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Miriam R Dean CNZM QC

Chair, Electricity Price Review

C/O Secretariat, Ministry of Business, Innovation and Employment  
15 Stout Street  
PO Box 1473  
Wellington 6140

Fonterra Co-operative Group  
Private Bag 885, Cambridge, New Zealand  
Victoria Road, Hautapu, Cambridge, New Zealand  
[www.fonterra.com](http://www.fonterra.com)

(Submitted via email to [energymarkets@mbie.govt.nz](mailto:energymarkets@mbie.govt.nz))

Dear Chair,

**Re: Consultation Paper “Electricity Price Review”**

Fonterra thanks the Electricity Price Review panel (*Panel*) for the opportunity to provide feedback on the consultation paper, “Electricity Price Review” (*Consultation Paper*).

Fonterra is a major electricity user and used approximately 1,100GWh of electricity (including on-site co-generation electricity) last season (1 August 2017 to 31 July 2018, aka FY18). Fonterra’s sites are located across New Zealand, resulting in Fonterra having relationships with 14 different electricity distribution businesses. Fonterra contracts directly with the electricity distribution business (*EDB*) for distribution services for most of its manufacturing sites. These contracts range in duration and frequency of renegotiation.

Fonterra is a member of the Major Electricity User Group (*MEUG*) and Business NZ Energy Council (*BEC*) and supports the points raised in these submissions on this Consultation Paper, except where they may differ by any points raised in this submission by Fonterra.

Fonterra has answered the Consultation Paper questions using the format provided on the following pages.

Fonterra looks forward to further engagement with the Panel on this topic and is willing to engage further regarding any of the points raised in this submission.

Yours sincerely,

Tony Oosten

Energy & Utilities Manager

[Tony.Oosten@fonterra.com](mailto:Tony.Oosten@fonterra.com)

## Summary of Questions

### Part three: Consumers and prices

#### Consumer interests

##### 1. *What are your views on the assessment of consumers' priorities?*

- Fonterra's manufacturing plants rely upon an economic, secure, and sustainable supply of energy – all of these factors are important.
- Fonterra is a member of the recently formed Climate Leaders Coalition group and has announced targets to reduce its operational emissions by 30% by 2030 (from a FY15 baseline) and to reach net zero emissions by 2050.
- Fonterra also announced its plans to transition its Stirling site to renewable energy, predominantly electricity. Fonterra is undertaking steps within its control to address some of the hurdles with transitioning to use electricity (such as the scale of its energy use to assist with minimising infrastructure upgrade and costs), however several regulatory and economic hurdles remain which will impact the future viability of this as a lower emission energy source.
- For example, the allocation of costs and risk for infrastructure upgrades typically sits with consumers to bear via either upfront capital contributions, or ongoing operational costs. The structure of such arrangements typically use the 67<sup>th</sup> percentile for WACC, despite there being no risk placed upon the infrastructure provider. Furthermore, the time it can take for infrastructure upgrades to be implemented does not match the timeline that industry can transition.

##### 2. *What are your views on whether consumers have an effective voice in the electricity sector?*

- As the Consultation Paper summarises, there are a range of different engagement avenues for consumers, with differing levels of effectiveness.
- Various parties are incentivised more than others to engage with regulatory bodies, such as Gentailers who are more likely to have dedicated staff to review regulatory developments and advocate for their interests. In comparison, consumers, including the likes of Fonterra, do not have dedicated staff or resources to do this on a full-time basis.
- However, Fonterra believes that regulatory bodies need to add weight to the consumer's voice to ensure that interests are fairly represented and a balanced outcome is achieved.

##### 3. *What are your views on whether consumers trust the electricity sector to look after their interests?*

No comment.

## Prices

4. *What are your views on the assessment of the make-up of recent price changes?*

- Fonterra notes that for large industrial users such as itself, they typically bear the costs associated with the infrastructure that has been built to meet their demand (i.e. via bespoke customer investment contracts and direct relationships with the infrastructure providers).
- Fonterra notes that industrial users such as itself, also face contractual complexity and hence costs due to multiple engagements for effectively the same provision of services with multiple electricity distribution businesses (EDB's) across the country. The potential development of a standard set of terms and conditions to be used across all EDB's (unless there are specific exceptions) would assist with reducing complexity and therefore costs.
- Fonterra notes its concerns with potential Customised Price Path (CPP) applications and associated cost increases for consumers if this is based upon future asset replacements that should have occurred as repair & maintenance costs during the Default Price Path (DPP) period.

5. *What are your views on the assessment of how electricity prices compare internationally?*

No comment.

6. *What are your views on the outlook for electricity prices?*

- Fonterra notes that, as per numerous external publications, that development in renewable energy generation technology and production volumes will result in the capital cost per MW produced decreasing. However, there is uncertainty if the decrease in capital cost is sufficient to offset the perceived higher cost from consenting and site development for new renewable generation sites.
- Fonterra also notes that pricing direct to consumers need to reflect the infrastructure investment required to meet that demand or to ensure that charging electric vehicles at off-peak times will actually avoid the need for major network investment and improve the utilisation of infrastructure investment.

## Affordability

7. *What are your views on the assessment of the size of the affordability problem?*

No comment.

8. *What are your views on the assessment of the causes of the affordability problem?*

No comment.

9. *What are your views on the assessment of the outlook for the affordability problem?*

No comment.

## Summary of feedback on Part three

10. *Please summarise your key points on Part three.*

- Several regulatory and economic hurdles remain which will impact the future viability of electricity as a lower emission energy source.
- There is an opportunity for better consumer consideration by regulatory agencies to ensure that a fair and balanced outcome is achieved, as other industry parties are better resourced and incentivised to engage on regulatory processes.
- There is complexity for industry to manage contractual relationships with multiple EDB's for supply of the same commodity.
- Industrial users typically directly bear the costs for infrastructure investment associated with its demand.
- Recent CPP decisions have shown that the Commerce Commission does not have sufficient information on costs and asset condition during the DPP's resulting in the need for CPP's which trigger consumer price increases.
- Costs to consent and develop new renewable generation may drive costs higher than the underlying cost reductions from renewable energy generation technology and production volume gains.

## Solutions to issues and concerns raised in Part three

11. *Please briefly describe any potential solutions to the issues and concerns raised in Part three.*

- Review of regulatory and economic hurdles for transitioning to utilise electricity to reduce emissions for process heat.
- Development of a standard set of terms and conditions to be used across all EDB's (unless there are specific exceptions) would assist with reducing complexity and therefore costs.
- Government and Regulatory bodies need to add weight to the consumer's voice to ensure that interests are fairly represented and a balanced outcome is achieved.
- The CPP process must be reviewed to ensure that it is fair and equitable to the end consumers and is not rewarding poor decisions during the DPP by EDB's.
- Pricing direct to consumers need to reflect the infrastructure investment required to meet that demand or to ensure that charging electric vehicles at off-peak times will actually avoid the need for major network investment and improve the utilisation of infrastructure investment.

## Part four: Industry

### Generation

12. *What are your views on the assessment of generation sector performance?*

- Fonterra believes that the electricity spot market is working effectively in the long run, however notes that there is still room for improvement in the short term. This includes work programs such as Real Time Pricing that the Electricity Authority and new generation entering the market which will displace higher cost generation thereby dropping the overall electricity spot market price.

13. *What are your views of the assessment of barriers to competition in the generation sector?*

- The review should consider the barriers to new generation due to the Resource Management Act 1991 consenting timelines and processes, and how this impacts the proposed new generation projects that have been consented but not yet enacted.

14. *What are your views on whether current arrangements will ensure sufficient new generation to meet demand?*

Please refer to Fonterra's response to Q13.

### Retailing

15. *What are your views on the assessment of retail sector performance?*

No comment.

16. *What are your views on the assessment of barriers to competition in retailing?*

No comment.

### Vertical integration

17. *What are your views on the assessment of vertical integration and the contract market?*

No comment.

18. *What are your views on the assessment of generators' and retailers' profits?*

No comment.

## Transmission

19. *What are your views on the process, timing and fairness aspects of the transmission pricing methodology?*

- Fonterra has engaged with the Electricity Authority and Transpower over many years on the proposed changes to the TPM and have put forward our views in our submissions on the various changes that have been proposed.
- As per past submissions on this topic, Fonterra expects a robust cost benefit analysis (CBA) to accompany any proposed change from the status quo.

## Distribution

20. *What are your views on the assessment of distributors' profits?*

- Fonterra believes that WACC should be at the 50<sup>th</sup> percentile as the investment risk is low, and the risk from extreme events (i.e. earthquakes, storms) can be insured against.
- Fonterra notes that WACC is currently set at the 67<sup>th</sup> percentile and could lead to higher profits for EDB's. Fonterra also raises concerns about the potential for cross-subsidisation to occur between the regulated and non-core part of businesses, or via related party payments to reduce direct profits. These are both areas that could warrant further investigation.

21. *What are your views on the assessment of barriers to greater efficiency for distributors?*

- As noted earlier, price reflective charges to end consumers on their use of the distribution infrastructure would assist with leading to efficient outcomes and potentially delaying or avoiding upgrades.

22. *What are your views on the assessment of the allocation of distribution costs?*

- The analysis in the Consultation Paper does not support the proposed reallocation of EDB costs from households to large industrial users.
- Fonterra notes that industrial users already pay demand charges and time of use based charges.
- As a large industrial user, Fonterra typically pays for the capital cost and ongoing maintenance cost of the assets directly installed to supply our load. There is no cross-subsidisation occurring from the other consumers, and often the infrastructure installed is there solely for the end industrial user.
- Fonterra notes that EDB asset management plans need to be lifted to the same quality as Transpower and cost benefit analysis done for all capital investment. This would reduce the risk of under maintaining the assets and then driving capital spend increases in CPP requests thereby increasing the regulated asset base and hence profit.

23. *What are your views on the assessment of challenges facing electricity distribution?*

No comment.

### **Summary of feedback on Part four**

24. *Please summarise your key points on Part four.*

1. The Review Panel should consider barriers to new generation (and transmission) due to RMA consenting timelines and processes.
2. The analysis of supplier economics profits is incomplete.
3. The regulated WACC for Transpower and EDB's should be at the midpoint as the residual revenue risk is really associated with insurable natural events.
4. Multi-EDB management arrangements should be analysed for efficiencies to reduce costs to consumers.
5. The analysis in the Consultation Paper does not support the proposed reallocation of EDB costs from households to large industrial users.

### **Solutions to issues and concerns raised in Part four**

25. *Please briefly describe any potential solutions to the issues and concerns raised in Part four.*

As per response to question 24.

## Part five: Technology and regulation

### Technology

26. *What are your views on the assessment of the impact of technology on consumers and the electricity industry?*

- As noted in response to question 1, there is an opportunity for decarbonisation via increased electrification of industrial heat, however there are significant hurdles associated with doing so, including the cost for both the electrical energy and the infrastructure upgrades required to provide it. Such a transition will occur over a period of time and end users need to ensure that such an energy supply is both secure and reliable, economic, and sustainable.

27. *What are your views on the assessment of the impact of technology on pricing mechanisms and the fairness of prices?*

No comment.

28. *What are your views on how emerging technology will affect security of supply, resilience and prices?*

- There is the potential for residential solar PV and batteries to benefit all electricity users.
- This is due to a number of reasons, including the fact that it will be built with private capital, the batteries will minimise the peak load demands, and this will reduce the cost to all users by reducing the peak negating the need for spend on infrastructure upgrades.
- It also has the potential to decrease demand and electricity prices by allowing hydro generators to hold back during the day and run at capacity during the peak periods, thereby reducing use of gas peaking plant.

### Regulation

29. *What are your views on the assessment of the place of environmental sustainability and fairness in the regulatory system?*

- Please refer to question 1 response.
- The inclusion of any fairness requirements must not drive cross-subsidisation and shield the residential consumers from the true cost of their use of the electricity transmission and distribution network.
- The Government could consider using its existing social focused departments to deal with electricity hardship issues directly, like Warmer Kiwi Homes program and winter energy payment.

30. *What are your views on the assessment of low fixed charge tariff regulations?*

No comment.



31. *What are your views on the assessment of gaps or overlaps between the regulators?*

- The cost of EDB's expanding into third tier services should be assessed for regulatory intervention to ensure that cost benefit analysis is done and cross-subsidisation does not occur, and avoid potential competition issues with private technology providers.
- As noted earlier, CPP applications and associated cost increases need to be carefully considered to ensure that future asset replacements are not the result of poor maintenance practices during the DPP period.
- As noted earlier, the quality of EDB asset management plans must be improved and standardised to ensure end consumers are not incurring unnecessarily higher costs via a potential CPP application.

32. *What are your views on the assessment of whether the regulatory framework and regulators' workplans enable new technologies and business models to emerge?*

No comment.

33. *What are your views on the assessment of other matters for the regulatory framework?*

No comment.

### **Summary of feedback on Part five**

34. *Please summarise your key points on Part five.*

1. Decarbonisation of industrial heat via electrification has significant hurdles associated with it. Any transition will occur over a period of time and end users need to ensure that such an energy supply is both secure and reliable, economic, and sustainable.
2. There is the potential for residential solar PV and batteries to benefit all electricity users.
3. Utilisation of other Government programs to address any potential fairness issues to avoid cross-subsidisation across users.

### **Solutions to issues and concerns raised in Part five**

35. *Please briefly describe any potential solutions to the issues and concerns raised in Part five.*

No comment.

### **Additional information**

36. *Please briefly provide any additional information or comment you would like to include in your submission.*

No comment.