ERANZ SUBMISSION TO THE ELECTRICITY AUTHORITY CONSULTATION ON A DEFAULT DISTRIBUTION AGREEMENT

Code Amendment Proposal: Default Distributor Agreement

15 October 2019

Electricity Retailers' Association of New Zealand
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Summary: ERANZ supports the default distribution agreement proposal but believes existing arrangements should be allowed to continue by mutual agreement.

The Electricity Retailers' Association of New Zealand (ERANZ) supports initiatives that have long-term benefits for end consumers. A default distribution agreement (DDA) is such an initiative. Having access to a standard agreement for common services will increase competition, innovation, and the efficiency of retail markets. A DDA will reduce transaction cost for both retailers and distributors, which will benefit consumers.

Given the numbers of new entrants in the New Zealand electricity retail market, and the potential for existing retailers to expand, ERANZ wants to see all retailers provided with level playing fields across all regions. A DDA will also create equal and open access to the emerging distribution services markets.

ERANZ considers that, over time, distributors and retailers will naturally converge to the DDA, particularly as the decision to move to the DDA can be triggered by either party. However, we believe there is no pressing need for retailers and distributors who are mutually satisfied with their current arrangements to be compelled to immediately change to a DDA or an agreed alternative. Where existing arrangements already exist, the default should be that these arrangements continue unless one or both parties trigger a move to a DDA or an agreed alternative.

ERANZ responses to the specific questions raised in the consultation paper are appended to this letter.

In addition to this submission, individual retailers will have comment on the detail of DDA proposal clauses, and the practical and operational implications on their organisation's processes and systems.

ERANZ members practical experience aligns with the problems the EA has identified.

The Electricity Industry Participation Code currently requires the twenty-eight electricity distributors to negotiate Use-of-System Agreements (UoSAs) with each retailer wanting to trade on its network. The result is an unnecessary duplication of effort, higher transaction costs, lower competition, and barriers to innovation.

The problems identified in the Electricity Authority's (EA's) consultations paper align with ERANZ members real-world experience. Feedback from our members is that negotiating bespoke UoSAs requires a significant commitment of retailer resources. Too often, it is a protracted process.

The requirement to negotiate with up to twenty-eight different distributors is a barrier to entry for smaller retailers to enter the market, or for existing retailers to expand into lower populated regions across New Zealand.

The voluntary approach to improvement via the adoption of a Model-Use-of-System Agreement (MUoSA) has not worked. Although there has been positive engagement from distributors, the level of improvement has not been consistent, nor have we observed a significant increase in standardisation.

The EAs proposed default distribution agreement is a much more efficient approach.

A standardised backstop contractual approach for the provision of what is a largely common set of network services across regions is a more efficient and practical approach which should mitigate the issues identified.

We agree that the Default Distribution Agreement proposal (DDA) will:

- ✓ *Address the contractual imbalance*
  There is an underlying problem with the status quo bilateral negotiations: namely, parties have an uneven ability to influence negotiations given the natural monopoly characteristics of EDBs. Under the status quo retailers are unable to negotiate on, and distributors are not incentivised to offer, a level playing field. The imbalance is a problem for new and emerging retailers, but one that could become increasingly important as distributors begin to compete with retailers in ancillary markets.

- ✓ *Lower costs*
  The transaction cost reductions from access to a DDA will benefit both retailers and distributors - and ultimately, end-consumers.

- ✓ *Improve competition by providing a level playing field*
  The availability of a complete, well-balanced distribution agreement on all networks will significantly lower barriers to retailer entry and expansion. A codified set of core terms and a default set of operational terms for each network will ensure that any retailer looking to enter a new network region can do so quickly and on an equal footing with existing retailers. A DDA will enhance the competitiveness of the retail market – benefitting consumers.

- ✓ *Strike the right balance between standardisation and flexibility*
  A DDA can reflect the specific characteristics of the distribution region. It allows for alternative agreements, for default operational terms to be updated over time, and allows for innovation. Flexibility is particularly important given rapid developments in consumer technologies.

- ✓ *Be consistent with the approach taken in similar jurisdictions*
  The contractual imbalance between competitive and monopolistic parts of a service value chain is not a unique problem. Many other sectors have this dynamic. There is an international trend to strengthen regulatory control over monopoly contract power.

- ✓ *Allow historical out of date distribution agreements to be updated*
  Feedback suggests there are a high number of historical distribution agreements. In some cases, these older agreements may be out of date. The DDA provides a simple and inexpensive method for either party to review these historical agreements.

ERANZ believes existing agreements should be allowed to continue in their current form.

ERANZ agree that if either party to an existing distribution agreement wishes to move to the DDA, they should be free to do so. Under the current proposal from the EA, the default scenario where neither party takes any action would result in the retailer automatically being put on the distributors DDA. ERANZ considers that where an agreement already exists the move to a DDA should be an active choice – if neither party act the default should be to continue with current arrangements in their current form.

Mandating replacement of existing agreements would simply discard all the effort the industry has expended over recent time, add unnecessary cost, be a distraction to new-entrant and established retailers alike, and divert them from their roles increasing innovation and competition in the market.

ERANZ believes that, over time, technological evolution and other changes will result in distributors and retailers naturally transitioning their existing agreements to a DDA. Forcing this transition before it is beneficial for parties to do so would be counterproductive.

The suite of default operational clauses should be as wide as possible.

ERANZ agrees that, in some instances, it will be important for the agreement to reflect the specific characteristics of the distribution region. However, in reality, we consider there should be few regional characteristics that require bespoke contractual provisions. The more standard contracts remain, the better.

One of the goals of the DDA is increased standardisation whilst retailing the flexibility for operational nuances. Despite best endeavours, EDBs may write bespoke operational clauses that, while they may work, may not be optimal or best practice, or may differ unnecessarily from the clauses of other EDBs who have the same operational requirements. This outcome would put us back in the situation of having differing contract clauses to achieve the same thing. To prevent the need for bespoke operational clauses, the standard suite of default operational clauses should encompass as many network nuances as possible.

Retailers need longer timeframes to assess non-standard operational terms.

Regardless of a drive towards standardisation, ERANZ acknowledges it is inevitable that there will still be some operational terms which vary between distributors.

Under the EAs proposal, a retailer has the right to dispute a distributors DDA operational terms within the first twenty business days of the DDA becoming available on the distributor's website. If there is no appeal in twenty days, the DDA is then used as the default agreement.

Under the proposal, distributors will be publishing their DDAs in quick succession, putting the onus on retailers to potentially evaluate a large number of distributor operational terms simultaneously.

ERANZ considers there is merit in each distributor being required to append a table to the DDA, which shows the operational clauses which *differ* from the standard DDA terms. This will allow retailers to undertake a more efficient and streamlined assessment of the proposed terms and avoid retailers missing operational clauses which could have ongoing unintended consequences.

Even with such a table appended to a DDA, a twenty-day assessment timeframe will not be adequate. Operational terms can be complex. And due to their systemic nature, the implications of operational terms are not always immediately apparent. Retailers need enough time to properly analyse the implications of each distributors bespoke DDA operational terms.

ERANZ considers a three-month timeframe would be more practical, particularly in this initial phase while the sector transitions to DDAs. There should be latitude for the EA to be able to extend the three-month timeframe if it eventuates that many distributors publish their DDAs simultaneously and include a significant of bespoke operational clauses requiring evaluation.

Retailers' will continue to work with the EA, the ENA, and EDBs to develop and implement solutions that bring long-term benefits to consumers.

Overall, ERANZ agrees that there are clear net benefits in advancing this proposal and that it will lead to a more competitive retail market and ultimately deliver benefits to electricity consumers. We encourage the Authority to progress the proposal as soon as possible.

Yours Sincerely

Cameron Burrows
Chief Executive

Appendix: Specific questions in consultation:

Question	ERANZ Response
Q1. What are your views on the problem definition? Specifically: a. the efficiency problem; b. the competition in retail markets problem; c. the competition in related services problem.	ERANZ members are at the coal face of negotiating distribution agreements with distributors. Based on this experience, ERANZ supports the DDA as an initiative that will increase the efficiency of the retail market. ERANZ believes the efficiency benefits of the proposal are likely to be significant. ERANZ considers the availability of a complete, well-balanced distribution agreement on all networks will significantly lower barriers to retailer entry and expansion. For example, the proposal would allow a new entrant retailer to establish distribution agreements on all networks in the country with low effort, in rapid time. This will enhance the competitiveness of the retail market. ERANZ members experience aligns with the EAs definition of the problem with the current approach to negotiating distribution agreements. ERANZ members have found the process of negotiating a distribution agreement time consuming and challenging. There has been some improvement, and ERANZ acknowledges the positive engagement from several EDBs. However, the level of improvement has not been consistent, nor has there been a significant increase in standardisation. Negotiating agreements can still take a significant commitment of retailer and distributor resources and can still be a long process. The underlying problem with the status quo bilateral negotiations is that it does not reflect the natural monopoly characteristics of electricity distribution businesses where distributors have monopoly negotiating power. Retailers are unable to negotiate on, and distributors are not incentivised to offer, a level playing field. This is a problem for new and emerging retailers, and one that will be increasingly important as retailers compete with distributors in ancillary services markets and other related products.
Q2. What are your views on the revised: a. Part 12A proposal;	ERANZ considers the DDA proposal provides an appropriate balance between standardisation and flexibility. Allowing for alternative agreements and providing for default operational terms to be

b. DDA template proposal.	updated over time will leave room for innovation. This is particularly important given rapid developments in consumer technologies. Providing for an inclusive consultation process backed up by the ability to appeal to the Rulings Panel will help ensure default operational terms are fair and reasonable. However, to save duplication of effort in terms of multiple retailers having to review the same document and possible multiple appeal to the ruling panel, we suggest distributors should provide the EA with their proposed distributor agreements, and have them approved as complying with the new proposed Part 12 requirements, before they are presented to retailers. ERANZ agrees that, in some instances, it will be important for the agreement to reflect the specific characteristics of the distribution region. However, in reality, we consider there are few regional characteristics that require non-standard contractual provisions. The more standard contracts remain, the better. To prevent the need for bespoke operational clauses, the standard suite of default operational clauses should encompass as many network nuances as possible. We also suggest that operational clauses that do differ from the default set of standard operational clauses be tabulated in an addendum to the DDA to make retailer review of the DDA more straightforward. We agree that if either party to an existing distribution agreement wishes to move to the DDA, they should be free to do so, with appropriate notice. However, ERANZ does not agree with the need to mandate the replacement of all existing agreements. In our view, retailers and distributors should be free to maintain their current agreements, in their current form, if both parties so choose. Under the proposal, existing UoSAs can stay in place as long as both parties agree to this and '*repackage*' it as an *alternative agreement*. There is a two-month window from when the EDB publishes their DDA for alternative agreements to be agreed upon (this could be the existing agreement repackaged) if no agreement on an alternative is reached *and notified* within the two-month window the DDA is deemed to be the agreement.

	Without action to opt-out, all existing UoSA will be automatically replaced by the DDA two-months after the DDA is published, even if the retailer and EDB are happy with the current UoSA in place. This would put an unnecessary cost on parties that are happy with their current agreements. Given wither party can elect to go onto a DDA, a better way would be for parties on existing UoSAs would be or them to opt into DDAs rather than them being placed on it at the end of a timeframe.
Q3. What are your views on the draft Code, appended to this paper, which would introduce the proposal?	At face value, the flexible and modular approach taken in the draft Code amendments seems like a practical approach. However, as ERANZ is not engaged at an operational level, we leave it to our members to comment on the detail of proposed changes, and the practical and operational implications on their organisation's processes and systems.
Q4. What are your views on the Regulatory Statement? Specifically: a. the efficiency costs and benefits; b. the costs and benefits in the retail market; c. the costs and benefits in the related-services market.	ERANZ broadly agrees with the EAs net positive benefit in the cost-benefit assessment (CBA) of the proposal. Given the number of new entrants into the New Zealand retail market over recent years and the potential for existing retailers to expand, we consider the Authority's estimate of productive efficiency benefits to be reasonable, and potentially conservative. ERANZ believes the paper potentially undervalues the benefits of the change for existing historical distribution agreements. From discussions with our members, we understand there are a high number of historical distribution agreements. In some cases, these older agreements may be out of date, and the DDA provides a simple and inexpensive method for either party to review these historical agreements. ERANZ also considers the Authority's estimates of costs to implement the proposal to be reasonable. We note that significant effort has already been expended to develop appropriate standard terms. We, therefore, consider that additional cost for EDBs to develop and publish a DDA will be incremental. However, ERANZ believes the net positive benefit in the CBA would be increased by the removal of the requirement that all parties migrate to new agreements, particularly in cases where both parties are satisfied with their existing agreement. We believe that this aspect of the proposal would not be justifiable under cost-benefit analysis and could reduce the overall net positive benefit of the

	introduction of the DDA. No evidence is provided that mandating replacement of existing distribution agreements would yield any discernible benefit, as there is no evidence of existing agreements impacting competition. Mandating replacement of existing agreements would simply discard all the effort the industry has expended over recent time, add unnecessary cost and be a distraction to new-entrant and established retailers alike and divert them from their roles increasing innovation and competition in the market.