31 January 2019

Dane Gunnell
Acting Manager, Price-Quality regulation
Commerce Commission
By email to regulation.branch@comcom.govt.nz

Dear Dane

EDB DPP3 reset cross-submission

1. This is a cross-submission by the Major Electricity Users' Group (MEUG) on the submissions of other parties that closed 20 December 2018 in relation to the Commerce Commission's EDB DPP3 reset issues paper.[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. NZIER advised MEUG that increasing revenue at risk from 1 to up to 5 percent would exacerbate the existing mismatch between the value of reducing outage duration to different classes of consumers, irrespective of the EDB they are connected to, and different historic trend-based quality thresholds for each EDB. We welcome several distributors also opposing the proposal to increase revenue at risk from 1% to up to 5%. NZIER's advice continued:

   > "Instead, the revenue at risk percentage set as an incentive to improve reliability and the cap/collar should be set for individual EDB so that they match the benefit to customers indicated by VoLL."

   We look forward to seeing the comments of other parties in cross-submissions on this additional part of NZIER's advice.

4. The preceding paragraph concluded with NZIER's advice to link quality improvement incentives with the benefit to similar types of customers affected by outages from having improved quality. By similar types of customers, we mean not just the usual household, commercial, industrial and rural classes, but also within those classes such as for households, those living in areas with materially different local network low voltage (LV) characteristics. An alternative or complementary mechanism considered in the Issues Paper to shift quality performance from a one-size-fits-all to a more targeted approach for similar types of customers was a Guaranteed Service Level (GSL) scheme. We are unsure if there is agreement on what a GSL scheme might look like and how that might differ from existing service charter payment schemes. Neither do we understand if current or any proposed compensation schemes for loss of or poor service delivery leads directly to lower

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[1] Refer Issues Paper, Default price-quality paths for electricity distribution businesses from 1 April 2020 published 15 November 2018. Submissions at https://comcom.govt.nz/regulated-industries/electricity-lines/electricity-lines-price-quality-paths/electricity-lines-default-price-quality-path/2020-2025-default-price-quality-path?target=documents&root=111927

returns to EDB shareholders', or those costs are simply recovered by an uplift in the revenue path across all other customers. The incentive effect of the former relative to the latter and comparison with how non-performing businesses are affected in workably competitive markets should be an important consideration.

5. Some EDB do recognise that the nature of engagement with consumers for regulated line services will need to evolve as new technology changes consumer expectations just as they are across most other sectors of the economy. For example, Unison noted (p1):

> "Regulators and consumers are expecting EDBs to engage more deeply on electricity supply issues and use digital communication channels to help manage or enhance the customer experience (e.g., outage communications to mobile devices)."

6. Similarly, FTI Consulting for Vector noted (slide 63) regulators needed to consider:

> "The value that customers place on specific service EDBs provide. A link between EDB service and value that customers place on it is the most powerful principle for setting incentive parameters."

7. MEUG suggests a key topic for possible future Commission DPP3 reset workshops is to consider if, how and when distributors might change from a one-size-fits-all to a more targeted approach for similar types of customers that links service levels with the value those customers place on that service.

8. The preceding paragraphs focussed on the most important issue, in our view, for the DPP3 reset being the evolution of the quality thresholds including linkages in performance/non-performance to an EDB's price path and linking that to the quality needs of similar types of customers. Meridian Energy's submission provided a helpful reminder that the regulatory framework, including that for the key issue for us of evolving the quality regime, must align with and be shown to be consistent with how a workably competitive market would work. MEUG agrees with the submission of Meridian (p2):

> "In the light of this and as a general comment Meridian is concerned that the Issues Paper does not place sufficient emphasis on alignment of distribution sector outcomes with those occurring in competitive markets. The Issues Paper states the Commission will balance the section 52A(1)(a) to (d) outcomes and exercise judgment in doing so, but does not appear to acknowledge that each of those outcomes needs to be pursued to a degree consistent with that which occurs in competitive markets. In other words, it is not enough, for example, that distribution businesses have some degree of incentive to pursue efficiency, or that they have some incentive to share efficiencies, or that they face some limitations in their ability to make excessive profits. The Commission's task – a difficult task as the Court observed - is to ensure those incentives and limitations are sufficiently strong that they produce outcomes consistent with what would be observed in competitive markets."

9. The balance of this cross-submission comments on some other matters of detail:

   a) Vector suggested differentiated cost indices to reflect in some cases materially higher costs in Auckland compared to the rest of New Zealand. MEUG agrees in principle that where there are likely material different expected future costs for different parts of New Zealand that different cost indices should apply. The mechanics of deciding when an expected cost differential is material or not should be developed to guide adding new indices and removing existing indices. MEUG would be concerned if, as a result of the DPP thresholds being based on national average cost forecast indices with wide standard errors that, some EDB could not practically meet price-quality thresholds and reasonably satisfy the needs of customers and shareholders, therefore forcing a choice between continuous breach of the thresholds or applying for a CPP.

Adapting the DPP regime to better reflect major differences between regulated EDB was also considered by Powerco (pp5-6) under the heading "Is there a gap in the regulatory framework around significant and unforecastable opex?" MEUG is supportive of incremental changes to the DPP regime to reflect differences between price-quality regulated EDB provided information disclosure and analysis, including more timely publication of summary benchmarking of performance (annually rather than after a DPP) by both EDB and the Commission. Powerco in its submission to the Electricity Price Review proposed large distributors shift to an IPP. Given uncertainty with the effect of emerging technologies our preference is to keep the regulatory regime for EDB as flexible as possible and therefore more adaptable to future uncertainties. Therefore, we prefer to modify and tailor the more light-handed DPP regime rather than shift distributors to an IPP or rely on use of a CPP. On reflection the outcomes of the Powerco CPP may well have been achieved at lower cost by tailoring the DPP than using the CPP process.

b) ENA recommended fire service levies should be passed through because those are expected to increase, and those increases are uncertain. MEUG is not convinced distributors are sufficiently different from non-regulated entities affected by changes in fire service levies, the quantum of value sufficiently large, or increases are inevitable given the fire service restructuring was announced based on efficiency savings and those may might materialise over DPP3. Hence, we do not support those being treated as an explicit pass-through.

c) ENA stated (p3 of second submission):

> "Electricity networks in New Zealand are performing well, by international comparison as well as when compared against their historical performance. The large majority of customers have their electricity connected and available for more than 99.9% of the time, and in many parts of networks most customers see less than one interruption per year. By industry standards the levels of customer complaints or disputes about the service provided by EDBs are also very low."

MEUG agrees with the intention in the opening part of ENA's submission to compare New Zealand's EDB performance against comparable international peers. It's difficult to make comparisons of EDB performance within New Zealand let alone with international peers. Nevertheless, the cost of doing so may be less than the value to consumers to know how they fare compared to similar consumers overseas. ENA provide no analysis to support the above view on how we compare internationally. The independent verifier for Transpower's IPP proposal published a helpful comparison of Transpower's performance with overseas peer transmission companies. MEUG suggests the Commission and ENA jointly prepare a similar benchmark analysis for distributors.

Yours sincerely

Ralph Matthes
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