



MAJOR ELECTRICITY USERS' GROUP

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Andy Hume
Manager Energy Markets
Energy Markets Policy Team
Ministry of Business, Innovation & Employment
By email to energymarkets@mbie.govt.nz

Dear Andy

Electricity price review draft terms of reference

1. This is a submission from the Major Electricity Users' Group (MEUG) to the Ministry of Business, Innovation & Employment (MBIE) on the draft terms of reference (TOR) for an electricity price review.¹
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Some members may make separate submissions.
3. Broad periodic reviews of the electricity sector are useful provided they are:
 - Comprehensive;
 - Evidence based; and
 - Open and accessible.
4. Suggested improvements to the draft TOR to better meet these criteria follow:
 - Improvements to make the review comprehensive**
 - a) The TOR should be clarified to explicitly state that, for the purposes of the review "end-consumers" includes all residential, industrial and commercial users. Otherwise this leaves open the possible interpretation the review is only of retail household costs and prices, which would not represent the comprehensive review the TOR implies the Government is seeking.
 - b) The draft TOR includes the impact of vertical integration². Consistent with the review being comprehensive, horizontal integration should be considered alongside the effects of vertical integration. There are two examples of horizontal integration the review should consider.

¹ MBIE emailed an invitation for submissions on the draft TOR on 20 December 2017.

² Draft TOR paragraph 3, bullet point 1.

First the effects of electricity suppliers moving into the telecommunications market and vice versa. Second experience to date of actual and possible problems constraining future horizontal integration in the regulated electricity distribution services market.

- c) The draft TOR includes “the regional distributional aspects of transmission pricing.”³ To be comprehensive MEUG recommends that text be revised to “the regional distributional aspects of distribution pricing including transmission pricing.” The inclusion of distribution pricing is important because, apart from very large customers connected directly to the grid or sub-transmission networks, most customers have distribution charges that incorporate re-bundled Transpower charges.
- d) MEUG is unclear how extensive the draft TOR exclusion of Input Methodologies (IM) and “issues that have already been subject to extensive scrutiny, consultation and litigation” in relation to Part 4 of the Commerce Act will be. We see the effectiveness of Part 4 as being one of, if not the most important, policy parameters for a comprehensive review of an electricity pricing review. New Zealand has a unique approach with:
- i) some monopolies subject to Default Price-Quality Price (DPP), Customised Price-Quality Price (CPP) and Individual Price-Quality Path (IPP) regulation;
 - ii) all monopolies subject to information disclosure; and
 - iii) IM used as a common foundation for selected processes and regulatory parameter assumptions, with selected Commission decisions appealable by way of merit review.

There has never been a review of the effectiveness of this regime since it was promulgated in 2008. The review need not canvas details of the IM such as the appropriate asset beta in estimating the regulated Weighted Average Cost of Capital (WACC). However, the use of IM as a foundation in the existing Part 4 framework and Part 4 as a whole should be part of the review.

Improvements to the evidence basis for the review

- e) In the draft TOR section headed “Information collection”, mention is made of financial performance information that may be analysed. We support evidence based analysis though are cautious on the metrics suggested because of problems in sourcing comparable data across all suppliers. Such problems became apparent with the review of petrol fuel supplier margins.⁴ We look forward to participating in the review to provide views on metrics that might be used.

Ensuring an open and accessible process for the review

- f) The draft TOR notes “the review will determine its own process, but is expected to involve wide consultation on issues and draft findings.”⁵ We agree with this pragmatic approach. MEUG note that over 2018-19 there are several important and resource intensive workstreams we, other customers and parties in the supply chain will be engaged on including:

³ Ibid, paragraph 4, bullet point 3.

⁴ <http://www.mbie.govt.nz/info-services/sectors-industries/energy/liquid-fuel-market/fuel-market-financial-performance-study-2017>

⁵ Draft TOR, paragraph 7.

- i) The DPP reset.
Electricity Distribution Business (EDB) regulated revenues, net of transmission charges passed through, are approximately \$1.7b pa.⁶ A 1% change in future DPP settings will result in a \$17m pa change in EDB costs to customers.
- ii) The IPP reset.
Transmission charges to EDB and grid connected large industrial customers are approximately \$834m pa.⁷ A 1% change in future IPP settings will result in an \$8m pa change in transmission costs paid directly by customers.⁸
- iii) A review of Powerco & Wellington Electricity Lines Ltd (WELL) CPP decisions.
The draft Powerco CPP decision proposes an increase in charges to customers of 4.4%.⁹ We think there are lessons from these applications that will require changes to the CPP regime before other applications are lodged.
- iv) Default Distribution Agreement including distribution and transmission pricing.
Distribution contract terms and conditions are at the heart of what customers can expect in terms of line services, what they must pay and the rights and obligations of EDB and customers. Work on a default distribution agreement (DDA) is complex and resource intensive; though necessary to avoid monopolies using their ability to dictate contract terms and conditions.
An important contract term is pricing. Approximately 27% of distribution charges to households are transmission charges.¹⁰ Hence to ensure fair (customers pay cost-reflective prices matching the service they want) and equitable (customers delivered equivalent services pay the same price) monopoly charges, both distribution and transmission charges need reviewing.
- v) Real-Time-Pricing (RTP)
The Electricity Authority (EA) have estimated the NPV for RTP to be \$53m with upper and lower-case estimates of \$114m and \$19.¹¹

It is important MBIE collaborate with the EA and Commerce Commission to minimise conflicts in consultation timetables and ensure industry resources are not diverted away from the above high value topics.

5. We look forward to participating in the review.

Yours sincerely



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Executive Director

⁶ MEUG estimate.

⁷ Ibid.

⁸ Customers will indirectly pay a share of transmission charges paid by generators connected to the grid.

⁹ Commerce Commission draft decision, Powerco's proposal to customise its prices and quality standards, 16 November 2017, paragraph 12, <http://www.comcom.govt.nz/dmsdocument/15880>.

¹⁰ EA, Electricity in New Zealand, January 2016, p7, <https://www.ea.govt.nz/dmsdocument/20410>.

¹¹ EA consultation paper, RTP proposal, 1 August 2017, p iv, <https://www.ea.govt.nz/dmsdocument/22389>