB boards and management being more risk averse in their approach to price-quality regulation.

Also, the Commerce Commission was silent on the need for higher penalties in its 13-page submission on the Panel's first report.

Instead, the Commission said that "the fundamental market and regulatory mechanisms of the electricity sector are working relatively well"<sup>15</sup>.

This would strongly imply that the Commission did not have concerns with the current penalties regime under Part 4, which is still maturing. Regulatory provisions for electricity distributors came into effect in 2013, and the regime needs more time to bed down.

Higher penalties have implications for boards and decision-makers, and it will encourage them to 'gold plate' or over invest in their networks to reduce outage times.

As such, ENA is strongly against higher maximum penalties, especially as EDBs can't always control breaches due to climate change, ineffective tree regulations, and changing work practices that further reduce risks to worker safety.

Perversely, higher fines will also discourage ENA members from carrying out replacement and maintenance work on assets. De-energising lines to carry out improvements are counted as outages and therefore are added to allowable minutes.

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<sup>15</sup> Commerce Commission submission on Electricity Price Review first report – Overview, paragraph 2.

**Bullet Point 4: The Commission would have the power to compare distributors’ performance when setting price-quality regulations. Comparative benchmarking would be used cautiously as one input in setting prices.**

The ENA is strongly opposed to the use of comparative benchmarking in price regulation. In theory it is a good idea, but, in practice, the conditions required to successfully adjust for factors that explain performance are never met. Our use of the word “never” is used very deliberately. Although the Commission has stated that it would only use benchmarking results “carefully”, the use of inaccurate information “carefully” does not make the results any less inaccurate.

Our strong resistance to the use of benchmarking comes from:

- direct experience of benchmarking under the old Part 4A – results were highly sensitive to model specifications, highly volatile, and the models often suggested impossible requirements for so-called inefficient businesses to become efficient. Yet despite the evidence provided that the models were clearly deficient the Commission still used these for price setting;
- an understanding of the restrictive technical conditions for benchmarking to be applied accurately.

ENA submits that the Panel should not pursue the proposed option of removing the prohibition on comparative benchmarking. This does not prevent the Commission from using other benchmarking tools (such as benchmarking performance over time), which is currently a tool used in DPP resets.

If the Panel remains minded to continue to recommend this option, the ENA requests that the Commission provide more information on how it could reliably use comparative benchmarking where models fail to normalise for explanatory factors that explain performance.

Significant progress has been made in improving certainty and predictability under Part 4. ENA submits it would be a significant step backwards to permit comparative benchmarking to be used for price setting, given the substantial deficiencies of benchmarking for businesses that confront such a wide variety of operating circumstances.

**Option E7 - To conclude**

We believe that a critical consideration of existing regulatory levers and how they are applied would lead to stronger performance outcomes for EDBs, as opposed to strengthening the powers of the Commerce Commission as proposed.

This must – and this is urgent - include the introduction of enforcement guidelines. It could also involve a regular, independent review of regulatory bodies to ensure that the implementation of regulation remains aligned with the outcomes it was designed to affect.

We agree with the panel that strong governance in the sector is required to navigate the challenges and opportunities facing the sector, and we believe that this governance is implemented in partnership

by both the regulator and industry. We therefore recommend a more critical, balanced, and holistic approach than is suggested by some of the above options.

## E8 Require small distributors to amalgamate

ENA agrees with the Panel, which does not favour this option.

There is little evidence to suggest that amalgamation of EDBs will result in noticeable efficiency gains.

A study by TDB Advisory, funded by five generator-retailers and seven distributors, said that: “Overall, we find the potential gains from EDB amalgamation are relatively small”.<sup>16</sup>

ENA members support collaboration and cooperation through associations and forums, shared services, joint technical standards, metering collaboration, procurement, and helping each other during adverse events.

## E9 Lower Transpower and distributors’ asset values and rates of return

ENA strongly agrees with the Panel, which does not favour this option.

We endorse the Panel’s final paragraph which says: “In considering this option, we are conscious of our terms of reference, the technical complexity of the issues involved, the need for investment and regulatory certainty, and the Government’s inevitable caution about considering changes to the Commerce Commission’s input methodologies.”<sup>17</sup>

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<sup>16</sup> TDB Advisory, Estimated Efficiency Gains from Amalgamation of Electricity Businesses, 31 August 2018, p25. <https://www.tdb.co.nz/wp-content/uploads/2018/09/Efficiency-Gains-from-EDB-Amalgamation.pdf>

<sup>17</sup> EPR Options paper, p28.

## F. Improving the regulatory system

### F1 Give the Electricity Authority clearer, more flexible powers to regulate network access for distributed energy services

ENA notes that the Panel favours this option. ENA disagrees with this recommendation.

ENA does not agree that the Panel has demonstrated the existence of a problem which requires giving the Electricity Authority more flexible powers to develop and apply “any such restrictions<sup>18</sup>” – restrictions on whom or what is not entirely clear.

Any problem with flexibility or clarity has not been explained using clear language and evidence, and network access is already on the work programme of the Electricity Authority.

One of the authority’s advisory groups recently presented a comprehensive report entitled “Advice on creating equal access to electricity networks (draft for discussion)”<sup>19</sup>.

The report was in many places aligned with the ENA’s own Network Transformation Roadmap – an open network framework is at the centre of a road map designed to guide networks along the path to realising the open network’s potential benefits.

Meanwhile, the Commerce Commission in 2018 successfully used its data-gathering powers to ‘call-in’ information on the amount of EDB investment in distributed energy resources. According to its website, the Commission can “look into concerns an electricity business is using its market power to drive a competitor out of business or to prevent a new competitor from starting up.”

ENA believes that a much clearer definition of any problem that exists must be demonstrated before the government considers changing statute. We also consider that it is not appropriate for the Authority to have powers to regulate industry structure. These more appropriately rest with Government and have been successfully addressed through Part 3 of the Electricity Industry Act.

As an alternative approach, ENA suggests including network access in the Government Policy Statement on distribution pricing (see option E2 and appendix two)

ENA also believes that a similar outcome can be achieved through recommendation F5 (below).

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<sup>18</sup> Electricity Price Review Options Paper, p30

<sup>19</sup> <https://www.ea.govt.nz/development/advisory-technical-groups/ipag/meeting-papers/2018/6-december-2018/>

## F2 Transfer the Electricity Authority's transmission and distribution-related regulatory functions to the Commerce Commission

ENA notes that the Panel does not favour this recommendation.

ENA continues to support transfer.

## F3 Give regulators environmental and fairness goals

ENA notes that the Panel doesn't favour giving regulators environmental and fairness goals.

ENA agrees with the Panel. Regulators should not be saddled with too many goals, especially goals that are already a focus of other entities. For example, government agencies such as the Environmental Protection Authority, Ministry for Primary Industries, and local government have environmental or sustainability goals. And in the context of electricity, the Interim Climate Change Committee is close to delivering evidence and analysis to a proposed Climate Change Commission.

It will make recommendations on planning for the transition to 100 percent renewable electricity by 2035 (which includes geothermal) in a normal hydrological year.

In addition, the ICCC's terms of reference<sup>20</sup> include a range of other issues with regard to electricity, including: the objective of minimising emissions, security of supply and affordability for consumers, as well as consequential opportunities to reduce emissions from the energy sector.

### **Option F3 Variation – Consumer Protection Function**

We note that the Panel favours giving the Electricity Authority a consumer protection function.

ENA offers its support in principle to the Panel. We would note that there are existing laws that protect consumers when buying from, or sharing information with, businesses selling in New Zealand, and on-line retailers.<sup>21</sup>

These include the Consumer Guarantees Act, Credit Contracts and Consumer Finance Act, and the Fair Trading Act.

Electricity consumers also can access the complaint resolution service offered by Utilities Disputes Limited.

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<sup>20</sup> <https://www.iccc.mfe.govt.nz/what-we-do/energy/>

<sup>21</sup> <https://www.consumerprotection.govt.nz/general-help/consumer-laws/other-consumer-laws-and-rules/>

## F4 Allow Electricity Authority decisions to be appealed on their merits

ENA notes that the Panel does not favour this option.

ENA disagrees – we support a balanced approach to the review of regulatory decisions.

Merits of Commerce Commission decisions are open to legal challenge, while those of the Electricity Authority are not.

Merits review allows all parties to have a say, and results in better regulation in the long term.

Internationally, merits review arrangements are a standard part of developed, high quality regulatory regimes that involve industries with significant private sector investment<sup>22</sup>.

The acknowledged benefits of merits reviews by policymakers overseas include:

- Merits reviews offer protection to regulated network service providers and to consumers against erroneous regulatory decisions that would otherwise go uncorrected.
- Review by an independent adjudicator can protect society against partisan regulatory decisions arising from regulatory capture, where the regulator favours the vested interests it regulates, or from a mistaken notion that it should act as a champion of consumers to the detriment of the legitimate commercial interests of the businesses it regulates.
- Merits reviews can help clarify how complex regulatory rules, and economic and legal principles, should be interpreted and applied. The regulator can use interpretive precedents to refine and improve its future decisions.
- By providing checks and balances, merits reviews can enhance the accountability of the regulator, and also promote confidence amongst consumers and investors in the regulatory process.
- Merits reviews' safeguards against regulatory errors and caprice reduces uncertainty for investors in regulated networks, who are typically making very long-lived investments, so face cost recovery over long and otherwise uncertain horizons.

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<sup>22</sup> Frontier Economics, Options for enhancing the Australian Limited Merits Review regime, October 2016, executive summary.

## F5 Update the Electricity Authority's compliance framework and strengthen its information-gathering powers

ENA supports the Panel, which favours this option. There is merit in the Minister being able to request the Authority to undertake reviews or studies relating to the electricity industry, in particular in regard to consumer issues.

## F6 Establish an electricity and gas regulator

ENA notes that the Panel is undecided on this option.

If we had a blank piece of paper, a single electricity and gas regulator would make sense. But creating one from two existing regimes would be costly and complex, and lead to considerable uncertainty for the industry.

ENA also does not consider that the gas industry's current self-regulation model is broken. The regulatory issues in the gas and electricity sectors are very different, and we believe amalgamating the regulators would be a significant distraction at this time.

## G. Preparing for a low-carbon future

### G1 Set up a fund to encourage more innovation

ENA notes the Panel is undecided on this option. Like the Panel, ENA doesn't have strong views either way on availability of new innovation funds outside the Part 4 regulation. ENA does support consideration of uncertainty mechanisms to support innovation within the Part 4 regulations.

On an innovation fund there are two perspectives;

- A fund, as proposed by the Panel, would be accessible to regulated EDBs with revenue caps, which we would encourage.
- On the other, the government already has funds available to encourage innovation, though these might not always be focused on outcomes sought by networks.

The Minister of Energy and Resources referred to government backing of emerging technologies in a speech to the 2019 Downstream conference.

These support mechanisms include the Low Emissions Vehicle Contestable Fund, Provincial Growth Fund, Green Finance Limited, and, the research and development tax incentive applying from April 2019.

### G2 Examine security and resilience of electricity supply

ENA notes that the Panel favours this option, and recommends the review be carried out by the Security and Reliability Council, an independent adviser to the Authority.

ENA would support this recommendation if it helps improve investment in infrastructure to support resilience.

But rather than support a review, ENA believes a better option is to update the terms of reference<sup>23</sup> of the Security and Reliability Council. This would include ensuring it is well supported and therefore has the capability to fulfill its role giving advice on reliability, security, and resilience.

In summary, ENA supports a review of the terms of reference of the SRC, and potentially increased support to carry out its role and follow through on its recommendations.

The Panel should also consider the relevance of the work being carried out by the Interim Climate Change Commission and the Government's subsequent need to make decisions on policy settings in achieving higher zero-carbon renewables in the electricity sector.

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<sup>23</sup> At <https://www.ea.govt.nz/development/advisory-technical-groups/src/charter-and-terms-of-reference/>

## G3 Encourage more co-ordination among agencies

ENA supports the Panel, which favours this option.

The logical forum for coordination by energy regulators on wider government policy and regulatory changes aimed at implementing New Zealand's move to a low-carbon economy logically rests with the Council of Energy Regulators.

## G4 Improve the energy efficiency of new and existing buildings

ENA supports the Panel, which favours this option.

ENA sees this option as related to option B4 – set up a fund to help households in energy hardship become more energy efficient, but we would caution against overlaps.

The Ministry of Housing and Urban Development already works with central and local government agencies, the housing sector and communities across New Zealand to:

- improve housing affordability and supply;
- ensure tenants live in warm, dry, healthy and safe rental housing;
- improve housing quality and choices for Māori and their whānau.

There is also significant information about energy efficiency available on the:

- Smarter Homes website run by the Building Performance division of the Ministry for Business Innovation and Employment.
- EECA Energywise website, which includes ways to save money through better insulation.

# Appendix 1: ENA Members

## Electricity Networks Association members are:

Alpine Energy  
Aurora Energy  
Buller Electricity  
Centralines  
Counties Power  
Eastland Network  
Electra  
EA Networks  
Horizon Energy Distribution  
Mainpower  
Marlborough Lines  
Nelson Electricity  
Network Tasman  
Network Waitaki  
Northpower  
Orion New Zealand  
Powerco  
PowerNet (including The Power Company, Electricity Invercargill, and OtagoNet)  
Scanpower  
The Lines Company  
Top Energy  
Unison Networks  
Vector  
Waipa Networks  
WEL Networks  
Wellington Electricity  
Westpower

## Appendix 2: Suggested Content for a GPS on Distribution Pricing

The Panel sought ENA's concise views on possible content of a government policy statement on distribution pricing (option E2). In ENA's view, the following points should be included:

### Specific policy outcomes

A government policy statement should aim for:

- All New Zealanders having a say in the future of the electricity sector;
- Electricity pricing that is fair, affordable, and efficient;
- 'Future-ready' electricity networks supporting New Zealand's transition from carbon-based fuels;
- An electricity sector supportive of new technologies that benefit New Zealand consumers.

For the distribution sector and pricing reform, the following areas will contribute to these outcomes:

#### A. Consumer engagement

The government policy statement should direct the electricity industry to actively engage with, and support, consumer contributions to distribution sector development. Contributions, which would include, but not be limited to, a consumer advisory council as proposed by the Panel and supported by ENA,

#### B. Fair and affordable network pricing reform

The government statement should specify that pricing of distribution network services needs reform to ensure that consumers can make informed choices about their electricity consumption and about the use of emerging technologies (such as electric vehicles).

The government needs to support pricing reform while directing EDBs to ensure electricity is affordable and fair for all consumers.

#### C. Limiting bill shocks from pricing reform

The statement should state it wants the electricity industry to work together to ensure that more efficient distribution prices are introduced in a timely manner, while ensuring that:

- consumer bill shocks from pricing reform are managed and, as necessary, transitioned over time;
- the regional diversity across New Zealand is recognised in design and implementation of pricing changes.

#### D. Support those in energy hardship through transition

The statement will support pricing reform transition by putting appropriate, targeted social support services in place for those in energy hardship. The industry will coordinate timing of pricing reform with social service availability.

#### E. Allocation of costs across networks – fair and efficient

The government statement will support scrutiny of how network costs are allocated across users and ask the distribution sector to demonstrate that costs are allocated efficiently and in a manner that is fair to network users.

#### F. Transition from LFC to other pricing options

The statement will support the Panel's recommendation to phase out the low-fixed charge regulations in a manner that takes into account outcomes B and C above.

#### G. Supporting network access for Distributed Energy Services

The government statement will say that access to distribution networks by third parties should avoid unintended consequences for consumers, and regulators should adapt existing regulatory arrangements as needed.

#### H. Making reforms supportive of network innovation

Nothing in the policy statement should limit the ability of the distribution sector to innovate or bring new services to network users, including through new business models.

#### I. Monitoring and review of effectiveness of GPS

The implementation and effectiveness of any policy statement needs to be formally monitored and reported on.

ends

## Appendix 3: Commerce Commission - Existing Oversight Mechanisms

**This appendix relates to option E7 - Strengthening the Commerce Commission’s powers to regulate distributors.**

### **Oversight Mechanisms – All distributors**

**a) Influencing monopolies:** The Commission describes how it influences monopolies<sup>24</sup> on its website:

“Each of these businesses should expect a reasonable return on their investments, and short-term rewards for good performance. Equally, excessive profits should be limited, poor performance penalised, and businesses held to account when things go wrong that could and should have been avoided.”

“We can influence these outcomes in two main ways. The first is by improving transparency about performance, which can affect the reputation of the business and its relationships with certain stakeholders. The second approach is to create financial incentives through revenue limits and quality standards.”

“To help improve transparency, we require monopoly businesses to publicly disclose information, and we can analyse and report on what we observe.”

“These revenue limits restrict excessive profits and can create an incentive to control costs, because every dollar saved improves the company’s bottom line. The minimum standards for service quality help address the risk that suppliers might cut costs by compromising quality.”

**b) Open letter:** The Commission can issue open letters which set out short-term and current priorities in the EDB sector. For example, a November 2017 letter<sup>25</sup> outlined priorities for the electricity distribution sector for 2017/18 and beyond, and May 2018 open letter<sup>26</sup> outlined intention to gather information from regulated electricity distributors to better understand how they are planning, investing and accounting for emerging technologies .

**c) Name and shame:** The Commission can make public statements at any time about its assessment of a distributor’s performance.

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<sup>24</sup> See <https://comcom.govt.nz/regulated-industries/our-role-in-regulated-industries/how-industries-are-regulated>

<sup>25</sup> See [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0019/59311/Open-letter-on-our-priorities-for-the-electricity-sector-for-201718-and-beyond-9-November-2017.PDF](https://comcom.govt.nz/_data/assets/pdf_file/0019/59311/Open-letter-on-our-priorities-for-the-electricity-sector-for-201718-and-beyond-9-November-2017.PDF)

<sup>26</sup> See <https://comcom.govt.nz/news-and-media/media-releases/2018/open-letter-to-better-understand-emerging-technologies-in-monopoly-parts-of-electricity-sector>

**d) Court case for contravention of information disclosure or price-quality regulation:** The Commission can refer contravention of information disclosure or price-quality regulation to the Courts. The Court has the power to impose pecuniary fines as detailed in the Act. This is discussed further below.

**e) Power to require EDB to supply information or documents or give evidence:** Section 98 of the Act allows the Commission to search under a warrant any place for the purpose of ascertaining whether a person has or is engaging in conduct that constitutes or may constitute a contravention of the Act.

**f) Market studies:** The Commission could initiate market studies of EDBs pursuant to s51(1) in Part 3A of the Act. A market study is an in-depth and independent study into the factors affecting competition for particular goods or services, to find out how well competition is working and whether it could be improved. Market studies look at the structure, conditions and performance of the market itself.

By gathering and analysing information on a market the Commission can identify whether there are features preventing it from working well, look at the effects of features identified and consider how the features can best be addressed using proportionate means.

**g) Fair Trading Act:** Distributors are subject to the Fair Trading Act (FTA). The FTA covers anything an electricity business might say about the service it's providing, either verbally or in writing. This includes any impression you might get from advertising, promotional material or sales pitch, or by something it doesn't tell you – that is, by important information being left out.

**h) Consumer Guarantees Act:** This sets minimum guarantees for goods and services so that goods are of an acceptable quality and that repair facilities, refunds or replacements are available for a reasonable time if goods are faulty or services substandard.

**i) Information disclosure:** The purpose of this form of regulation is to give transparency about how the regulated businesses are performing, and provide a check that regulation is working (Subpart 4 of Part 4). Under s.52P the Commission makes a determination to set out the information disclosure requirements. The Act requires the Commission to summarise and analyse the data and to also comment on how effective the information disclosure requirement imposed on distributors are in promoting the purpose of Part 4 of the Act (s.53B on the effect of being subject to information disclosure regulation).

**j) Review of Asset Management Plans:** The way a distributor manages its network assets will have a significant impact on the costs customers incur and level of reliability they experience. In July 2018 the Commission issued a paper as a starting point for discussions with industry about the technical and commercial issues that may need to be overcome in developing a fully systematic and analytical asset criticality framework.

**k) Input methodologies:** The purpose of these is to promote certainty for suppliers and consumers in relation to the rules, requirements and processes applying to regulated goods and services (s. 52R). Input methodologies apply (and limit companies' discretion) in relation to a wide range of financial and operational factors for regulated businesses (see s.52T). Any appeal about an input methodology

determination is limited to merits review and must be initiated within 20 working days (see s.52Z and s.52ZA).

**I) Negotiate/arbitrate regulation or compulsory arbitration:** Criteria and process are stipulated in the Act as well as payment of compensation (see s.53I, s.53J and s.86C).

**Oversight Mechanisms – non-consumer owned distributors**

**Price-quality regulation** applies to non-consumer-owned distributors. The price-quality paths restrict the revenue that can be earned and require distributors to deliver services at a quality that consumers would expect. As well as setting the price-quality path the Commission monitors compliance with these paths (s.53N). Subpart 6 of the Act, s.53K to 53ZB, describe this regulation.

ends

## Appendix 4 – Reasons why benchmarking doesn't work for some businesses

**This appendix relates to Option E7, bullet point 4: The Commission would have the power to compare distributors' performance when setting price-quality regulations.**

The reason that benchmarking does not work for businesses such as EDBs is that the factors that must be incorporated into the models to explain performance are so numerous, varied and difficult to measure that resulting measures of efficiency always include both "inefficiency" and unmeasured factors. Businesses that have more of the unmeasured factors than others are penalised.

For example, Unison Networks has a significant proportion of its business that is affected by hydrogen sulphide in Rotorua. This raises its costs of building and maintaining its assets and limits the choices of equipment that can be used because of the corrosive effects of sulphur.

It is more expensive to build in Vector's area due to volcanic rock, which is extremely difficult to drill through. And compared to most, if not all other EDBs, the Auckland network incurs higher costs due to traffic congestion.

Other networks will face other factors that provide them with relative differences to other networks. Benchmarking models **never** adequately adjust for these factors and therefore performance comparisons between businesses simply become nothing better than random number generators.

So why do other regulators use comparative benchmarking despite these deficiencies? It is difficult to say, but potentially because the much larger scale of international EDBs means that unmeasured factors that explain variations in performance are of less importance (i.e., the businesses are inherently more comparable). We are also not aware of any post-implementation reviews of benchmarking models that have validated the findings.

From a technical stand-point, benchmarking models typically do not measure efficiency or productivity directly but deem residual variations between businesses as "inefficiency".

Models are often specified as:

$$\text{Opex}_i = a + b_1x_{1i} + b_2x_{2i} + b_3x_{3i} + b_4x_{4i} + b_5x_{5i} \dots + b_nx_{ni} + e_i$$

Where

Opex<sub>i</sub> is operating expenditure for business i

a is a fixed parameter

b<sub>#</sub>x<sub>#i</sub> is the contribution from each explanatory factor to performance (e.g., customer density, customers served, demand met, etc)

$e_i$  is inefficiency, measured as a residual for each business.

The problem is that the models are never complete (i.e., they exclude a number of the x-variables) and are specified more narrowly. So, the residual efficiency term ( $e_i$ ) then includes the effects of all the unmeasured factors. There is no possible way that a regulator can use the results “carefully” to eliminate the biases of omitted variables.

Similar issues exist with parametric and non-parametric models of productivity that specify “output-input” relationships. For example, in 2003 the Commerce Commission’s consultant<sup>27</sup> specified an output-input model that included as outputs:

- Through-put;
- Customer numbers;
- System line capacity.

And inputs:

- Opex;
- Overhead network;
- Underground network;
- Transformers;
- Other assets.

But it is evident that this is a highly simplified model of electricity network businesses, with no adjustments for factors such as those identified above to explain variations in performance. Under this model, the highest productivity businesses were allegedly twice as productive as the least productive lines business. This was completely implausible – with the least productive network needing to more than double the amount of electricity delivered and customers served, but with no more infrastructure or expense to “catch up” to the most productive. Tellingly, the highest measured productivity businesses were Electricity Invercargill and Nelson Electricity, which were exclusively high-density, urban-only networks (with zero rural lines), which should have alerted the Commission to a problem. Raised in submissions, this issue was ignored by the Commission.

ends

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<sup>27</sup> Meyrick and Associates (2003) *Regulation of Electricity Lines Businesses, Analysis of Lines Business Performance – 1996–2003*