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Electricity Review Panel
C/- Ministry of Business, Innovations and Employment,
Wellington

By email to energymarkets@mbie.govt.nz

Unison Submission on the Electricity Price Review Options Paper

Introduction

1. This submission responds to the Options proposed by the Panel in its paper: *Electricity Price Review Options Paper.* Unison has contributed to the development of the ENA's submission and largely supports its recommendations. In this submission we elaborate on areas of key interest to Unison. We have focussed on Options that the Panel has proposed that directly affect distribution, but note our general approval of the proposed options to increase retail competition and strengthen arrangements in the wholesale electricity market.

2. As was noted at the Panel's workshops, we think it will be important for the Panel to reflect on the proposed changes as-a-whole to ensure that there are not unintended consequences, or that options do not inadvertently lift prices to consumers due to increased costs or undue risk aversion.

3. In that respect, we note that it is important to protect the competitive process, not competitors in a market. Although Unison is not an expert on retail market competition, we do raise a concern that a prohibition on win-backs may reduce the benefits to customers who switch, and may not do anything to promote the customer benefits of switching for the large group of customers who do not, or cannot switch. Indeed, prohibiting a means of competition – the ability to make a counter-offer – is counter-intuitive. There have been clear increases in the numbers of competitors in the retail market, despite the known intensity of retail competition, including by way of win-backs, so it is not obvious that win-backs are a consumer detriment. We suggest that, if the Panel recommends, and the Government accepts, a proposal to prohibit win-backs, it would be important to review the impact that this has on the benefits available to customers from switching.[1]

4. In the remainder of this submission we address a selection of the proposed options that we wish to address beyond the points made in ENA's submission.

[1] It was suggested at the Wellington workshop that a measure of success is that the gap between what switching and non-switching customers pay is reduced. If the gap reduces because the benefits of switching are reduced, then this would not be success.

E Improving transmission and distribution

E1 Government Policy Statement on Transmission Pricing

5. Unison expresses cautious support for a TPM on Transmission Pricing.

6. The Panel states:

> "A government policy statement is an effective way for the Government to express its policy objectives, in particular whether it is generators or residential and business consumers in poorer regions, such as Northland and King Country, that should benefit from lower charges under the Electricity Authority's proposed transmission pricing methodology.
>
> Transpower's submission set out objectives that could help shape a policy statement, including that any change was simple to understand and implement, and was incremental, thereby minimising the real harm of price shocks. An overriding objective should be to avoid or minimise dramatic price increases. That means they should be phased in."

7. It is not yet clear, without seeing the detail of a statement, that a Government Policy Statement on Transmission Pricing would necessarily provide an aide to the Authority in completing its review of the TPM. While we are in full agreement that the TPM Review has taken too long, and there have been a number of mis-steps by the Authority, a Government Policy Statement on Transmission Pricing risks politicising the review and providing another point of argument in any potential judicial review of the Authority's ultimate decision. There is a risk that a GPS on transmission pricing could add complexity to the Authority's test against its statutory purpose, by adding further factors that the Authority must consider. We believe that a GPS would only be helpful if it assisted the EA narrow the trade-offs it must make in testing various options against its statutory Purpose.

8. While we agree that transition mechanisms are potentially quite important in smoothing the effects of TPM changes over time, we disagree that the Government can effectively determine which poorer regions or groups of customers should benefit from TPM reform. There are many poorer regions who are currently disadvantaged by the current TPM, in that their charges have lifted substantially, ostensibly due to investments that have been made to benefit other regions. For example, the East Coast of the North Island has many highly deprived communities that have seen their interconnection rates increase by 50% since 2010, but have not received additional transmission services in the form of new or higher capacity lines.

E2 Government Policy Statement on Distribution Pricing

9. The Panel has suggested that a GPS would be useful in guiding the process of network pricing reform. In the case of distribution pricing reform, we support the issue of a GPS that shows the Government's endorsement of change, with appropriate transitions. It is impossible to design new distribution prices that will not have effects on some customers, even though in an overall sense, change would be revenue-neutral in the short-term and should assist to support lower-than-otherwise prices in the long-term as consumers are encouraged to manage their use more carefully.

10. EDBs are already approaching the task of price reform with a cautious view, noting the imperative to manage customer impacts carefully. A GPS is unlikely to significantly influence how EDBs undertake the price reform process, but having Government support would assist the industry to engage with stakeholders, especially consumers. A coordinated approach from industry, regulators and consumer groups is essential to build public support for the introduction of service-based pricing.

E3 Regulate cost allocation principles

11. While we agree that it is timely for network companies to review their cost allocation approaches, we are not clear on the need for further regulation. If there is to be regulation, we support a principles-based approach, as there are often significant judgements involved in determining appropriate cost allocations. What works acceptably on one network may not work on another network, due to variations in customer mix and socio-demographics. Cost allocations approaches also need to be viewed in light of durability to changes in technology and usage patterns. For example, we note that the analysis provided in the Review's Technical Paper examined GWh shares of network costs, but if small residential consumers have significant uptake of roof-top solar, then the burden of distribution costs would increasingly fall to commercial customers. This may not be desirable or sustainable. Caution in this area is required.

12. Sequencing is also important. Cost allocation is a zero-sum issue and the majority of consumers are likely to benefit from decreases in distribution prices in the 2020 DPP reset as a result of falling interest rates, which would be reflected in a lower regulatory WACC. It is preferable for EDBs to focus on pricing reform as a priority, compared to revisiting their cost allocation methodologies.

E4 Limit price shocks from distribution price increases

13. The Panel has suggested that the Electricity Authority potentially be given a role in approving EDB's "Tariff Structure Statements" (TSS) mirrored off the approach used in Australia.

14. EDBs are acutely conscious of the impacts of network price reform and the need to ensure appropriate transitions to new pricing models. The ENA has been supporting Members to develop an industry-wide roadmap for network pricing reform as well as provide analytical support in assisting Members to understand the potential impacts of different pricing options.

15. Unison does not support the Authority having a role in authorising EDB's pricing approaches. This is for three reasons:

    1. It is likely to slow the process of price reform down as the Authority would have to assess more than twenty TSS each year;
    2. It would add substantial compliance costs to the process; and
    3. The Authority would have to recruit significant practical capability to ensure it can effectively review TSS.

E5 Phase out Low Fixed Charge Regulations

16. We believe that with the exception of some interest groups, there is broad support and understanding for the reasons that the Low Fixed Charge Regulations are creating undesirable outcomes, which are likely to increase in future. Unison submits that the Panel should recommend the Government give high priority to phasing out the Regulations with a clear direction to MBIE to develop a phase out plan as soon as practicable.

17. There is a strong interaction between removal of the Regulations and distribution pricing reform. In particular, the form of distribution pricing structures could be quite different depending on the pace and confidence in phase out of the Regulations. More complex pricing options would likely be required in the event that a better balance cannot be achieved between fixed and variable prices in a timely manner. Certainty in this area as soon as possible would be highly beneficial in promoting the pace of distribution pricing reform.

E6 Ensure access to smart meter data on reasonable terms

18. The Panel proposes that the Authority urgently examine the basis on which EDBs can access smart meter data. We agree with the Panel's option, and in particular, determination of reasonable terms. There is a risk that consumers will effectively end up paying twice for their smart meter: once through the retailer and twice through charges to distributors. As EDBs were not parties to the original agreements between retailers and MEPs we are effectively captive customers to meter providers.

19. While the Electricity Authority has promoted the success of retailer-led smart meter roll-outs, the Code has not enabled EDBs, who have a clear interest in meter functionality and access to data, to provide better services to their consumers. Unison submits that the Panel should also recommend that the EA revisit the regulatory arrangements for the appointment of a MEP, so that both retailers and distributors in smart meter data and functionality have clearly defined rights. New Zealand has missed an opportunity to ensure effective coordination of interests in smart meters in the initial roll-out of meters. This issue should be addressed prior to any future meter upgrades as next generation meters and associated communications equipment become available.

E7 Strengthen Commerce Commission powers to regulate distributors' performance

20. The Panel has made a number of recommendations with respect to the Commerce Commission's Part 4 powers. We address each in turn.

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

21. We agree that if the Commission has identified a governance failure in an EDB that is leading to undesirable outcomes for consumers, through its Part 4 "Summary and Analysis" duties or other means that it may be useful for the Commission to have the power to regulate an exempt EDB. In this scenario, a CPP would be the most appropriate solution, albeit focussed on network reliability/resilience and network management, as opposed to price.

22. We also think the Commission should also have the opposite power to exempt an EDB from DPP/CPP regulation or components of it where this is unnecessary in the interests of consumers. A number of consumer-owned EDBs are non-exempt only by virtue of some Trustees not being appointed. They set prices substantially below the DPP allowed benchmark, yet they must undergo the same expensive compliance reporting requirements. This is wasteful and not in the long-term interests of consumers.

Require a distributor to move from compliance with default price-quality regulations to more stringent customised price-quality regulations if an investigation found this would be better for consumers

23. We do not support the forceable requirement for an EDB to move to a CPP. This would fundamentally shift the dynamic between the Commission and EDBs back to pre-part 4, where regulation was seen as a punishment, rather than a natural state for a privately owned monopoly. It would also significantly increase compliance costs for EDBs that are required to complete a CPP.

24. We are also not clear on the policy driver for this proposal – in particular, where an EDB has failed to apply for a CPP, but the Commission had identified it would be desirable for it to do so. Moreover, as further precedents emerge from quality breaches that the Commission is working through, EDBs will be better placed to judge the expectations on their businesses. If a business is unable to sustainably meet the reliability limits, it will have the new opportunity (post 2020) to apply for a quality variation to its DPP, which must be supported by an engineering report, or apply for a CPP if a step change in expenditure is required. This provides proportionate and cost-effective avenues for EDBs to appropriately tailor their price-quality requirements to their businesses.

25. At the Wellington workshop, the Panel also sought to test whether shifting larger EDBs to IPP Regulation would be an improvement. We note that IPPs are expensive, and again it is unclear what problem this would be seeking to address. We understand that a CPP application, which is essentially a one-off IPP costs around $4 million to prepare. If Unison, which is the fifth largest distributor in the country, were to become subject to this regime, the cost per consumer of each IPP would be of the order $40 per consumer. Accordingly, from a policy objective, it would be necessary to identify offsetting benefits from a more intensive process to reset prices and quality standards.

26. We would also be concerned that the Commission (and the narrow community of expert advisors on economic regulation in New Zealand) would have sufficient resources to carry out additional IPPs.

27. Finally, we note that the Commission has tools available to it that it has not yet used to promote performance improvements in EDBs, including additional disclosure or certification requirements such as attainment of ISO55001 certification – the standard for asset management. We consider it would be better for the Commission to explore these tools than change the regulatory dynamic. In

our view, the regime is developing in a manner that will create the right incentives and drivers for EDBs to apply for CPPs where desirable, which will ensure the regime remains affordable.

Apply higher maximum penalties to deter big distributors from breaching price-quality regulations

28. Unison does not support this option for three reasons:

a) The Commission has not published enforcement guidelines. This would assist EDBs to better understand the Commission's expectations.

b) There has not yet been any fines or penalties for failing to meet price-quality regulation although we understand that there are likely to be penalties announced in the near term. This combined with the reasons for the penalties will provide EDBs with a clear understanding of what is expected of them, which may address any concerns that EDBs are not giving sufficient weight to the quality standards.

c) The reliability requirements, in particular, are based on variables that are subject to high levels of variability, and are to a high degree driven by a number of factors outside of EDBs' control. Increasing penalties when EDBs do not have 100% control over their ability to comply, would likely raise the risk that EDBs over-invest to reduce the chance of breach and may have a chilling effect on Directors willing to be Board Members of EDBs. Neither would be in the long-term interest of consumers.

Compare distributors' performance when setting price-quality regulations. Comparative benchmarking would be used cautiously as one input in setting prices.

29. Unison strongly disagrees with this option. An extensive submission on this matter is included in the ENA's submission which sets out why comparative benchmarking should not be used for price-setting purposes. In short, the variations in factors that drive variations in EDB performance are both numerous and material. No benchmarking model has ever been developed, which accommodates these issues for EDBs. We note that the AER has recently undertaken benchmarking work (albeit at an industry trend level). Their consultant made the following statement in response to concerns about failures to measure all relevant factors relevant to productivity:[2]

> " **5. Several submissions have noted that a measured decline in productivity does not mean that productivity was not achieved. Rather, it may be because they delivered outputs not captured under our models. What is the magnitude of the risk/possibility that the time trend is capturing outputs that have not been specified? Can we still rely on our existing models, even if the models do not capture potentially material outputs delivered by distribution businesses?**

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[2] https://www.aer.gov.au/system/files/Economic%20Insights%20AER%20Memo%20on%20Forecast%20Opex%20Productivity%204Feb2019.pdf

Some submissions (eg NERA 2018, p.5) argue that negative measured productivity growth may simply reflect the fact that tops–down models cannot capture all the outputs being provided by a DNSP. As a result, if the DNSP is using inputs to increase an output not explicitly included in the model then its measured productivity will be negative, all else equal, because the models capture the increase in inputs but not the increase in the relevant output. This is, of course, possible as tops–down benchmarking measures are limited to only including a small number of high level and readily measurable outputs.

30. The consultant's solution to these problems with measuring changes in productivity changes over time was to exclude time periods where industry changes were occurring, but this kind of solution would not address problems of unmeasured factors that vary *between* businesses in a comparative benchmarking study.

31. While we think that the case for the Panel not to recommend removal of the prohibition on comparative benchmarking is compelling, Unison submits that if the Panel were to continue to make this recommendation, that it qualify the recommendation so that MBIE carries out further analysis to determine under what conditions comparative benchmarking could be used. From Unison's perspective, use of comparative benchmarking in price-setting would be a significant backward step, and would undermine confidence in the robustness in regulatory outcomes.

F Improving the Regulatory System

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

32. The Panel suggests reforms in three areas:

a) "An amendment to the Electricity Industry Act 2010 would confirm the Electricity Authority can regulate terms and conditions for use of transmission and distribution networks. This would remove the uncertainty about the scope of the Electricity Authority's powers in the legal challenge to its right to establish default agreements between distributors and retailers for access to distribution networks (see C4).

b) Secondly, obligations in section 54V of the Commerce Act 1986 would be refined to ensure effective co-ordination of the functions of the Electricity Authority and Commerce Commission.

c) Thirdly, the provisions in Part 3 of the Electricity Industry Act 2010 restricting relationships between a distributor and a generator or retailer that are not at arm's-length would be able to be tightened, if necessary. Distributors can limit competition in some new distributed energy services that may not be covered by existing provisions, which refer only to generating and retailing electricity. In particular, there is a concern distributors can exploit information advantages (such as household consumption data not available to competitors) and use monopoly services to subsidise competitive services in emerging markets (such as offering discounted battery services by recovering any losses through monopoly lines charges)."

33. Unison's responses are as follows:

a) We are concerned that the Authority is not well-placed to stand between distributors and retailers, particularly as there are not safeguards to protect the interests of distributors against poor quality decision-making given that merits appeal is not available on Authority decisions. In particular, we are concerned that the Authority will seek to tilt risk-sharing so that EDBs bear greater risks associated with the services being provided, without these risks being compensated for under the Commerce Commission's regime. While there are likely to be some advantages to standardised contracting arrangements between distributors and retailers, there are also likely to be disadvantages as default arrangements simply become the standard arrangement, potentially limiting the incentive to consider new arrangements that may better allow innovations in the retailer-distributor relationship. Arrangements may also be slow to adjust to changing industry dynamics. It is ironic that the Authority was so concerned that progress in taking up the Model UoSA by the industry was too slow that it decided to regulate, but it is now more than two years since taking that decision and we are yet to see a revised agreement.

b) We agree with the Panel that the Authority and Commission need to coordinate carefully. This is particularly the case given the growing recognition that distributors play a central role in enabling market access to new technologies. We worry particularly that the Authority will require EDBs to undertake new activities or provide greater information to market participants without the Commerce Commission reflecting new requirements in the costs to be recovered by distributors. Accordingly, while we support further strengthening coordination between the two regulators, we think this should be strong enough such that when one regulator makes a decision that affects activities regulated by the other regulator (especially when the Authority imposes new obligations on EDBs) it is a requirement that the impacts are provided for by the other regulator. Conversely, if those impacts are not provided for, then there should be an ability for EDBs to challenge Code amendments or new requirements. This would ensure that coordination occurs effectively between the regulators and there is consistency in regulation.

c) The Panel's expressed concerns about distributors using consumption data to compete with other market participants, needs to be assessed within the context of the use of emerging technologies. We would agree with the Panel that distributors should not be able to compete in the retail market in a general sense using consumption information received through provision of smart meter data or via network billing, but we understand that this is already a feature of data agreements as well as UoSA's. EDBs can only request and use data for network management purposes. However, the use of such data to assess the potential for alternative solutions is a different matter, particularly as networks increasingly consider the potential for micro-grids or off-grid solutions at extremities of the network. We are very doubtful that there is likely to be strong appetite for other parties to solve the coordination challenges associated with delivering alternative solutions in rural or remote rural areas. The critical issue will be to ensure that policies do not ultimately prevent efficient solutions.

   With respect to cross-subsidisation of entry into new services such as provision of batteries, we also note that safeguards already exist to prevent such activities. These include cost allocation and related-party dealing rules, which the Commission has comparatively recently amended in response to emerging markets and technologies. We also point out that network pricing reform will provide an under-pinning value proposition for new services, which has been a frequent complaint on those concerned about accessing the value stack necessary to justify new services. In particular, variances in network peak and off-peak prices will drive value propositions for battery storage options, where these are economic at shifting effective consumption from peak to off-peak times.

Overall, Unison submits that the Panel's recommendations in this area need to reflect the changing electricity market land-scape and ensure they do not give rise to un-intended consequences. The Panel's Review process has been tightly constrained by time. In this area we consider that the Panel is better to recommend that MBIE undertake a larger scale review of market structure arrangements, rather than jump to increasing the Authority's powers to regulate. In our view, MBIE is best placed to undertake the review, given the significant impact that structural regulations have on market participants' business opportunities as well as much better ability to develop an integrated policy position given recommendations that will shortly be provided by the Interim Climate Change Commission.

F4 Allow Electricity Authority decisions to be appealed on their merits

34. The Panel is not minded to recommend merits appeals on Authority decisions. Unison agrees with the ENA's submission that there are good grounds for permitting merits appeals on Authority decisions, including the discipline that it would place on the Authority for the quality of its decisions.[3] Irrespective, of merits appeal however, is the need for an effective means of overseeing the regulators. Although the Select Committee process is intended to provide oversight of performance, we do not believe this is adequate.

Closing comment

35. If the Panel would like to discuss our views further, please contact Nathan Strong on 06 873 9406.

Kind regards,

Nathan Strong
General Manager Business Assurance

[3] We would, however, support a carve out for merits appeal on the Transmission Pricing Methodology Review. Given the substantial value at stake, negatively affected parties would face strong incentives to appeal even if the prospects of success were remote.