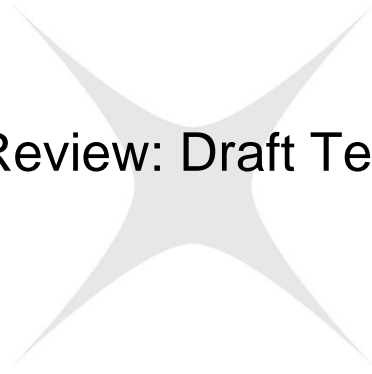


Submission

**Electricity Pricing Review: Draft Terms of Reference**

19 January 2018



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## 1 Introduction

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Aurora Energy welcomes the opportunity to submit on the draft Terms of Reference (ToR) for the Electricity Pricing Review (the Review).

No part of our submission is confidential and we are happy for it to be publicly released.

If the Ministry of Business, Innovation and Employment has any queries regarding this submission, please do not hesitate to contact:

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## 2 Ensuring a successful review

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Aurora Energy is conscious that the last review of the electricity industry was undertaken in 2010, but a lot has changed since then.

If this latest review is to be successful, with enduring and positive outcomes, it is critical that it is independent, its scope is tightly managed, and there is strong emphasis on consultation and stakeholder engagement:

- The Electricity Review Team (ERT) selected for the task should be independent of both industry stakeholders and regulators. There are various precedents for the composition of the ERT, including the last Ministerial Inquiry into the Electricity Industry (a three-person panel), and the recent establishment of the Cullen Tax Working Group.
- The draft ToR are potentially broad and open-ended. Exclusion of matters such as the Input Methodologies (IMs) is critical to ensuring that the scope of the review is manageable, and can be completed within the intended (tight) one-year time-frame.
- Consultation with stakeholders should be part of the review process, including early engagement. The Commerce Commission provides a useful precedent for successful stakeholder engagement processes, such as it employed in the recent IMs review. We would be disappointed if the ERT simply adopted a 'propose and respond' approach to the review and subsequent policy development.

The Review should report on the full supply chain of electricity generation, transmission, distribution and retail, identify opportunities to reduce costs in each part, and consider the factors that affect consumer energy bills.

## 3 Need for a clear review purpose and direction

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The draft ToR states that the review will consider whether prices are "fair and equitable", while also considering whether regulatory structures are delivering "efficiency and fairness".

This has parallels with the principal objective that the former Electricity Commission operated to, before the Electricity Commission was replaced with the Electricity Authority and a new objective put in place. That objective included "*ensur[ing] that electricity is produced and delivered to all classes of consumers in an efficient [and] fair ... manner*".

We are not sure why there is differentiation in the focus areas of equity and fairness in pricing, as equity and fairness are largely overlapping concepts, and the reference to both may be superfluous.

Our understanding, based on statements made by the Minister of Energy, is that a key driver for the review is ensuring that electricity services are affordable. This has elements of both fairness (including

equity) and efficiency. If services are provided at a higher cost than is efficient; e.g., because competition is not strong enough to drive costs and prices down to efficient levels, then electricity will be less affordable than otherwise.

We suggest that the purpose of the review be tightened to recognise; (i) the substantial overlap between the concepts of fairness and equity, and (ii), the importance of efficiency to ensuring affordable electricity services.

## 4 Implications of new and emerging technology

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At the time of the last electricity review, there wasn't the same focus on new or emerging technology that there is now.

This can be seen vividly, for example, by comparing submissions made in relation to the establishment of the IMs and the first price resets under Part 4 of the Commerce Act, with the second set of price resets and the recently completed statutory review of the IMs.

Much of the debate in the more recent reviews reflected competing tensions between regulated suppliers wanting to ensure the Part 4 settings enable recovery of prudent and efficient costs, and incumbent retailers' concerns about new and stronger competition if regulated suppliers use new and emerging technology to broaden the types of services they offer to end-consumers, beyond just poles and wires. The Commerce Commission has assessed the competitive implications of emerging technology, in detail, as part of the recent IM review and has come to the pragmatic decision that regulation is not required at this time. If the Review is to focus on emerging technology, we recommend that the ToR require the ERT to assess enduring benefits to consumers in the long-term, and not be swayed by temporary or shorter-term views.

## 5 Eliminate regulatory overlap

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The last review of the electricity industry adjusted the roles of the Commerce Commission and the Electricity Authority (replacing the Electricity Commission). This included moving responsibility for grid investment approval to the Commerce Commission, and transferring responsibility for regulation of EDB and Transpower pricing to the Electricity Commission.

The boundary between the Commerce Commission and Electricity Authority should form part of the Review scope.

It could be useful for the ERT to have another look at the issue. We see benefit in providing clear boundaries between regulators, and allowing better specialisation of the Commerce Commission as the 'economic' regulator (covering price control, monopoly investment, service quality, access terms and conditions, network pricing methodologies, and long-term consumer interests), with the Electricity Authority concentrating on its role as 'market' regulator.

## 6 Review of the Low Fixed Charge Regulations is overdue

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Review of the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 (LFC regulations) is well overdue. We consider that the industry has evolved to the extent that the LFC regulations are no longer required to meet their original policy intent of energy efficiency. Further, there is a reasonable body of evidence that the LFC regulations provide little benefit as a social welfare adjunct.

## 7 Challenges getting information on sector profitability

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Aurora Energy has no concerns about the ERT looking at the profitability of different parts of the electricity industry.

We have been subject to information disclosure regulation, including rules around financial separation and cost allocation, asset valuation and financial performance measures, since 1994. There is a high degree of transparency of financial performance and profitability within the electricity distribution sector. If a regulated supplier is earning profits above an appropriately benchmarked weighted cost of capital (WACC), it is not necessarily a bad thing, but a likely sign of improved performance and reward for efficiency gains. There are mechanisms within the existing regulatory framework that ensure that electricity consumers share in the benefits of those improvements and efficiency gains.

The ERT will likely face challenges in accessing information to review the retail and wholesale side of the market. At present, Contact Energy is the only major gentailers that provides separate disclosure of its retail and generation activities.

Key challenges will include deciding which asset valuations to use (there have been multiple asset valuations since the initial establishment of Contact Energy, Genesis, Meridian and Mercury, which masks profitability), and how to retrospectively allocate costs between generation and retail (particularly in respect of related party transactions and unreported internal hedging arrangements).

It could be helpful for the ERT to look at profitability based on historic asset value (an approach the Commerce Commission applies to electricity networks), and the impact of subsequent asset revaluations (the Commerce Commission treats electricity network asset revaluations as profit).

## 8 Suggested changes to the draft Terms of Reference

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The draft ToR for the Review could be enhanced by:

- A clearer and tighter purpose statement: Amending the overarching purpose to recognise that efficient operation of the electricity sector is critical for ensuring that electricity services are delivered at least cost and maximise affordability;
- Learning from other sectors: Providing direction that the experience in, and lessons from, postal and telecommunications is relevant to the issue of new technology;
- Enabling suppliers to embrace and cope with new technology: Specific consideration of the risks and opportunities from new technology for regulated suppliers, and whether changes to Part 4 of the Commerce Act are needed to ensure there are no barriers to regulated suppliers adapting to, and coping, with the changes; and
- Minimising any overlaps between the functions and responsibilities of different regulators: ERT to consider whether the boundaries between the Commerce Commission and Electricity Authority need to be tightened to enable greater specialisation in, and separation of, economic regulation of electricity networks (covering price control, monopoly investment, service quality, access terms and conditions, network pricing methodologies, and long-term consumer interests) and market regulation.