Electricity Authority Funding Options following Strategic Baseline Review

Final Report

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Glossary

Abbreviation	Stands for
BBC	Better Business Case
FTE	Full-Time Equivalent
SOI	Statement of Intent
The Act	The Electricity Industry Act 2010
The Authority	The Electricity Authority

Acknowledgements

We would like to acknowledge the input received as part of our original strategic baseline review as well as the constructive engagement with the Ministry of Business, Innovation and Employment, the Electricity Authority and its advisors on its "Business Case: Enabling a Consumer-Focused Transition".

Executive summary

This report follows our earlier strategic baseline review, turning to potential funding options

We were engaged by the Ministry of Business, Innovation and Employment (MBIE) in December 2022 to undertake a strategic baseline review of the Electricity Authority (the Authority). We reported on the strategic baseline review in August 2023 but were not able to provide strongly evidenced funding options given the information available to us at the time. That is, we would have had to make assumptions that would be better informed by the Authority's intended actions in response to:

- the strategic baseline review recommendations (particularly shifts in ways of working and potential efficiencies) and
- its thoughts on medium-term regulatory strategy and its priorities in light of this strategy.

Instead, our strategic baseline review outlined further work that would be needed to provide clear funding options and the Authority agreed to undertake further work to develop potential funding options. The Authority has developed a "Business Case: Enabling a Consumer-Focused Transition" (Business Case) which we were asked to review and if possible, given additional information in the Business Case, consider the outstanding question from the strategic baseline review relating to options to manage within different funding paths. We report on that here.

We have not developed any separate or additional options as the Business Case would not provide sufficient additional information to do so. We have also not been asked to endorse these options (which we were not involved in developing) nor recommend a particular option. This report presents the options put forward by the Authority and provides context for considering them.

The Authority faces funding pressures

The Authority's Business Case identifies the following cost pressures, consistent with our strategic baseline review (which also highlighted potential operational cost efficiencies and cost pressures (as shown in Figure 1):

- the transition to a net zero economy
- changes in technology, innovation in new technologies
- the extension to its statutory objectives to include protecting the interests of domestic and small business consumers
- a gap between stakeholders' expectations and their perceptions of the Authority, and
- areas for improvement and funding pressures identified in the strategic baseline review.

The Authority has developed four funding options in light of these pressures

The Authority has developed four options in its Business Case, which are presented alongside the status quo in Table 1.

Table 1: Overview of the Authority's funding options

	Status quo	Option 1	Option 2	Option 3	Option 4
Service provider costs	$70.4m	$78.0m	$78.0m	$78.0m	$78.0m
Authority costs	$30.4m	$30.4m	$36.9m	$46.9m	$55.8m
Total Full-Time Equivalent (FTE)	132	132	157.5	196.0	231.5
Total GMO funding in 2024/25	$100.8 m	$108.4m	$115.0m	$124.9m	$133.8m

Source: Electricity Authority "Business Case: Enabling a Consumer-Focused Transition, October 2023

The Authority's business case addresses some of our earlier feedback

We provided feedback on a *Near Final Business Case* provided by the Authority on 7 September 2023 and the Authority has addressed a number of our comments in the tight timeframe available. Further, the Authority appears to be working on addressing a number of the recommendations in our original strategic baseline review already which we commend.

There are further considerations relevant to the funding options the Authority has developed

Nevertheless, there are further areas of our feedback relevant to how funding options are considered and areas where there are choices and potentially different ways of doing things. These include:

- **Marginal benefits/benefits realisation**: being clearer what the benefits associated with activities expected to be funded under each option are and how these will be realised.
- **Prioritisation, efficiencies and ways of working**: alignment with Better Business Case components and our strategic baseline review does not help the choice of funding quantum without a sense of associated benefits. Further, efficiencies are all assumed to require further investment, while changes in ways of working may enable greater efficiency.
- **Service provider costs**: these increase by $7.6 million under all options put forward and this level then continues. This is driven by: inflation Negotiations , contractual discussions Negotiations , and current procurement processes for two contracts Negotiations . There are options within this, including requiring inflation to be offset by efficiencies (at least when contracts are renewed) and not increasing for contractual requests; while if inflation is to be funded ongoing this will have further implications in outyears (either for overall funding or savings required of the Authority/providers). The Authority also identifies that there may be further requests for cost increases from service providers that are associated with the transition of the energy sector.
- **Timing of costs**: further funding is sought from 2024/25 ongoing, whereas costs pressures reflect a mixture of one-off (e.g. develop a medium-term regulatory strategy, which admittedly may need to be refreshed in future), ongoing (e.g. consumer engagement) and increasing (e.g. inflation-linked, noting the public sector funding framework anticipates efficiencies would normally offset these) pressures, and we would expect funding in future years to reflect the changing nature of these pressures.
- **Roles of support and policy teams**: between 2017/18 and 2021/22 FTE increases were greatest in wider support functions. Support roles currently account for 32 per cent of the Authority's Full-Time Equivalent employees (FTEs), and just under 30 per cent of the

proposed increases in roles relate to support. We suggest the increases across support and policy roles be considered relative to possible ways of working in the current fiscal environment. The Authority's costs per FTE relative to benchmarks were also considered high in our strategic baseline review (noting the challenges associated with benchmarking as highlighted in the Business Case).

- **Managing the scale of change**: the feasibility and impact of the proposed level of increase in FTE should be considered along with potential challenges in managing culture, coordination and role clarity, people and project management, decision-making and delegation. This is particularly true in the context of likely operational changes to address recommendations from the strategic baseline review.

Developing a medium-term regulatory strategy and linked prioritisation framework remain as our proposed priorities

Consistent with our original strategic baseline review, we recommend, within any funding path, the Authority prioritises developing a medium-term regulatory strategy (based on a clear intervention logic) and associated prioritisation framework. These could be considered as discrete activities under any option and in fact should inform what activities are undertaken, and how, for any funding option, and as such could be considered as a one-off cost as it could be provided without additional FTE. We also suggest the Authority consider its ways of working following work on a medium-term regulatory strategy and continue to progress recommendations from the strategic baseline review.

1. Introduction

This section sets out the:

1. context and purpose of this report
2. scope of work and approach taken
3. outline for the remainder of the report.

1.1 Context and purpose

In October 2022, the Electricity Authority (the Authority) issued a consultation document for its 2022/23 and 2023/24 levy-funded appropriations (Electricity Authority, 2022). This set out two phases of proposed increases to baseline funding:

- Phase 1: for proposed increases of $0.5 million for 2022/23 and up to $7.8 million for 2023/24 and outyears, which was the subject of the consultation document.
- Phase 2: further increases in funding for 2024/25 and outyears, which at the time was proposed at an additional $3.537 million for 2024/25 and outyears but for which an independent baseline review of the Authority’s operations was to be undertaken prior to any consultation.

In December 2022, the Ministry of Business, Innovation and Employment (MBIE) engaged us to provide an independent strategic baseline review of the Authority. The review was intended to provide assurance around the extent to which the Authority is adequately and appropriately resourced to respond to current and future challenges, and to support MBIE in its advice to Ministers on funding needs. The four main questions we were asked to consider were:

1. How well positioned is the Authority to deliver on its role, strategy, and government priorities?
2. How well is the Authority performing (efficiency of resource use, and value add/quality of outputs delivered)?
3. What cost pressures does the Authority face over the next four years, and do they align with its strategy and priorities?
4. What are options to manage within different funding paths?

On 18 May 2023, the Government released Budget 2023. The Authority received approval for an uplift in its appropriation of $0.5 million in 2022/23 and $4.6 million (approximately 60 per cent of the amount requested) for 2023/24 and outyears.

In August 2023, we finalised our strategic baseline review which answered the first three questions above but the Authority did not have the information needed in the time available to robustly answer the fourth question (significant assumptions would have been required). Instead, we set out what information was needed to do so and shared with MBIE and the Authority some of the key choices and funding elements to consider.

In addition, it was agreed with MBIE and the Authority further work was needed by the Authority to inform future funding options. Since that time, the Authority has developed a "Business Case: Enabling a Consumer-Focused Transition" (Business Case) which we were asked to review and if possible, given additional information in the Business Case, consider the outstanding question from the strategic baseline review relating to options to manage within different funding paths.

1.2 Scope and approach

As noted above, we have been asked for this report to review the Authority's Business Case and if possible, given additional information in the Business Case, consider the outstanding question from the strategic baseline review relating to options to manage within different funding paths. In order to do this, we:

- as part of our strategic baseline review, outlined information needed in order to develop funding options and separately set out possible considerations and key choices
- reviewed a *Near Final Business Case* provided by the Authority on 7 September and provided feedback on it to the Authority and met with the Authority, MBIE and the Authority's advisors to discuss this feedback
- reviewed the final Business Case and analysed it in the context of informing funding options. This report captures this analysis.

> **We have not developed these options and have not been asked for a recommendation**
>
> We have not developed any new options, formed a view on any preferred option, nor undertaken a full Better Business Case review as these were beyond the scope of our engagement. As such, we wish to be clear we have not identified or developed the funding options presented in section 2 ourselves – this was a process undertaken by the Authority and its advisors separate from any input from Sapere beyond what was in, or discussed during, the strategic baseline review. In light of this, we do not and have not recommended any particular option.

1.3 Report outline

The remainder of this report addresses:

- relevant pressures for the Authority in section 2
- funding options developed by the Authority in section 3
- key considerations relating to these funding options in section 4, and
- areas we recommend the Authority prioritise under any funding option in section 5.

2. Relevant pressures for the Authority

Below we highlight the key pressures the Authority faces, drawing from our strategic baseline review and summarising key aspects from the Authority's Business Case to provide some of the context to the Authority's funding options.

2.1 Context of pressures as flagged in our strategic baseline review

Our strategic baseline review highlighted among its high-level findings that the Authority:

- **Context**: faces a quite different environment than when initially established, with significant medium-term dynamics that will have implications for the Authority (posing cost pressures as well as opportunities) and pose risks to reliability.
- **Awareness**: shows early signs of being cognisant of key areas for improvement with some common themes raised from our work (both in terms of how it is positioned and how it is performing).
- **Cost drivers**: applies the majority of its funding to service providers and system operator expenses (i.e. outsourced services), which drove most of the cost increases between 2011/12 and 2016/17. Outsourcing expenses are linked to inflation, though the Authority's operating costs have accounted for a greater portion of more recent cost increases, driven by increases in employee expenses and external advice.
- **Funding pressures**: would be squeezed in terms of its funding without some level of increase, given inflationary pressures in its contracted services (as shown in Table 2). Medium-term dynamics may require more from the Authority with pressures as well as opportunities for potential savings over time (as shown in Table 3).
- **Funding options**: needs to tell a richer story around its funding needs, supported by robust analysis with further work suggested to estimate funding needs over time. We noted work on a medium-term regulatory strategy would usefully inform this.

Table 2: The Authority's component of funding (excl. Real Time Pricing and market making) assuming inflation in service provider contracts

Expenses (millions)	2022/23	2023/24	2024/25	2025/26	2026/27
Status quo	$24.96	$23.49	$21.43	$20.32	$19.19
Full proposed levy increase (pre B23)	$25.46	$31.30	$32.78	$31.67	$30.53
Partial levy increase (as in B23)	$25.46	$29.85	$27.79	$26.68	$25.55

Source: The Electricity Authority levy funded appropriations

It further highlighted the following medium-term dynamics and potential implications (Table 3) and potential cost efficiencies and pressures (Figure 1), noting the last three potential cost efficiencies may require initial investment or reprioritisation before delivering savings, and any efficiencies in engagement would need to be considered relative to potential pressures on the breadth of engagement. We were unable to say whether the completion of major projects releases capacity, or whether there is an equally large implementation tail.

Table 3: Medium-term dynamics and potential implications for the Authority

Underlying dynamics	• The transition to a low-emissions economy and therefore decarbonisation of our energy systems – market design and security arrangements. • Improvements in, and the role of, new technologies. • Increasing focus on small domestic consumers.
Sector implications	• Increased proportion of renewable electricity, with increased intermittent generation and retirement of thermal generation with risks for reliability. • More diverse and distributed generation, increasing the number of participants and resulting in different types of arrangements. • New business models and contracting arrangements, particularly in relation to risk management. • Increased information and data flows and importance of cyber security. • Increased complexity of operational coordination and risk to security of supply.
Potential implications for the Authority	• Additional workload pressures to support these shifts and delivery of statutory objectives. • Requirements to modernise the Code. • Opportunities to support rapid, short cycle innovation. • Ensuring systems support further digitisation and information flows. • A need to review standards the Authority has control over (such as Part 8 of the Code, currently being reviewed) to ensure barriers to entry are minimised and standards are relevant. • A need to engage with a wider range of sector participants as well as new opportunities to do this efficiently.

Our strategic baseline review also noted, in general, most of those we interviewed thought the policy area of the Authority has a significant task ahead requiring increased resource. However, there was caution about how well-placed the Authority is to deliver and to which policy issues the resource would be applied to.

Figure 1: Summary of potential cost efficiencies and cost pressures

Potential cost efficiencies:	**Potential cost pressures:**
Focusing more on its core function as a regulator and minimising/focusing any spending on boundary issues with other regulators/agencies. Possible efficiencies in engagement, operating processes and decision-making. Reducing turnover and improving technical capabilities. Leveraging technology and data analytics.	Increased demand for core skills. Inflation. Improving confidence in reliability. Addressing the back-log of Code changes. Modernising the Code. Engaging with a broader and more diverse sector and reaching consumer perspectives. Addressing emerging options from advisory groups and review works. Engaging with regulatory agencies on the Energy Strategy and long-term issues. Data needs and cyber security. Heightened risk of legal challenge. Increasing expectations of Crown entities.

2.2 Pressures flagged in the Authority's Business Case

The Authority's Business Case notes it is seeking funding for:

1. its own operations
2. third party service provider contracts.

It notes:

1. before 2023/24, the Authority's funding had not changed significantly since establishment in 2010, with funding increasing in nominal terms by less than 1.5 per cent per annum between 2012 and 2023. Table 4 shows how changes to funding in 2023/24 were allocated against the Authority's regulatory functions as grouped in its Statement of Intent (SOI).

2. the drivers of change underlying the Authority seeking further funding are:

   a) the transition to a net zero economy
   b) changes in technology, innovation in new technologies
   c) the extension to its statutory objectives to include protecting the interests of domestic and small business consumers
   d) a gap between stakeholders' expectations and their perceptions of the Authority, and
   e) areas for improvement and funding pressures identified in the strategic baseline review.

Its strategic case highlights:

1. Its statutory objectives and functions, and strategic ambitions (including discussing its actions and focus across functions and relating to its new objective and summarising where the increase in 2023/24 has been directed):

   a) *Statutory objectives*: to

      i. promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers; and

      ii. protect the interests of domestic and small business consumers in relation to the supply of electricity to those consumers.[1]

   b) *Statutory functions* (grouped as per its SOI, see funding allocation in Table 4):

      i. promoting market development through market facilitation measures and amending the Code

      ii. protecting the interests of domestic and small business electricity consumers

      iii. day-to-day operation of the electricity system and markets, including contract management with the System Operator to ensure coordination in real time of supply and demand in the wholesale market

      iv. enforce compliance by ensuring the Electricity Industry Act 2010 (the Act), regulations under the Act, and the Code are followed by electricity industry participants

      v. monitor the market, inform and educate market participants through making tools and information available.

   c) *Strategic ambitions*:

      i. low-emissions energy

      ii. thriving competition

      iii. consumer centricity

      iv. innovation flourishing, and

      v. trust and confidence.

2. Its government expectations (through its Letter of Expectations), which include:

   a) *entity-specific*: addressing recommendations related to the 9 August 2021 event, monitoring wholesale market power, supporting renewable generation, firming capacity, and demand-side participation, maintaining focus on distribution network regulatory settings, outcomes relating to its new objective, and monitoring retailer conduct and supporting broader sector initiatives.

   b) *expectations across entities*, which include supporting future focused Māori Crown relations and contributing to improving living standards and wellbeing.

3. Alignment to MBIE's work programme and other energy regulators

[1] The first is the "main objective" with the second an "additional objective" and section 15 of the Electricity Industry Act stating that "the additional objective applies only to the Authority's activities in relation to the dealings of industry participants with domestic consumers and small business consumers."

4. The transition to a net zero emissions economy, noting:
    a) mass deployment of intermittent generation will be required
    b) electricity demand will increase as New Zealand electrifies
    c) significant investment in networks will be required
    d) changing technology and market dynamics, including intermittent generation and distributed energy resources.

5. Protecting consumers

6. Stakeholder expectations, perceptions and relationships

7. The strategic baseline review

8. Examples of important areas the Authority has deprioritised/delayed, which include:
    a) keeping the Code current
    b) wholesale market reconciliation at 30-minutes
    c) the updating the regulatory settings for distribution networks work programme
    d) the Future Security and Resilience work programme, where not all activities on the roadmap are currently being progressed
    e) compliance education, and
    f) network pricing.

Table 4: Allocation of the Authority's costs by grouped regulatory function in 2021/22 and 2022/23

Breakdown of operating costs by grouped function	**Actual 2021/22 $000**	**Actual 2022/23 $000**
Appropriation income	**77,372**	**92,073**
Function costs		
Operate the electricity system and markets (*includes third-party contracts*)	54,186	65,429
Promote market development	11,482	14,350
Monitor, inform and educate	8,558	9,178
Enforce compliance	3,146	3,116
Total function costs	**77,372**	**92,073**

Source: Electricity Authority "Business Case: Enabling a Consumer-Focused Transition, October 2023". Here it notes: i) The Authority's costs have been attributed to its core regulatory functions, as detailed above. The funding for its 'protection of small consumers' function is incorporated into the other four functions as the additional objective was only added last year. ii) The underlying methodology allocates personnel and external costs being directly attributed to the appropriate function, but where this is not possible then those costs are treated as overheads, e.g. office rent costs or support staff costs. Overheads are then allocated across our functions based on an appropriate underlying measure e.g. full-time employee numbers.

3. Funding options developed by the Authority

The Authority sets out four options largely covered in the executive summary and economic and financial cases. We summarise the funding sought under each option as well as under the status quo for 2024/25 below. The Business Case discusses the benefits in terms of additional, more timely, or more researched outputs/engagements and reductions in risk as more funding is provided in progressive options in the economic case (we discuss this further in section 4) and refers to the high-level expected outcomes in the executive summary.

The Business Case does not explicitly consider funding in subsequent years but implicitly assumes the 2024/25 level stays the same, noting under option 4 phased onboarding could allow for savings of around $6 million in 2024/25 from the level presented. Given this, we focus on presenting funding levels for 2024/25 and comment on phasing and inflation in service provider contracts in section 4.

Below we highlight from the Business Case:

- a summary of funding for service providers and the Authority's operations (with associated FTE) under the status quo and the Authority's different funding options (Table 5)
- a detailed breakdown of where funding would be directed under each option relative to the status quo from the Financial Case of the Business Case (Table 6)
- a breakdown of the staffing increases associated with each option (Table 7), and
- how funding under each option aligns with the Authority's grouped statutory functions (Table 8).

3.1 Summary of the Authority's funding options

Table 5 shows overall funding would increase from $100.8 million currently (as in 2023/24) to between $108.4 million (7 per cent increase) and $133.8 million (33 per cent increase) under options 1 to 4. Of this, service provider costs would increase by 11 per cent under all options and the Authority's costs would increase by between 0 per cent and 85 per cent under options 1 to 4.

Table 5: Summary of the Authority's funding options

	Status quo	Option 1	Option 2	Option 3	Option 4
Service provider costs	$70.4m	$78.0m	$78.0m	$78.0m	$78.0m
Increase on 2023/24 ($m)		$7.6	$7.6	$7.6	$7.6
% increase from 2023/24		11%	11%	11%	11%
Authority costs	$30.4m	$30.4m	$36.9m	$46.9m	$55.8m
Increase on 2023/24 ($m)		$0.0	$6.6	$16.5	$25.4
% increase from 2023/24		0%	22%	54%	84%
Total FTE	132	132	157.5	196.0	231.5
Increase on 2023/24 (FTE)		0	26	65	100

	Status quo	Option 1	Option 2	Option 3	Option 4
% increase from 2023/24		0%	20%	49%	76%
Total GMO funding in 2024/25	$100.8 m	$108.4m	$115.0m	$124.9m	$133.8m
% increase from 2023/24		7%	14%	24%	33%
$ increase from 2023/24 ($m)		$7.6	$14.1	$24.1	$32.9

Source: Electricity Authority "Business Case: Enabling a Consumer-Focused Transition, October 2023

3.2 Breakdown of spending under each option

Table 6 provides a more detailed breakdown of the costs under each of the options relative to the status quo in 2023/24. It shows, of options 2 to 4, where the Authority's operating costs progressively increase, this is mainly driven by the increase in FTE and to a lesser extent external support for network pricing and future security and resilience and increases in office space. The increase in service provider costs is the same across all options and the Business Case states is driven by inflation Negotiations Negotiations contractual discussions Negotiations, and current procurement processes for two contracts Negotiations

Table 6: Breakdown of spending under each of the Authority's options ($m)

	2023/24 Status quo	2024/25 Option 1	2024/25 Option 2	2024/25 Option 3	2024/25 Option 4
Authority's operating costs					
FTE costs	16.035	16.035	20.225	26.696	32.287
Overheads based on (FTE)	14.344	14.344	15.990	18.533	20.730
External support (Network Pricing)		0	0.615	0.805	1.685
External support (FSR)		0	0	0.100	0.300
Other fixed costs (office space)		0	0.100	0.750	0.750
Total for Authority operations	**30.379**	**30.379**	**36.930**	**46.884**	**55.753**
Service provider costs					
System operator	47.065	Negotiations			
Service provider - clearing manager	3.128				
Service provider - wholesale info and trading system	1.942				
Service provider - reconciliation manager	0.990				
Service provider - registry	0.778				

	2023/24 Status quo	2024/25 Option 1	2024/25 Option 2	2024/25 Option 3	2024/25 Option 4
Service provider - FTR manager	0.908	Negotiations			
Service provider - depreciation and amortisation	1.199				
Service provider - IT costs	0.024				
Market making	14.400				
Total service provider costs	**70.434**	**77.988**	**77.988**	**77.988**	**77.988**
Total appropriation	**100.813**	**108.367**	**114.917**	**124.871**	**133.740**

Source: Electricity Authority "Business Case: Enabling a Consumer-Focused Transition, October 2023 (pages 103-104)

3.3 Breakdown of staffing under each option

Table 7 shows the breakdown of current staffing by business unit of the Authority, which would not change under option 1, and how many additional FTE are added to each team progressively under each of options 2 to 4. We note resourcing increases progressively across all teams under options 2 to 4, totalling an additional 25.5 to 99.5 FTE. We discuss the support staff to policy staff split in section 4.5.

Table 7: Current and incremental additional FTE by team under each of the Authority's options

	Current state	Option 1	Option 2	Option 3	Option 4
Market Operation Policy + Real Time Pricing	8.4	0	2	2	2
Wholesale Market Competition	13.4	0	1	2	1
Future Security & Resilience	6.2	0	1	1	1
Consumer Care	6.0	0	1	3	5
Distribution regulatory reform	5.2	0	2	4	3
Network Pricing	7.0	0	2	3	4
Legal	8.5	0	2.5	1.5	3
Compliance	12.5	0	3	3	3
Monitoring	14.3	0	1	4	4
Organisational Performance & Delivery	11.7	0	1	3	1
System Operator oversight / commercial	6.6	0	1	1	1
People & Capability	8.0	0	2	2	1
Data & Information Management	10.6	0	2	3	1
Communications & Engagement	9.6	0	2	3	1

	Current state	Option 1	Option 2	Option 3	Option 4
Office of the CE	4.0	0	0	1	3.5
New Market Policy Team	0.0	0	2	2	1
Incremental new FTE compared to prior option	**0**	**0**	**25.5**	**38.5**	**35.5**
Total increment to FTE from current state	**0**	**0**	**25.5**	**64.0**	**99.5**
Accumulative total FTE	**132.0**	**132.0**	**157.5**	**196.0**	**231.5**

Source: Electricity Authority "Business Case: Enabling a Consumer-Focused Transition, October 2023 (page 13)

3.4 Funding by grouped statutory function under each option

Table 8 reconciles the Authority's current and proposed funding under the Authority's options 1 to 4, with the groupings of the Authority's statutory functions it uses in its SOI. This highlights the significance of the 'operate the electricity system and markets' component, which includes associated service provider costs and Authority operating costs. Hence it is the only line to increase under option 1 but also increases further under options 2 to 4 despite no stated increase in service provider costs. Funding for all other grouped functions increases progressively with each subsequent option.

Table 8: Spending by grouped regulatory function under the Authority's options ($m)

	Current state	Option 1	Option 2	Option 3	Option 4
Promote market development	11.2	11.2	14.1	18.0	22.4
Monitor, inform and educate	6.1	6.1	7.2	9.4	10.8
Protect the interests of small consumers	4.1	4.1	5.0	6.8	8.4
Operate the electricity system and markets	75.8	83.4	84.3	85.0	85.5
Enforce compliance	3.6	3.6	4.4	5.7	6.7
Total Authority costs	**100.8**	**108.4**	**115.0**	**124.9**	**133.8**

Source: Electricity Authority "Business Case: Enabling a Consumer-Focused Transition, October 2023 (page 14). The Authority has attributed expenditure to its grouped regulatory functions consistent with the groupings under its Statement of Intent as discussed in the Business Case. The allocation methodology attributes personnel and external costs directly to the appropriate function where directly linked, but costs which do not have a direct link are treated as overheads, e.g., office lease or support costs. The Authority has allocated overheads to its grouped regulatory functions based on what it considers an appropriate underlying measure (e.g., FTE).

4. Key considerations relating to these funding options

In its introduction, the Business Case notes it has followed the intent/structure of the Better Business Case (BBC) framework rather than strictly following the BBC guidance. We agree it would not meet the usual BBC requirements despite the improvements made particularly to the strategic case since the earlier draft we were provided. However, given our scope of engagement, we focus below on key considerations in relation to the funding options the Authority has presented and/or where there appear to be choices and the potential for different ways of doing things. This includes:

- marginal benefits/benefits realisation
- prioritisation, efficiencies and ways of working
- service provider costs
- the timing of costs
- the roles of support and policy teams, and
- managing the proposed scale of change.

4.1 Marginal benefits/benefits realisation

The Business Case generally draws the benefits for each option based on the stronger strategic case of the opportunity for the industry rather than the marginal impact of additional activities or areas of focus possible with additional funding. The options progressively expand the size of each team across the organisation, mostly to deliver more or faster on planned projects than prior options. The Business Case then shows spending by grouped statutory function (looking across service provider and the Authority's internal operating costs).

However, it is not clear what the marginal benefits of each option are and how benefits will be realised. The references to the expected gains from transformation of the energy system do not address the Authority's role such that potential benefits realised from the costs under each option could be considered. For instance, during our strategic baseline review a number of those we interviewed suggested that they (and, as a result, wider consumers in New Zealand) faced costs from regulation not keeping pace in terms of requiring sub-optimal solutions. This suggests a marginal benefit of maintaining a fit-for-purpose code would be the reduction in these costs through allowing alternative solutions (rather than a portion of benefits from decarbonisation). However, it is unclear under which (if any) of the funding option(s) these benefits would be realised. Similar exercises would be necessary to determine the marginal benefits of other activities proposed with the new funding.

Furthermore, the benefits realised from the investment as a result of the 2023/24 levy increase, which allowed the Authority to grow its staff by 30 FTEs, means there is a risk of double counting benefits from further increases in staff (if the existing increase is able to achieve the benefits), or not getting further benefits but simply asking again, next year, for the same sorts of increases. The only way of knowing this would not be the case would be to more clearly identify the marginal benefits under each option and how these are to be realised.

4.2 Prioritisation, efficiencies and ways of working

The prioritisation criteria used in the options assessment in the Business Cases are about alignment with the strategic case, economic case, commercial case, financial case, management case and our strategic baseline review. These aspects of alignment do not particularly help decision-makers, as they are applied to four funding scenarios, which are about general increases in the Authority's cost structure and associated outputs without clarity on the associated marginal benefits.

The Business Case states:

- the opportunities for efficiencies were considered but would require further investment, and
- efficiencies may be possible under funding options involving greater funding increases.

As noted in our strategic baseline review, we agree certain efficiencies could require upfront investments for the resulting efficiencies to be achieved. However, given the potential payoff, their relative priority may be worth further consideration, particularly if a longer-term view is taken beyond 2024/25.

Related to this, it is unclear whether potential changes to ways of working have been considered, which we would usually expect before funding of the level suggested is sought. Changes in ways of working have the potential to reduce funding pressures and, in some cases, improve effectiveness/stakeholder perceptions, but could present tough choices. As examples of the kinds of changes that could be considered:

- Changes in the way industry experts, working/advisory groups, industry engagement and the approach to the use of external advice may involve different levels of cost, timing, practicality, and engagement. More specifically, we have observed a commendable increase in engagement already occurring by the Authority (e.g. resuming regulatory managers updates, providing industry updates, and intending to consult on its workplan alongside its levy funding proposal again). The Business Case suggests this has occurred with only a small increase in support teams, which raises the question of whether increases in policy and support teams are needed to achieve the likes of reducing the gap between the industry's expectations and perceptions of the Authority. However, we note further consumer engagement may be an extension beyond that currently though, and the extent of this will also need to be a choice.
- Changes in the roles of support teams. For instance, during our strategic baseline review we were told the legal team was involved in policy issues alongside policy teams throughout the process. It was noted this assisted with joint understanding of context and was felt to produce better results. This could well be a very sensible approach given the Authority's role in relation to the Code; however, we note in many other government agencies, the legal team is specifically engaged for targeted legal advice/services and note this would be another model or way of working that we would expect to be considered prior to seeking additional funding.

Further, the funding sought is heavily project-based. We suggest funding options try to consider the right size and organisational structure to deliver an ongoing workplan of projects into the future (noting this may require further work on a medium-term regulatory strategy and organisational plan).

That is, most agencies have topics they would like to explore and develop medium-term workplans, consistent with an overarching strategy, which comprise a mix of business as usual and specific projects balancing areas that must be done and those the organisation may like to do, with some aspects not able to be progressed. We note the Authority has helpfully added information on areas it has chosen to deprioritise given its constraints, and we note prioritisation will always be required and simply suggest the fit of specific projects within a longer-term focus be considered given the Authority's statutory objective and functions. As picked up in the next section, this suggests specific focus on developing the Authority's medium-term regulatory strategy and prioritisation framework.

The Business Case highlights a focus on building internal capabilities and its expectation for this to result in efficiencies by way of reduced consultancy spend, setting out criteria for when it would engage consultants.

4.3 Service provider costs

Under all options in the Business Case, service provider costs increase by $7.6 million in 2024/25 and then remain at this level. This is driven by:

- inflation Negotiations
- contractual discussions Negotiations
- current procurement processes for two contracts Negotiations

However, we note there are options in relation to service provider costs. These include:

- requiring inflation to be offset by efficiencies (at least when contracts are renewed) or if this is not considered possible, recognising beyond 2024/25 further inflation-related increases are expected (noting the Authority may be expecting to address this as part of the following year's levy consultation), and/or
- not increasing for contractual requests beyond those where current procurement processes may indicate progressing without further funding is not possible.

We note with contracts with a technical or information technology base, these would typically be structured to enable surplus available for capital and systems refresh without further recourse to the levy. However, the Business Case suggests further funding to resource the Authority to extract value from service provider contractual arrangements (page 45). Further, it would be useful to clarify whether additional services may be required/expected under latter options (and if this has been costed in) and we suggest opportunities to combine service contracts or procure them differently could also be considered (as touched on in our strategic baseline review). At the least, there needs to be an open book examination of service providers' cost pressures.

4.4 The timing of costs

As with efficiencies, we appreciate the Authority has added a section to its Business Case on trade-offs, phasing and scaling following our feedback on an earlier draft. This focuses on:

- it being difficult to tell when the transition to a net zero emissions economy may be complete (if prior to 2050), and

- other than for option 4, any delay in paying for the envisaged additional FTE would be offset by recruitment costs.

We acknowledge these points and this may be the case in 2024/25. However, we would find it useful to consider for the additional areas where funding is sought, which relate to/are driven by:

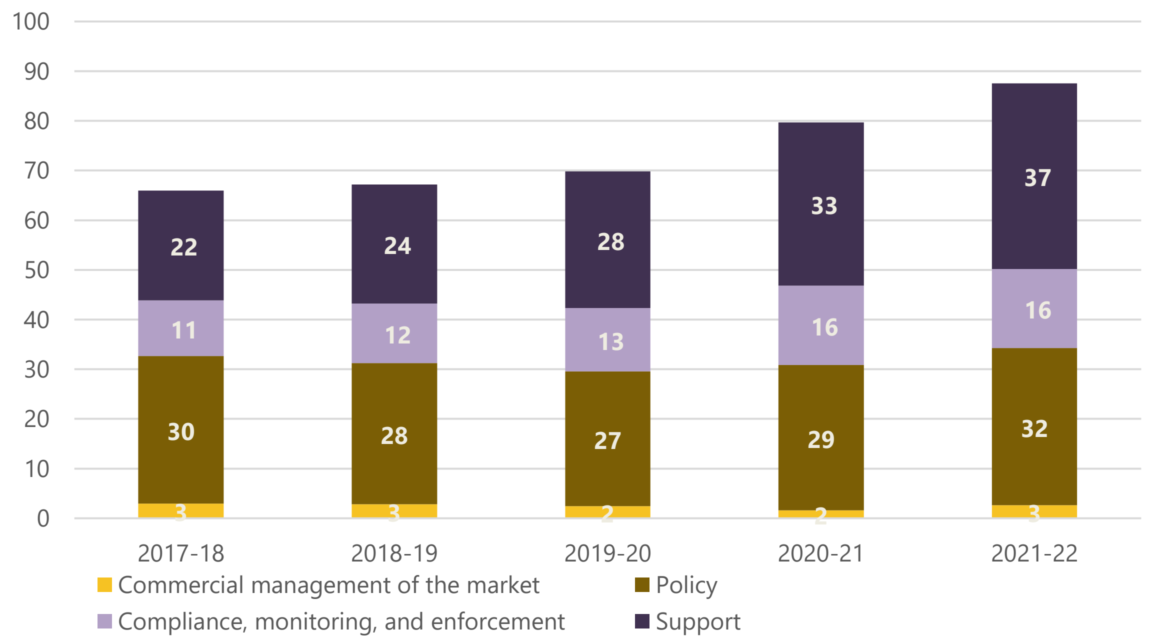
- areas where pressures have pent up and a one-off shift is needed
- one-off relative to ongoing activities
- areas where pressures are likely to continue/increase into the future.

For instance, we suggest our proposed work on a medium-term regulatory strategy and associated prioritisation framework could be considered as an initial one-off exercise that would be of value and would not necessarily require an ongoing increase in staffing. However, a one-off shift in funding may be needed to address any back-log of proposed Code amendments (noting this may take some time to complete), while funding a wider level of consumer engagement and resuming the regular process of Code amendments are likely to be ongoing pressures. Funding associated with the transition to a net zero economy may involve a combination of these (one-off and ongoing/increasing pressures).

4.5 The roles of support and policy teams

The Business Case options involve increases in FTE in support functions, which was an area our strategic baseline review highlighted has grown the most between 2017/18 and 2021/22 (see Figure 2) and which the Business Case states received a small level of increase in 2023/24. While the Business Case highlights the challenges of benchmarking, our strategic baseline review also highlighted the Authority's costs per FTE exceeded those we did compare with.

Figure 2: The Authority's annual average FTE counts from 2017/18 to 2021/22



Source: The Electricity Authority

Table 9 shows the proposed increases in support roles relative to overall FTE increase under the Business Case options using the categorisation of business units falling under support in our strategic baseline review. This includes legal, organisational performance and delivery, people and capability, communications and engagement, and the office of the Chief Executive (but we have not included data and information management, which would increase the number by an additional two, three, and one in options 2-4). This shows these support functions currently account for 32 per cent of FTE and would account for between 27 per cent and 29 per cent of FTE increases under options 2 to 4 (with no increase in FTE under option 1).

Table 9: Support FTE and increments to it under each Business Case option

	Current state	Incremental additional FTE under each funding option			
		Option 1	Option 2	Option 3	Option 4
Legal	8.5	0	2.5	1.5	3
Organisational Performance & Delivery	11.7	0	1	3	1
People & Capability	8.0	0	2	2	1
Communications & Engagement	9.6	0	2	3	1
Office of the Chief Executive	4.0	0	0	1	3.5
Total support/increment in support (as per our strategic baseline review)	**41.8**	**0**	**7.5**	**10.5**	**9.5**
Total incremental FTE	**0**	**0**	**25.5**	**38.5**	**35.5**
Total FTE	**132.0**	**132.0**	**157.5**	**196.0**	**231.5**

As identified above under efficiencies and ways of working, we suggest it is worth understanding the relative roles across different teams and whether different ways of working have been considered in order to avoid any risks of untargeted/unprioritized spending based on a current structure and operating model, despite work noted in the Business Case as underway to ensure the structure and broader operating model are fit for purpose. As part of this, we acknowledge it will be important to note certain elements of this "support" category need to be considered in the context of the Authority's role (and responsibility for secondary legislation), and changes discussed above in relation to its statutory objective that are likely to influence its level of external engagement.

We would also be interested in understanding the degree to which an organisational strategy that has some dynamic, floating resource to deal with the emerging issues at pace has been considered rather than a generally upscaling of existing teams. We suggest this may warrant consideration given:

- work has not yet been undertaken on the medium-term regulatory strategy and associated workplan applying a related prioritisation framework
- the proposed increases in resourcing have not been clearly justified in terms of marginal benefits
- the unclear evidence all work required would be ongoing, and

- many of the activities identified are projects that, once complete, should become business as usual.

We understand that this is something the Authority may consider but its focus is on attracting and retaining skilled permanent staff and it would not want this to be simply a short-term solution or increase its consultancy spend.

4.6 Managing the proposed scale of change

As noted above, the strategic case in the Business Case is the strongest part of the Business Case and has been strengthened since the original draft we commented on. However, the commercial and management cases are much lighter. We discussed the service provider component above and suggest the feasibility and management of such a scale of increase in FTE at a time when the Authority is likely to also pursue changes in the way it operates following the strategic baseline review also warrant consideration.

The Business Case notes the Authority already has work underway looking at its organisational structure and framework. Beyond discussion of this, the management case focuses on recruitment, skill needs and team leadership. We suggest the feasibility and impacts of the scale of growth proposed by the Authority also be considered.

In broad terms, staffing at the Authority has increased from around 100 to 130 over the last year, and the Authority's preferred option is to increase this further to 196. It is worth highlighting this level of change is also likely to create challenges in managing culture, coordination and role clarity (linked to the point above around support and policy staffing), people and project management, decision-making and delegations. If latter options were to be pursued, we would encourage these aspects to be considered further as part of managing the change. The Authority has informed us it is cognisant of these matters and believes it is well placed to manage this level of change.

5. Areas we recommend the Authority prioritises under any funding option

Following discussions in earlier sections, we recommend the funding options developed by the Authority be considered in the context of the discussion in section 4 and, irrespective of funding, the Authority prioritise:

- developing a medium-term regulatory strategy and associated prioritisation framework
- considering its ways of working in light of this
- progressing recommendations from our strategic baseline review.

5.1 Medium-term regulatory strategy

Consistent with our original strategic baseline review, we recommend, within any funding path, the Authority prioritise developing a medium-term regulatory strategy (based on a clear intervention logic) and associated prioritisation framework. These could be considered as discrete activities under any option and in fact should inform what activities are undertaken and how for any funding option, and as such could be considered as a one-off cost as it could be provided without additional FTE.

5.2 Ways of working

Following the work proposed above and in light of the recommendations from our strategic baseline review, we suggest the Authority consider its operating model and ways of working to ensure it effectively and efficiently progresses its medium-term regulatory strategy and delivers its statutory obligations and statutory functions in the context of the drivers of change highlighted in section 2.

5.3 Progressing strategic baseline review recommendations

Consistent with the above, we recommend the Authority continues to prioritise addressing key areas of improvement and recommendations in our strategic baseline review. This includes in relation to funding options:

- developing a long-term strategic outlook, medium-term regulatory strategy and prioritisation framework with associated levers/approaches
- improving the maturity of key relationships and collective responsibility
- clarifying the production costing for key activities (how resourcing from across teams contributes to key outputs and activities)
- understanding how activities will be delivered differently and the short and longer-term cost and expected outcome implications of this. This includes what will be delivered jointly with other parties and what the funding implications are. An input-output or Intervention/Investment Logic Mapping exercise could help link this with the medium-term regulatory strategy.
- understanding the benefits and key risks associated with funding activities to different levels.

References

Electricity Authority. (2022). *2022/23 and 2023/24 Levy-funded Appropriations*. https://www.ea.govt.nz/assets/dms-assets/30/Final-2022_23-and-2023_24-levy-funded-appropriations-consultation-document1375503.1.pdf

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