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Ministry for Business Innovation and Employment

Via email: energymarkets@mbie.govt.nz

Draft Terms of Reference – Electricity Price review

Mercury welcomes and appreciates the opportunity to comment on the proposed Terms of Reference (ToR) for the Government's Electricity Pricing Review.

Mercury is an electricity generator and retailer providing energy services to homes, businesses and industrial customers throughout New Zealand. We have a long heritage in renewable energy in New Zealand serving about 1-in-5 homes and businesses under the Mercury brand and other specialty brands. We also have proven capability and technical expertise in smart metering services and solar. Our goal is to be the leading energy brand in New Zealand, inspiring our customers, owners and partners by delivering value, innovation and outstanding experiences.

Pro-competitive reforms have delivered a world leading electricity market

New Zealand's electricity market has been subject to a number of policy reforms under different governments which have progressively improved its performance. A common and important feature of previous reviews has been the Government's desire to improve market signals and remove barriers to entry to promote competition, rather than attempt to promote specific technologies or business models. This has placed New Zealand in a highly favourable position internationally with the International Energy Agency (IEA) recently noting New Zealand is "a world leading example of a well-functioning electricity market, which continues to work effectively."¹

Mercury considers the principles of promoting competition and technological neutrality should be included in the ToR. The performance of New Zealand's electricity market should be compared and contrasted with other international jurisdictions in terms of these attributes.

Focus on material future benefits for consumers

Given the high performing nature of the electricity market we consider there is scope for the EPR to identify early the areas of greatest net benefit for consumers. Given the broad terms of reference, we support the Government's proposed staged approach where a fact base is established to determine subsequent review priorities. Linking to credible and relevant international benchmarks and datasets, such as those from the IEA and the World Energy Council Trilemma Rankings as well as domestic analysis, (for example the series of reports from Concept Economics on the impacts of emerging technologies²) will be essential.

In Mercury's view, the EPR will be of most productive value for consumers if it focuses on those policy settings that will deliver material future cost savings rather than a retrospective analysis of historic pricing drivers. We set out our views below on these priorities.

¹ International Energy Agency Review of New Zealand (2017) <https://www.iea.org/countries/membercountries/newzealand/>

² Concept Economics – New Technologies Studies Parts 1 – 3 available from <http://www.concept.co.nz/publications.html>



Priority Areas for the Electricity Pricing Review

More efficient distribution pricing signals

We consider the review is well timed with emerging technologies like distributed solar generation, battery storage and electric vehicles set to radically shift the ways consumers engage with their electricity supply and drive significant household energy savings. For example, at the equivalent of 30c/L of petrol, renewable electricity offers the potential for substantial transport cost savings as well as wider economic and social benefits to New Zealand through a transition to electric vehicles. Given such benefits, Mercury has consistently advocated that the Government should implement a renewable energy rather than renewable electricity target.

Consistent with the pro-market approach from successive governments to date, there is no need to directly subsidise emerging technologies but rather focus on getting the policy settings and price signals right so that investment decisions in emerging technologies are efficient and deliver positive social outcomes.

One key area of focus for the EPR should be on the impacts of current distribution pricing structures on future electricity prices to consumers. If current non-cost reflective distribution pricing structures persist there is the potential for significant inefficient investment (estimated at \$1.8bn over a 20 year period³) in emerging technologies. This will drive costs to the most vulnerable electricity consumers who are unable to make investments in emerging technologies and will instead be forced to bear a disproportionate share of the remaining distribution network costs avoided by those consumers who can.

We are very pleased to see the inclusion of the LFCT in the review given the strong consensus across the sector and the IEA in its recent country review of New Zealand, that this requirement is leading to regressive outcomes for consumers and undermines the Government's climate change objectives. Mercury considers reviewing the LFCT should be a priority initial focus for the EPR particularly given more targeted support for vulnerable consumers has recently been introduced through the Government's Winter Energy Payment scheme.

Ensuring competitive outcomes for investment in emerging technologies

Creating a level playing field for emerging technologies by ensuring distributors are not able to inefficiently cross-subsidise between regulated and competitive investments should be another priority area for the EPR. Mercury supports clarity being provided to consumers early so they can have confidence such cross-subsidisation is not occurring. Effective ring fencing arrangements such as those that have been implemented in the United Kingdom and Australia should be considered as part of the EPR.

Mercury also considers that the historic provisions allowing distributors to retail electricity should be reviewed. These provisions were put in place at the start of the competitive market as a backstop in case retail competition did not develop and did not envisage the rise of distributed technologies. With significant competition now evident in retail markets these provisions are no longer required and risk undermining further competition developing in retail electricity markets and the markets for distributed technologies.

While Mercury assumes emerging technology issues like these are in scope based on the wording of section 5 of the ToR it would appear that issues related to the input methodologies are excluded. This would appear to create a conflict so further clarity would be welcomed as to how such issues are to be addressed.

Distributor consolidation is also an issue that has received considerable attention, particularly given concerns as to the ongoing financial viability of smaller distributors with the rise of alternative supply options to the monopoly network. Mercury considers such issues should be in scope of the EPR particularly given this was identified as an issue in the recent IEA review of New Zealand. This should also include an assessment of whether investments in unregulated business areas not related to the core distribution business are efficient.

³ http://www.concept.co.nz/uploads/2/5/5/4/25542442/new_technologies_economic_report_v2.0.pdf



Mercury would like to acknowledge the strong engagement by both the Electricity Authority and Commerce Commission on the above issues and working towards more effective regulatory arrangements. This work is ongoing and we see the EPR as an important forum to further advance the debate and complement the existing regulatory programme.

Transmission Pricing Reform

Further clarity would be welcome as to whether it is the intent of the EPR to include wider issues related to the ongoing reform of the Transmission Pricing Methodology (TPM). The regional distribution aspects of transmission pricing appear in scope of the ToR but given the current TPM has been subject to extensive scrutiny, consultation and even litigation it could be considered to be excluded.

Related government policy measures

It is also important to note that many of the factors affecting the costs, rather than the price, of electricity to households are unrelated to the electricity sector. One main example here is the energy efficiency of housing stock. The Government's Healthy Homes package has introduced much more targeted and effective ways to improve the efficiency of the rental housing stock as well as target financial assistance for the most vulnerable consumers. Mercury supports this approach rather than blanket measures that potentially distort merchant and consumer investment signals in the electricity market. The EPR should consider how these initiatives and complementary policy settings outside of the electricity sector will impact on consumer electricity costs in the long run and whether in fact they may offer greater net benefits and may be a more appropriate focus for reform.

Conclusions

Mercury considers the terms of reference should reflect the following:

- Maintain the pro-competitive and technology neutral approach that has characterised previous reviews and placed New Zealand's electricity market in its current world leading position;
- Focus on what measures and policy settings will enable material savings for households in the future rather than on historic factors and include credible international benchmarks and domestic analysis;
- Consider how the current broad scope of the review could be narrowed to focus more on priorities that will deliver the greatest net benefits for consumers such as reviewing the LFCT; ensuring that network and consumer investments in emerging technologies are least cost and efficient by reforming distribution pricing and ensuring network regulation promotes a level playing field for competition;
- Provide further clarity as to what issues are out of scope given apparent overlaps, specifically around emerging technologies and transmission pricing; and
- Consider the positive impact of related government policy measures on the consumer electricity costs such as energy efficiency.

Yours sincerely



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