

24 February 2020

Dr James Tipping
Electricity Authority
By email to strategy@ea.govt.nz

Dear James

EA Strategy Reset 2020 – emerging themes consultation

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Authority (EA) discussion paper "Strategy development - Working draft emerging themes" dated 7th February 2020.¹
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Some members may make separate submissions.

Use NPV to prioritise EA focus and avoid using nebulous measures for outcome themes

3. We agree the five draft outcome themes are important. They are new to the EA's thinking. They are not just a way of classifying outcomes the public wants. They can also be used to define broad categories of factors to be considered in how a policy problem is described, options collated and ranked and preferred options implemented. In other words, the themes are not just important for assisting focus on outcomes but also on the factors in the external environment that need to be considered.
4. There is nothing particularly important in the descriptors used for the list of themes and the themes could have been grouped and listed in other ways. For example, "Zero-carbon Aotearoa" and "Consumer centric" could have been collapsed into the holistic descriptor "well-being." The important observation, in our view, is the draft five themes encompass both the external factors to be considered by the EA for analysing issues and in considering outcomes in a system wide approach.
5. Another important observation in the paper is (p10) "Our existing key strategic directions – improving price signals, reducing barriers, improving customer participation, and increasing flexibility and resilience – are still fundamental building blocks for achieving these system outcomes." We support retaining these key strategic directions.

¹ <https://www.ea.govt.nz/about-us/strategic-planning-and-reporting/strategy-reset-2020/>, document URL
<https://www.ea.govt.nz/dmsdocument/26339-strategy-development-2020-emerging-themes-discussion-paper>.

6. The difficult work is quantifying in Present Value terms (and in some complex cases, probability weighted or by use of scenarios) the multiple factors and different cost and benefit flows under each of these themes so that a comparison of options can be made on a Net Present Value (NPV) basis, decisions made and post-implementation reviews of decisions undertaken.
7. There is no mention in the paper of shifting away from using NPV for national cost-benefit-analysis (CBA) as the primary decision tool. Neither is there acknowledgement quantitative CBA remains the gold-standard for decision making. We suggest the EA state clearly it has an aversion to using nebulous measures for the outcome themes.
8. In support of MEUG's preference for quantifying problems and making decisions on quantitative analysis we refer the EA to MEUG's submission on the review of the Crown Minerals Act in January 2020. In that submission we discussed MEUG's support for Treasury's work on a Living Standards Framework (colloquially referred to as "well-being") and noted Treasury's emphasis that the Living Standards Framework is a tool to assist policy thinking but must be accompanied by quantitative analysis to assess options:²

No need for additional well-being concepts in the CMA

11. Figure 2 in the discussion paper titled "Wellbeing in the regulatory systems for Crown Minerals" is a helpful summary of how the CMA intersects with other legislation to provide a matrix covering the four capital stocks of financial and physical capital, human capital, social capital and natural capital. Those four capital stocks are at the heart of Treasury's thinking on a Living Standards Framework as "an aide for policy advisors" and to assist Treasury measure and meet its departmental vision of "higher living standards for New Zealanders."⁶
12. The possibility of changing the CMA to require consideration of the Living Standards Framework or four capital stocks misses the point of the Framework. The Framework is a tool for developing policy advice and is being continuously improved by Treasury. It should already be part of every government policy analysts' toolbox. Financial and physical capital is the most important of the four capital stocks for decisions required under the CMA and therefore conventional business cost-benefit-analysis techniques are most relevant. Treasury remind users of the Framework that considering the effects of a proposed policy change on the four capital stocks does not excuse policy advisors from concluding their analysis with a quantitative assessment of the benefits and costs:⁷

"When projects have many different benefits, the Living Standards Framework can help you think through the different aspects, and illustrate the gains from doing it, and the synergies or trade-offs of the different options.

This, of course, needs to be accompanied by the assessment of the value of these gains and the costs involved."
13. MEUG therefore does not support a change to the CMA that includes reference to the four capital stocks that are the foundation of Treasury's evolving thinking on a Living Standards Framework, colloquially referred to as "well-being".

9. Finally, to reinforce the risk of the draft outcome themes being misunderstood or hijacked by biased advocates because of nebulous measures of success, MEUG has concerns with some of the "loose" narrative in the paper and the EA Strategy reset 2020 web page. For example, with text underlined by MEUG:

² MEUG submission to MBIE, 27th January 2019 at <http://www.meug.co.nz/node/1049>

- The web page states, “Stakeholders have asked us to lead the sector, listen more and set the narrative to move beyond electricity to energy and social outcomes.”
- “With an increased focus on wellbeing and social equity, affordability of electricity is another key aspiration.” (discussion paper p11).

Perceptions of what social outcomes and social equity mean will differ widely within and between the public, politicians and market participants. There is a risk the discussion paper may have set expectations by some parties that the EA intends to have an activist role to achieve social outcomes and social equity. To avoid this risk the EA should consider keeping abreast of the Treasury work on the Living Standards Framework (a.k.a. “well-being”) as it is an evolving and disciplined policy framework to assist policy makers quantify and understand interrelationships of issues with difficult to assess benefit and cost flows.

De-carbonisation is a factor to consider not a goal

10. The Zero-carbon Aotearoa draft outcome theme is a factor to consider and not an absolute goal. MEUG’s submission on the EA draft appropriations for next year noted the risk of unintended consequences of blindly setting a de-carbonisation goal:³

c) Throughout the discussion paper are phrases such as “decarbonisation challenges”, “a transition to a low-emissions economy” and “preparing for a low-carbon future.” Those phrases encompass two themes.

First, an expectation that electrification of the economy will grow and that will bring challenges of more infrastructure and cost, and reliability as some renewables are variable. As noted in paragraph 5. B) iii) above the future will need both renewable and non-renewable generation. Literally de-carbonising the electricity sector may be counter-productive to the wider aim of adapting at least cost the whole economy to climate change effects.

Second, a wider government programme to transform the economy through a managed transition.

The former is directly within the scope of the Authority and the latter needs to be considered but is not within the primary jurisdiction of the Authority. MEUG suggests using “climate change challenges” might be a more neutral phrase and would clearly encompass the physical generation supply and electricity infrastructure build challenges the Authority’s programme should focus on.

Ever improving capability to quantify measures of success, undertake sophisticated quantitative analysis and post-implementation reviews are needed

11. Empathy and connectivity with and cultural awareness by the EA of consumers, market participants, service providers, and government are all important. They should be considered business-as-usual attributes subject to continuous improvement. There is no evidence the EA, relative to any other Crown entity or government department, has a fundamental failure with any one or collectively all those attributes.

³ MEUG to EA, 3rd December 2019, page 2, at <https://www.ea.govt.nz/dmsdocument/26341-meug-submission-202021-levy-funded-appropriations>

12. MEUG's concern is the EA's capability to keep abreast of the ever-increasing demand for more complex quantitative analysis and to do so at speed.
13. As noted in paragraph 7, in our view quantitative CBA remains the gold-standard for decision making. The complexity and rigour required to undertake a robust CBA has been tested in the TPM guidelines review. More complex CBA are likely in the future.
14. Since 2013 we have learnt that maximising expected national net consumer and supply surplus in partial equilibrium CBA is insufficient when there is a material difference in benefits parties receive relative to costs that needs to be considered because transition and political costs and risks are important. The review of TPM guidelines is a good example. This is an increasingly common issue across all policy making. Another example for MEUG is the difference between who pays and who benefits from the EECA levy on electricity users. Our expectation is that more granular data and analysis, even to the level of similar groupings of consumer or market participant (e.g. regional and or income bracket), will become the new gold standard to assess distributional effects where those are material.
15. NPV is not a tool though for continuous market monitoring. In that case other metrics are useful such as the Herfindahl-Hirschman Index (HHI) or Economic Value Added (EVA).⁴ Each metric has its pros and cons depending on the intended use. In an ever increasingly data rich environment, development and implementing new monitoring tools and monitoring metrics is critical for the EA as regulator and facilitator of improvements to both the electricity market and the whole electricity supply chain (i.e. includes the line monopolies and system operator statutory monopoly).
16. Finally, the EA should be more reflective of decisions taken so that lessons can be learned to improve future decision making. The EA has to date proven adept at undertaking some complex post-implementation reviews such as the national market for instantaneous reserves in 2019, retail data project in 2018, save protection scheme in 2017, dispatchable demand in 2017, prudential requirement changes in 2017, demand side bidding and forecasting in 2016.⁵ We expect post-implementation reviews will become more not less complex in the future. Notably, after three post-implementation reviews in 2017, there have been only one per year since. If there is value in learning lessons from post-implementation reviews, then the frequency and speed of undertaking those needs to lift. Hence our suggestion that capability in quantitative analysis is a future strategic issue.

Yours sincerely



Ralph Matthes
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⁴ EVA is not a metric the EA have adopted to date; though MEUG believes it should be considered and has recommended that to the EA, refer MEUG to EA, 3rd December 2019, pp 3-4, at

<https://www.ea.govt.nz/dmsdocument/26341-meug-submission-202021-levy-funded-appropriations>

⁵ Post-implementation reviews found at <https://www.ea.govt.nz/monitoring/enquiries-reviews-and-investigations/>.