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Dear Miriam

Electricity Price Review – Options Paper

Thank you for the opportunity to comment on the Electricity Price Review (EPR) Options Paper. We congratulate the Panel and Secretariat for its efforts on the review to date.

We see the EPR as an opportunity to put the customer at the centre of the industry, underpinned by the strong foundations of governance, innovation and transparency. This in turn will facilitate significant improvements in affordability, customer choice, fair pricing and the uptake of new technology. Innovation is critical to ensuring a just transition to a zero-carbon economy as well as ongoing system resilience in the face of challenges such as climate change and population growth.

In the spirit of the Panel's call for bold solutions, which we strongly support, we set out below our four bold areas of focus.

1. Customer

We support the Panel's intention to put the customer at the centre of industry and government decision-making. However, we believe it is fundamental that data analytics, as are used in other modern businesses, form a basis of transparency and enable the proposed Consumer Advisory Council (the Council) to identify customer trends and behaviours. The Council needs to be targeted in its focus on championing the interests of customers, and understanding customers is critical to this. Seeking to solve issues which impact customers in a complex market, without this evidence base, leaves the Council exposed to industry and regulatory capture and reliance on out-dated assumptions and methodologies which have not served customers well.

Sophisticated data analytics capability – in line with the approach of other service industries and increasing customer expectations - will enable both the Council and industry to move the dial on better decision making, through early identification of trends and challenges. Vector would be happy to share its extensive data analytics experience and capability with the Council, once it is established.

2. Governance

The criticality of the electricity and gas sector is rapidly increasing. This is a time when the electricity sector needs strong governance to navigate the complex, cross-cutting issues and opportunities of the future. These include decarbonisation, the convergence of the transport and electricity sectors, distributed generation, and the changing role of the customer in our electricity market. As we navigate this change, we need to re-organise ourselves around the customer and ensure that the sector's governance is strongly informed by robust evidence.

The Options Paper discusses the need for high-level coordination, an objective we strongly support. We recommend that an equally bold approach is needed for the energy sector – the establishment a **new Ministry of Energy**. This would bring together relevant parts of the Ministry for the Environment, Ministry of Business, Innovation and Employment, as well as the Ministry of

Civil Defence and Emergency Management to address the interdependencies between workstreams which are focused on the zero-carbon economy, electric vehicles, resilience and growth, economic development and energy hardship.

We note that the State Services Commission's (SSC's) plans to reform the State Sector Act are also calling for a more agile, issues driven, and cross-government approach to policy decision-making, as exemplified by the new Ministry of Housing and Urban Development.

We also advocate for a more streamlined approach to regulation. We continue to believe that the Electricity Authority's (EA's) jurisdiction to regulate electricity networks should be transferred to the Commerce Commission (the Commission), and the idea of a single industry regulator should also be examined closely. In addition, there needs to be balanced accountability mechanisms for both Government and industry, including an extension of the current scope of merits review, and a regular, independent review of regulators' performance. EDBs are internally accountable to their boards and shareholders (who in many cases are also customers), and externally they are accountable to customers and regulators through price-quality regulation and disclosure obligations. The role of regulators is just as critical to the governance of the sector and should be subject to equally stringent oversight.

However, strong sector governance is about much more than the right structural frameworks and accountabilities. In these times of change, just as important is having the right skills and competencies, as well as the right culture – one which puts customers and data-driven evidence at the heart of decision-making.

We recognise that changes to institutional governance and culture will take time. It is therefore imperative that the Panel takes steps in the short term to address priority areas where the regulatory system is failing to deliver. Foremost of these is the Transmission Pricing Methodology (TPM) review, which has fallen well short of regulatory best practice in almost every respect. The Panel's proposal to introduce a Government Policy Statement (GPS) on transmission pricing should be implemented without delay, and the EA should be given a clear direction to cease all further work on its TPM review until it is provided with the GPS.

To assist with the Panel's consideration of a transmission pricing GPS, Vector has commissioned a draft set of principles from Compass Lexecon, an international firm with global experience in this sector. The full report can be found attached to this submission at Appendix 1, but in summary, transmission prices should:

- Be simple, practicable and understandable to sector participants
- Allow recovery of sunk costs in the least distortionary manner, via a postage-stamp charge spread evenly across network users (including loads and generators)
- Make beneficiaries of new transmission investments internalise the cost of such investments to promote efficient choices between relying on existing assets or expanding the network
- Introduce regulatory changes incrementally to minimise regulatory uncertainty, without altering the rules of the game for existing investments in network or other assets; and
- Avoid creating price shocks that may threaten affordability of end-users or have material distributional effects.

We also see merit in introducing a GPS for distribution pricing. This should explain that the Government sees pricing reform as necessary for facilitating the transition to a new energy future, while also acknowledging the need to balance customer interests in simplicity, fairness, and minimising bill shock alongside economic efficiency. In the context of increasing distributed

generation and two-way electricity flows, it should also clarify that distribution system costs need to be shared across all users of the networks.

Finally, clearer guidance is needed on how the Commission's rules are enforced, particularly in relation to breaches of distribution price-quality standards.

3. Affordability

We strongly support the Panel's emphasis on affordability and customer hardship, as outlined in section B of the Options Paper, as well as the measures proposed in Section C to improve retail competition. We know that a large portion of our customers in Auckland live in energy hardship, and, as a majority customer-owned EDB, our customers' interests are our interests.

However, to have real impact, initiatives to reduce electricity prices need to focus on the true drivers of those prices. As the Panel noted in its initial paper, the largest portion of a customers' residential bill is comprised of generation and retail costs (51% of the total bill in 2018), while the percentage attributable to distribution is 25% – less than half as much. Moreover, customer-owned EDBs redistribute a large share of their profits to customers – in 2018, Vector's majority shareholder Entrust paid a \$350 dividend to 331,000 households and businesses in the Entrust district. This equates to two months free electricity each year for the average Aucklander.

Affordability is another area where data analytics can play a key role, by increasing understanding of consumption behaviours to inform strategic energy efficiency interventions which have long-lasting impact. We believe that interventions which lead to permanent energy savings should be prioritised as these deliver greater return on investment and have greater impact, than one-off payments to customers.

Whilst we support customer driven energy efficiency measures, we need to address the real drivers of cost to impact on prices in a meaningful way. It is therefore essential that competition in the wholesale market is functioning effectively. Unfortunately, there is clear evidence that this is not the case. Vector supports the package of wholesale market reforms proposed by the Panel, and views these proposals as the absolute minimum steps necessary to restore confidence and transparency in the market. However, we are concerned that the proposals do not go far enough in addressing market power concerns.

We are disappointed that the Panel appears to have dismissed the findings of Dr Steve Poletti at the University of Auckland showing significant market power rents in the wholesale market (up to \$6 billion over seven years, representing 35-40% of total wholesale revenue). Unfortunately, Dr Poletti's analysis and conclusions have been widely misunderstood and misrepresented by the large gentailers and the EA. In particular, the argument that Dr Poletti's analysis fails to take account of the need to recover fixed investment costs is simply false – his modelling incorporates both 'infra-marginal rents' and 'scarcity rents' which enable fixed cost recovery for both existing and new plants. Generators do not need even higher prices to earn a normal rate of return on their assets, and these high prices represent a direct wealth transfer from customers to the large gentailers.

To truly shift the dial on prices, the Panel and regulators need to give urgent attention to this issue. Given the above it would seem further investigation, potentially by the Commerce Commission, should be undertaken. The Panel should also consider much bolder options for improving wholesale market performance, such as requiring operational separation of the vertically-integrated gentailers so that all contracts are traded transparently via the hedge market; reducing market concentration by transferring generation assets to a new SOE; and examining options for wholesale market re-design that have been adopted in other jurisdictions.

Achieving fair prices also requires attention to cost allocation between commercial and residential customers. Although the Panel has focused its attention on EDBs' cost allocation methodologies, current price disparities are in large part attributable to the generation and retail segment of the

bill. According to the Panel's own figures, **industrial users currently pay 8.2c per kwh** for generation and retail, whereas **residential customers pay 15.5c per kwh** – nearly double the price – for these same services¹. We cannot see any obvious reason for these glaring disparities, particularly given that many services to residential customers are increasingly automated (such as direct debit payments) and the low propensity of many customers not to switch. Again, this is an area that needs closer review by the Panel given the significant impact this differential has on customer affordability, fairness and equity.

4. Innovation

Technology and innovation will continue to disrupt the way our sector operates, and, as described above, will play a key role in ensuring that electricity remains affordable as demand, and demand peaks, increase. In parallel to the electrification of transport, our zero-carbon economy strategy will include a transition to more intermittent, climate dependent, sources of renewable generation. Vector has taken the bold step of embracing disruption while many others choose to be 'frozen in time' and preserve the status quo.

Innovation is also key to ensuring resilience in the face of growth. The population of Auckland is projected to increase to 1.9 million by 2025². Distributed energy services will help to support this growth in a way that is sustainable and affordable, by reducing customers' reliance on centralised sources of power – an invaluable asset to our city's resilience.

The greatest driver of distribution costs is the infrastructure investment required to manage demand peaks. As EDBs (and our customers) currently bear the cost of this network investment, we have a clear and unique incentive to support distributed energy services, which can keep these costs as low as possible. Furthermore, distributed energy has a critical role to play supporting resilience, affordability, and our just transition to a zero-carbon economy. While 'behind the meter' technologies such as rooftop solar and electric vehicles are currently mainly available to customers who can afford them, a system level transition to greater distributed energy services, supported by distribution investment (rather than relying on individual customers), would benefit all users of the system.

Our energy future is uncertain and the sector is facing significant change, challenges, and opportunities. Enabling industry to meet these challenges requires a regulatory approach which is proportionate and considers opportunities for coordination and innovation alongside a traditional focus on competition. Innovation also has economy wide benefits which cannot be captured by a single firm. Along with the high-risk nature of R&D and innovation, this creates an incentive for businesses to under-invest. Enabling businesses to overcome this market failure requires a regulatory framework which enables, rather than inhibits, innovation.

We therefore do not support the proposal for legislative change to potentially restrict the ability of EDBs to invest in distributed energy services, as outlined in *F1: Give the EA clearer, more flexible powers to regulate network access for distributed energy services*. This proposal seeks to pre-emptively expand a regulatory approach which carries forward assumptions of the past, without considering the challenges and opportunities which are unique to the present and future. We also note that any expansion of regulation in this area is a matter of primary legislation, and therefore should only be undertaken based on a robust and transparent policy process (as was undertaken ahead of the structural separation of the electricity supply chain in the first place).

The role of EDBs in supporting the uptake of critical technology and innovation could, for example, be considered by the new Ministry of Energy proposed above. Options actively being considered internationally include a 'regulatory sandbox'.³ As summarised in the Imperial College of London's report, *Redesigning Regulation* "we must resist from trying to squeeze a very

¹ EPR Discussion Document, page 23.

² <https://figure.nz/chart/SJ55NQw8yzlKHUOn>

³ See <https://www.utilitydive.com/news/experiment-without-penalty-can-regulatory-sandboxes-foster-utility-innov/550950/>

exciting multi-vector future into a rigid command and control straitjacket. The current arrangements will crush innovation and also add significant cost to the consumer”.⁴

Finally, we support the panel's proposal to examine the security, reliability and resilience of electricity supply. Given the interconnected nature of the electricity supply chain, and the fact that both resilience threats and technological solutions cut across vertical segments of the market, it is essential to take a holistic approach which incorporates both macro drivers (such as climate change and cyber security) and micro drivers (such as vegetation management regulation). We believe that resilience, security and reliability is an example of a cross-cutting issue which should be considered by the proposed Ministry of Energy. This work should reflect a holistic approach to security, resilience and reliability and address both macro and micro factors related to resilience.

We look forward to working with the Panel, Government and regulatory agencies in the months ahead to implement the recommendations arising from the review.

Kind regards

A handwritten signature in black ink, appearing to read "Simon Mackenzie".

Simon Mackenzie
Group CEO

⁴ “Redesigning Regulation: Powering from the Future”, 2018, Sandys, Dr Hardy, Prof Green, Dr Rhodes. Imperial College of London.