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Hon. Dr. Megan Woods
Minister for Energy and Resources
Parliament Buildings
Wellington
c/- Vanessa Head, Private Secretary (Energy & Resources)

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By email:

energymarkets@mbie.govt.nz

Dear Minister

Electricity Price Review's proposed terms of reference

Thank you for the opportunity to provide comments on the Electricity Price Review's proposed terms of reference (ToR).

Contact is an integrated energy company and important part of the energy mix in New Zealand, operating efficiently to safely provide electricity and gas to homes and businesses across the country. In addition to this letter we attach Contact's fact sheet which outlines our well established positions on a number of matters relevant to this review.

The ToR will benefit from greater clarity; What problem is the review trying to solve?

It is not clear from the ToR what the Government believes is the problem or, put another way, the question the Government wants to answer.

Contact encourages the Government and MBIE to be as clear as possible on their objectives, starting with the problem definition. The clearer these are, the more effectively stakeholders will engage with the process and the better the outcomes of the review will be. Importantly the definition of "fair and equitable" will require thoughtful consideration. As we discuss below we believe the electricity sector has an important leading role to play in delivering a lower carbon future for New Zealand. We believe "fair and equitable" should consider the intergenerational benefits that can be delivered through this lower carbon future.

There are many plaudits that the market works; any review should improve the market, not work against it

In Contact's view, New Zealand has a world-class electricity system which is the envy of much of the developed world.

Just last year the International Energy Agency described New Zealand as:

"a world-leading example of a well-functioning electricity market, which continues to work effectively".¹

In addition to this New Zealand has been ranked:

- fourth for energy security amongst the top 25 energy users in the world²
- in the top 10 of 125 comparator countries and the best performing country in the Asia-Pacific region³ by The World Energy Council's 2017 Energy Trilemma Index, which ranks countries on how well they achieve the energy 'trilemma' balance of security, equity and sustainability.

New Zealand has real opportunities to meet the Government's goal of 100% renewable electricity and to help New Zealand move the broader energy sector (transport, industry and electricity) to a low carbon future; but the market needs the right settings

Contact is 100% behind the Government's goal of achieving 100% renewable electricity by 2035⁴. Contact believes it is also possible for New Zealand to achieve even greater carbon reductions by that date through electrification of transport and industry.

Contact believes there is a significant opportunity for the review to look at what needs to be done to support the transition to a low carbon economy, including a clear strategy and stable and sound policy and regulation to help New Zealand meet not only its 100% renewable electricity targets, but to take a world-leading position and transition the broader energy sector.

Investors will be required to help New Zealand meet its climate change ambitions, multiple reviews are destabilising

In order for New Zealand to reach its 100% renewable electricity target, or indeed go further and help transform the energy sector, significant investment will be required.

If the proposed 12-15 month Government review, going back to 1999, proceeds this could adversely impact on the Government's low carbon goals and slow down New Zealand's ability to harness its great renewable energy opportunities as major investments do not typically occur in uncertain environments.

The Government should be mindful of the impact of such a review (based on the proposed broad ToR) on investor sentiment and how this sits with the Government's broader economic and environmental goals.

Any review should be focused on the future

The future of the electricity market is a bright one with increasing innovation, increasing customer engagement, high levels of competition, and the potential to deliver a lower carbon economy. The review should focus on how business, Government and industry can work together to achieve this future for the benefit of all New Zealanders now and in the long term.

¹ Energy policies of IEA countries, New Zealand 2017 review, p13

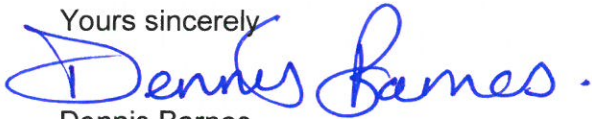
² <https://www.bec.org.nz/projects/bec2050/media/new-zealands-energy-system-ranked-fourth-most-secure-in-the-world>

³ <https://www.bec.org.nz/news/media-releases/nz-ranked-in-top-10-in-global-energy-comparison>

⁴ In a mean hydrological year

Please contact Louise Griffin should you wish to discuss this feedback at Louise.Griffin@contactenergy.co.nz.

Yours sincerely



Dennis Barnes
Chief Executive



Q&A

Question	Answer
<p>Who is Contact Energy?</p>	<p>Contact is an electricity retailer to over 560,000 customers and generates around 20% of New Zealand's electricity needs. Contact has around 67,000 shareholders. Contact shares are widely held with no controlling shareholder. Many of Contact's shareholders are mum and dad retail investors, as well as the many hundreds of thousands of New Zealanders who maintain ownership of Contact through their investments in Kiwisaver funds.</p>
<p>What is Contact's view of the current electricity system?</p>	<p>In Contact's view, New Zealand has a world-class electricity system which is the envy of much of the developed world and it is important that the review does not jeopardise or undermine the fundamentals of a market which is clearly delivering for customers, the national economy and the natural environment.</p> <p>Just last year the International Energy Agency (IEA) described New Zealand as:</p> <p><i>"a world leading example of a well-functioning electricity market, which continues to work effectively".¹</i></p> <p>The New Zealand electricity market is also highly competitive:</p> <ul style="list-style-type: none"> • Retail electricity prices have been falling in real terms² • New Zealanders now have a choice of over 40 retailers, a number of whom have new product offers not seen in New Zealand before • New Zealand has been ranked fourth for energy security amongst the top 25 energy users in the world³ • The World Energy Council's <u>2017 Energy Trilemma Index</u>, which ranks countries on how well they achieve the energy 'trilemma' balance of security, equity and sustainability ranked New Zealand in the top 10 out of 125 comparator countries • In the same Trilemma Index, New Zealand ranked as the best performing country in the Asia-Pacific region, and the only non-European country in the top 10.⁴ • Statistics New Zealand's 2015-16 household expenditure survey shows electricity is 2.9% of average weekly household expenditure – the lowest proportion of household budgets since 2000-2001.
<p>Does Contact think there is merit in a review?</p>	<p>Contact believes yet another review into the electricity system will only be of value if it focuses on the right areas. Such a review should focus on ways to ensure the electricity system is fit for the future, and how we can meet the Government's 100% renewable electricity targets and transform the entire energy sector to a lower carbon future.</p>
<p>Should the review focus on lines companies?</p>	<p>Contact recommends that the review focus on the future, specifically:</p> <ul style="list-style-type: none"> • What is required to support the Government's goal of achieving 100% renewable energy by 2035, and even greater carbon reductions more generally, including the ability to deploy our

¹ Energy policies of IEA countries, New Zealand 2017 review, p13

² <https://www.ea.govt.nz/about-us/media-and-publications/market-commentary/market-insights/real-residential-energy-prices-reduce-for-the-second-year-running/>

³ <https://www.bec.org.nz/projects/bec2050/media/new-zealands-energy-system-ranked-fourth-most-secure-in-the-world>

⁴ <https://www.bec.org.nz/news/media-releases/nz-ranked-in-top-10-in-global-energy-comparison>

	<p>renewable resources to decarbonise transport and business, for example, through electric vehicles and the conversion of manufacturing processes from fossil fuels to low carbon, renewable energy.</p> <ul style="list-style-type: none"> Ensuring the regulatory settings for investment in new technologies promote the best long-term outcomes for consumers and ensure a level playing field between all possible suppliers of new energy technologies. <p>In 2017 the New Zealand Government asked the International Energy Agency (IEA) to undertake a special examination of the distribution sector as part of this in-depth review, with a focus on the sector's ability to respond in a timely, efficient and cost-effective manner to these emerging challenges.</p> <p>The IEA completed their report in 2017. Contact is broadly supportive of the recommendations of the IEA. Including that the Government:</p> <ul style="list-style-type: none"> “Direct the New Zealand Productivity Commission to review the electricity distribution sector, with a view to identifying opportunities to improve its productivity, flexibility and its capacity to more effectively respond to the challenges posed by the potential transformation of the sector. This includes examining the sector's structure, governance and options to encourage the development of more integrated regional management, operation and development of distribution networks. Enhance the regulation of all distribution services, including: Further developing incentives for the procurement of demand response, energy efficiency services, distributed generation and other local network management resources, where it is prudent and cost-effective to do so and where it may serve to accelerate the development of an efficient and innovative retail sector.” <p>One way of achieving the IEA's suggestions would be to include these recommendations in the scope of the review</p>
<p>What are Contact's views on some of the key terms proposed to be used in the ToR?</p>	<p>Contact understands from the draft ToR that the review will examine whether the price paid by end consumers for electricity is “fair and equitable”.</p> <p>Contact believes it is essential for clarity from the outset that the terms “fair” and “equitable” are clearly and explicitly defined, including the metrics by which these terms will be measured. A “fair and equitable” system should consider the intergenerational benefits that can be delivered through the lower carbon future the Government and Contact seek. We urge the Government to look at this through a long term lens.</p>
<p>What is Contact's view on the proposal to look at the market since 1999?</p>	<p>Since the electricity market was established in its current form in 1998, the sector has been subject to five major reviews⁵. Given the number of reviews which have been undertaken since 2000 and that the period since the establishment of a competitive market has been well canvassed, Contact also questions the need for a review to go back to 1999 and suggests any review is future focused and / or focused on the period since the last review i.e. 2009.</p>
<p>What are Contact's thoughts on a review</p>	<p>Contact has been vocal for many years that the LFUC no longer achieves its objectives and delivers benefits to those who need them least without</p>

⁵ 2000: Electricity Industry Inquiry, 2006: Electricity Market Review, 2008: Review of Electricity Market Design by the Electricity Commission, 2009: Announcement by Commerce Commission of findings from review of Wolak report, 2009: Ministerial review of electricity market

<p>of the low fixed user charge (LFUC)?</p>	<p>supporting those who would most benefit from the regulation. Contact supports the review looking at the impact of the low fixed charge and a focus on the role and effectiveness of current regulatory structures. The effect of the current low fixed-charge option, while well intentioned, has been to reduce the cost of electricity for low-use, rather than low-income, households. The result being a subsidy for people with second houses, dual fuel and smaller households that use less electricity.</p>
<p>What is Contact's view about how future technologies should be dealt with in the ToR?</p>	<p>Contact strongly supports the review considering the ability of the current regulatory market to respond to emerging technologies and believes this is one of the areas where the review must focus in order to deliver value. For this reason we also believe the input methodologies (IMs) must also be considered in any review.</p> <p>For many years the electricity industry has been viewed as having stable, predictable technology with reasonably clear delineations between the different segments of the supply chain, enabling a clear distinction between monopoly and competitive service providers. This position is now changing.</p> <p>These structural industry changes are creating important issues for the regulation of the electricity industry both in New Zealand and abroad. The key issue being that traditional monopoly conveyance services are now facing competition from new technologies like batteries and solar.</p> <p>The review should ensure the regulatory settings for investment in new technologies promotes the best long-term outcomes for consumers and ensures a level playing field between all possible suppliers of new energy technologies.</p> <p>Emerging technologies fall into a class of technologies that deliver fundamentally competitive activities.</p> <p>Not only does the opportunity to review the IMs arise infrequently in the legislation, as Contact has set out in a number of submissions to the Commerce Commission over the last 12 months, but the ability of networks to include the likes of batteries and solar within their regulated asset base risks significantly distorting competitive markets. This is an area in which the concept of fairness is arising, and one which the review should address in its ToR.</p> <p>By way of example, concerns across the sector are arising from the fact that:</p> <ul style="list-style-type: none"> • Assets (such as batteries or solar) can be included in the regulated asset base if a regulated business considers they are required for regulated purposes – a guaranteed rate of return is then achieved on those assets which others are not able to realise with such certainty • Regulated suppliers may not have incentives to realise the full value of investments in emerging technologies for consumers • Regulated suppliers may be able to earn additional returns from assets included in the regulated asset base (e.g. from ancillary services) without consequential adjustments to the permitted regulated returns, and • The <i>de minimis</i> thresholds and other flexibilities in the cost allocation input methodology is likely to shift costs onto customers of regulated suppliers. <p>There should also be greater focus on the importance of non-transmission solutions and the information disclosure required in order for parties other than Transpower or networks to provide these services.</p>
<p>What are Contact's views on data collection?</p>	<p>As MBIE already collect the key components of retail electricity prices, including how they have changed over time and how they compare internationally, it is unclear why they are to be included within the ToR.</p>

	<p>On the matter of historic analysis of data, Contact notes that in the email accompanying the ToR MBIE noted <i>"the Government has decided that it will undertake a review of electricity prices to investigate whether the electricity market, as it exists at present, is delivering a fair and equitable price to end-consumers..."</i> given this, and the significant number of detailed reviews which have been undertaken since the market's inception, Contact see no reason to go back to 1999 and recommends a much later exclusion date.</p>
<p>Does Contact have a view on how ROACE is defined and calculated?</p>	<p>Yes. Given the ToR proposes to focus on the financial performance of suppliers across the supply chain, including gross and operating profit, return on capital employed, return on average capital employed and variation in price for different customer segments, the ToR must spell out how ROACE is defined and calculated, and the terms 'gross and operating profits' as clarity around these terms will be critical from day one of the study.</p> <p>Contact requests that it provides all materials to the study on a financial year basis in order to ensure consistency between data provided and previously reported external data and results.</p> <p>A consistent approach to asset valuations will also be critical to effectively comparing ROACE.</p>
<p>Does Contact have a view on the input methodologies being out of scope?</p>	<p>In recent years the energy (unregulated) component of residential electricity prices has fallen while over the same period, the transmission and distribution (regulated) component has increased.</p> <p>Contact therefore strongly opposes the input methodologies (IMs) being out of scope and fails to see how a review could meet its own ToR and assess the following matters (contained earlier in the terms of reference) absent a review of the IMs:</p> <p><i>the ability of the market and regulatory system to enable and benefit from emerging technologies and innovation in business models, and the likely impact on prices.</i></p> <p><i>the role of emerging technology and the impact on prices, and how this may affect different customer groups.</i></p> <p><i>the current regulatory environment and its ability to respond to emerging technologies.</i></p>
<p>Does Contact have any other thoughts on the ToR?</p>	<p>It is important to Contact that its obligations to the financial markets (particularly in New Zealand and Australia) are considered at all times. We ask that, in advance of MBIE publishing or releasing any material that includes information obtained directly or indirectly from Contact, the company is given an opportunity to review the material for commercial or financial market sensitivity.</p> <ul style="list-style-type: none"> • In particular, Contact points to its continuous disclosure obligations to the NZX and ASX which, if Contact is to become aware of potentially material information, must come before any considerations to the review. • Contact requests that all material it releases or provides for the purposes of this review be treated as confidential and commercially sensitive under the Official Information Act. • Given the importance of getting such a review right, we also ask that sufficient time is given to industry participants. <p>Contact encourages MBIE and the Government to take time and set this review up properly from the outset with suitably qualified advisers, open communication and time.</p>

