

21 December 2012



Vector Limited
101 Carlton Gore Road
PO Box 99882, Newmarket
Auckland 1149,
New Zealand
www.vector.co.nz
Corporate Telephone
+64-9-978 7788
Corporate Facsimile
+64-9-978 7799

Electricity Authority
PO Box 10041
Wellington

Sent by email to: submissions@ea.govt.nz

Proposal to amend Electricity Industry Act to enable collection of fees

1. Vector welcomes the opportunity to respond to the Electricity Authority's (Authority) consultation paper *Proposal to amend Electricity Industry Participation Act to enable collection of fees*, dated 23 November 2012. No part of this submission is confidential and we are happy for it to be publicly released.
2. We are copying this submission to Gareth Wilson at the Ministry of Business, Innovation and Employment as it relates to a policy question which would ultimately require a decision by the Minister of Energy and Resources.
3. Vector's contact person for this submission is:
Sally Ma
Regulatory Analyst
09 978 8284
Sally.Ma@vector.co.nz

Introduction

4. The Authority is proposing that the Electricity Industry Act 2010 (Act) be amended to enable the collection of fees, by the Authority, from industry participants. The Authority is of the view that current arrangements restrict its ability to carry out its statutory functions effectively and that a mixed fee and levy funding arrangement would improve its efficiency and effectiveness. Vector would not support any proposals that would allow the Authority to raise fees with the purpose of circumventing the parliamentary appropriation process. To do so would be inconsistent with the Authority's duty as a public body to be accountable to Parliament for its expenditure.

5. In Vector's view, there is no compelling reason for the Authority to start charging fees in order for it to improve the way it functions. The Authority's own analysis recognises that it needs to reprioritise and better manage its budget and work programme. Vector **recommends** that the Authority focus its efforts on improving existing arrangements and mechanisms. For example, the Authority could set the levy in a way that creates greater transparency and direct links between levy payments and the functions/services delivered.

Vector's response to the Authority's questions

Question 1: Introduction of efficient user-pays charges

6. In principle, Vector does not object to the introduction of a user-pays charge, subject to the efficiency of such regimes.
7. Vector does not believe the Authority has demonstrated that the envisaged fee regime would offer efficiency gains warranting its introduction. For instance, a user-pays charge would involve development work to identify the beneficiaries and exacerbators for each cost, and consultation on proposed methodologies to recover the costs from the appropriate parties would be required.
8. However, the consultation paper only identifies one example of a fee the Authority is considering imposing – a user-pays charge for poor quality data. One example is not enough to demonstrate that a user-pays regime would be beneficial. The Authority has ostensibly undertaken a wider assessment of charges given paragraph 1.1.3, which states "...analysis suggests that there is a case for a range of efficient user-pays charges to fund some areas..."
9. Vector **recommends** that the Authority identify the other fees and the process by which the fees are determined and agreed with participants before further progressing its proposal.
10. Furthermore regarding the proposed fee for poor quality data, Vector disagrees with the Authority's view that an *ex-post fee* would dilute incentives for industry participants to improve behaviour. The underlying concept of a penalty (or fee in this case) is that it is imposed *ex-post* - i.e. after an action or inaction - to incentivise certain behaviour, such as deterrence. In this case it aims to deter bad quality information.
11. On this basis, Vector considers that an *ex-post fee* does provide sufficient incentive for improving information quality. For example, distributors that are subject to price-quality control by the Commerce Commission face *ex-post* fines of up to \$5 million for breaches of price paths and quality standards. The incentive effect of such fines is not lessened by their *ex-post* nature and

distributors go to substantial efforts to avoid breaching their price-quality path.

Question 2: Efficiency gains through enhanced flexibility

12. The Authority argues that conforming to the Parliamentary appropriation timeline restricts their ability to effectively carryout their functions - for example, the introduction of new services or functions need to accord with the appropriation cycle. For the avoidance of doubt, Vector would not support any legislation changes that would enable the Authority to circumvent the normal parliamentary appropriation process, including obtaining levies/fees for revenue outside of that process.
13. The Authority is not the only public body who is required to conform to this “rigid” timeline. The appropriations process is common to most public bodies by virtue of their function and revenue stream. The appropriations process incentivises public bodies to justify their work plans and expenditure to parliament and serves as an important balance to ensure appropriate and efficient expenditure. The Authority’s frustration with the cycle suggests that perhaps it should dedicate more effort to improve its planning and consideration of its work programme to cater for the cycle, rather than seeking legislative change to avoid conforming to it. The Authority acknowledges that its concerns can be addressed through *existing* mechanisms, which weakens the proposal further (paragraph 4.5.2).
14. Vector also disagrees that the Authority is significantly constrained from creating direct links between participants’ own actions and payments by those participants. Section 128 (3) – (5) of the Act provides flexibility in the method used to set the levy. Vector **recommends** that in the first instance the Authority consider setting out its levy in a way that creates greater transparency between levy payments and functions/services before proposing to amend legislation. For example, the Authority could allocate part of the levy based on the proportion of service provider costs incurred by each business in the previous year.

Vector’s other comments

Uncertainty and risk

15. Vector has previously raised concerns that the Authority appears willing to implement regulation to deliver minimal and uncertain net present value to the industry.¹ The current levy regime provides certainty of cost to industry

¹ Vector Limited Submissions to the Electricity Authority on: *Standardisation: Model Use-of-System*

participants. The levy is disclosed in the Authority's annual appropriation and work programme consultation paper - giving industry participants enough time to influence the levy and to factor it into their own budget forecasts and price setting.

16. However, under the Authority's proposal, fees could be imposed at any time during the year and could be set differently for each industry participant. The fees (and their timing) would be difficult to forecast and this will bring about uncertainty, pose risks for affected businesses and most likely increase costs for consumers. Retailers generally only change their prices once per year and may increase their prices for end consumers to cover the risk that the Authority could notify new prices during the year.
17. The uncertainty around the forecasting of fees, and hence price setting, also poses a risk to distributor's ability to comply with their price cap under the default price-quality path set by the Commerce Commission. Distributors need to forecast the amount of levies they will pay over the year. Errors in forecasting can lead to breaches of the price path. If fees are set in the way the Authority appears to intend, the ability of distributors to accurately forecast levies will be reduced, increasing the risk of breaching a price path.
18. Vector **recommends** that if fees are charged, they are charged in a way that maximises certainty for industry participants. For instance, more certainty could be created by setting fees at the same time every year, in a similar manner to how the Gas Industry Company (GIC) sets its ongoing fees.²

Comparisons with other independent Crown Entities

19. In part, the Authority relies on comparisons between itself and a selection of other independent Crown Entities (ICE) to justify its proposal. Figure 6 illustrates that 8 out of the 14 selected ICEs collect fees as well as a levy for their revenue stream (not including the Gas Industry Company). However, this is not an exhaustive list of existing ICEs.³
20. Vector finds it interesting that the Authority has chosen ICEs such as the Office of Film and Literature Classification, Drug Free Sport and the Takeovers Panel to compare itself to. The nature of these ICEs is materially different from that of the Authority; they do not govern an industry or carryout market functions, but rather respond directly or indirectly to related participants on a *needs* basis. Comparisons between the Authority and these bodies are, therefore, not very informative.

Agreements and Proposed Code Amendments, 8 September 2011, pages 14-15; *Efficient procurement of extended reserves*, 14 November 2012, page 6.

² See <http://gasindustry.co.nz/work-programme/market-administration/ongoing-fees>

³ A full list of independent Crown Entities can be found at: http://en.wikipedia.org/wiki/Crown_entity

Removing levies on Transpower and distributors

21. The Authority clearly recognises that there are parallels between its consideration of funding arrangements and transmission pricing. This is reflected in the fact that the Authority has applied a similar analysis framework for both matters (i.e. a preference for market based charging mechanisms and, failing that, a preference for charges to be based on exacerbators or beneficiaries pay approaches).
22. One desirable feature of the Authority's transmission pricing proposals is to shift from charging distributors for transmission services to charging retailers and generators. Vector considers that this approach has a number of advantages, including (most relevant to Authority funding arrangements) the reduction in the transaction costs of distributors incurring the transmission charges and then passing them onto retailers.
23. The Authority's industry levies are similarly a pass-through cost. The levies the Authority imposes on distributors are then passed through in full to retailers. Vector does not see any benefit in these arrangements. They impose unnecessary administrative costs on distributors who essentially operate as "middle-men" between the party charging a levy/fee and the consumer who ultimately bears the cost.
24. Also relevant to this matter is the approach adopted by the GIC, in which industry participants pay a retail levy and a wholesale levy. Both levies are determined in advance for the upcoming financial year and no GIC levies are imposed on gas transmission and distribution businesses.
25. Vector **recommends** that the Authority consider the option of recovering industry levies from generators and retailers, and removing levies on Transpower and distributors.

Yours sincerely,



Bruce Girdwood
21 December 2012