Submission to the Electricity Authority

on

Default agreement for distribution services

Made on behalf of 18 Electricity Distribution Businesses

PwC submission on behalf of group of 18 distributors

April 2016

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Introduction

Overview

1. This submission responds to the Electricity Authority's (Authority) Consultation Paper, "Default agreement for distribution services" released on 26 January 2016 (the Consultation Paper). This submission has been prepared by PricewaterhouseCoopers (PwC) on behalf of the following 18 Electricity Distribution Businesses (EDBs or distributors):

    - Alpine Energy Limited
    - Aurora Energy Limited
    - EA Networks
    - Eastland Network Limited
    - Electricity Invercargill Limited
    - Electra Limited
    - MainPower New Zealand Limited
    - Marlborough Lines Limited
    - Nelson Electricity Limited
    - Network Tasman Limited
    - Network Waitaki Limited
    - Northpower Limited
    - OtagoNet Joint Venture
    - The Lines Company Limited
    - The Power Company Limited
    - Top Energy Limited
    - Waipa Networks Limited
    - Westpower Limited.

2. Together these businesses supply 27% of electricity consumers, maintain 44% of total distribution network length and service 71% of the total network supply area in New Zealand. They include both consumer owned and non-consumer owned businesses, and urban and rural networks located in both the North and South Islands.

3. The distributors which support this submission also support the submission made by the Electricity Networks Association. The purpose of this submission is to highlight topics of particular interest to the 18 distributors listed.

4. We trust this submission provides useful input to your consultation on the Consultation Paper. We would be happy to answer any questions you may have regarding this submission.

5. The primary contacts for this submission are:

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Summary

6. The following points summarise our views on the matters raised in the Consultation Paper. They are discussed more fully in the body of this submission.

Problem definition

7. The distributors which support this submission oppose the proposal to introduce a Default Distributor Agreement (DDA). We are concerned that the Consultation Paper's justification for the DDA appears to be built on assertions and assumptions regarding potential problems. No significant evidence has been presented in the consultation paper to demonstrate that the problems identified are material. The benefits of the proposal also appear over-stated.

8. Additionally, many distributors and retailers have recently invested significant time and resources in agreeing to new use-of-system agreements (UoSAs), based on the Authority's model UoSA. The distributors who have recently agreed new UoSAs based on the model UoSA,[1] or are currently part-way through negotiations on new UoSAs, strongly object to having to incur new costs to develop, offer and negotiate new contractual terms so soon.

9. The distributors which support this submission recommend the Authority does not progress with its DDA proposal. Instead, we recommend the Authority retains the approach where industry participants can agree updated contracts between themselves based on a model UoSA. This should be either the current model or an updated version, developed with industry input and reflecting the learnings and experience of the industry in negotiating changes to the model. The Authority should then continue monitoring uptake rates and provide a clear statement of its expectations of when updated UoSAs should be agreed by all parties and of the extent to which variations to the model UoSA are expected. We consider that 1-2 years would be a reasonable timeframe in which to expect all parties within the industry to agree updated UoSAs.

10. The comments made below regarding improvements to the DDA proposal are made without prejudice to our view that the model UoSA should be retained.

Comments on the DDA process

11. If the DDA proposal is progressed by the Authority, the following changes would improve the process for developing and agreeing a default agreement:

    - Where a UoSA has been signed between a distributor and a retailer since September 2012, based on the 2012 model UoSA, that UoSA should be seen as the default. This will mean the parties who have already signed UoSAs based on the 2012 model will not need to incur additional costs in reaching a different agreement.

    - There should not be any appeal rights to the Rulings Panel where there are disputes over operational terms. The Dispute Resolution Procedure within the DDA should be sufficient to handle any disagreements.

    - As noted above, preferably all parties should be given 1-2 years to agree on a UoSA that is based on the model. However, if the Authority progresses with the DDA proposal the timeframe for developing operational terms and making alternative agreements to the

[1] This submission uses the term 'based on the model UoSA' to refer to a UoSA that was agreed in a process in which the Authority's model UoSA (the version published in September 2012) was the starting point but the final signed UoSA contained variations from the model that were agreed between the parties.

DDA should also be 1-2 years. The proposed timeframe in the Consultation Paper (120 working days for operational terms plus 2 months to agree an alternative) is not at all sufficient for all retailers and distributors in the country to complete the necessary review, negotiation and decision steps that will be required. In particular, all parties will need to be engaged in multiple simultaneous negotiations so it will not be feasible to complete the negotiations in the timeframe suggested by the Consultation Paper.

- Clarification that the new Part 12A does not apply to conveyance. We note that conveyance remains a valid option for the sector and is capable of delivering good outcomes for consumers.
- The Authority should introduce a clear process and timeframe to consider and make amendments to the DDA– this will help to ensure the DDA remains relevant and up-to-date as technology and business processes evolve. However, parties should not be automatically required to adopt the new DDA whenever an amendment is made.

Comments on the DDA template

12. If the DDA proposal is progressed by the Authority, the following changes would improve the DDA template itself:

    - Schedule 2 from the model UoSA must be re-instated in the DDA. Removing this from the DDA undermines trust-owned distributors' ability to dispense dividends to their beneficiaries. The current process has been in place since the separation of distribution and retail activities and works very well. The Authority's view of the appropriate scope of distribution services to be covered by the DDA is unduly narrow – there is no good reason to exclude the additional services that could have been covered in Schedule 2. Also, the effect of removing it will be to require distributors and retailers to negotiate yet another series of contracts, which will add costs and be inefficient.
    - There should not be a 'one-size-fits-all' liability cap of $2m, or any other value. A fixed value is problematic because it changes the potential liability exposure of a distributor when the number of retailers on a network changes, which is irrelevant to the level of damage caused. A key principle for designing liability caps should be that an event should lead to consistent liability limits per customer affected irrespective of the size, scale or number of the industry participant(s).
    - The ability for either party to terminate the contract by giving 120 days' notice should be re-instated. A lack of a termination right would be problematic as it would enable all retailers to prevent sensible contractual or operating model changes going ahead (eg it would mean that any move to a conveyance model would require unanimous support from all retailers on a network; which may be unworkable in practice).
    - The DDA should not include detailed "example" operational terms. These terms could be perceived as best practice by retailers and/or the Rulings Panel and thus become embedded in agreements by default. Instead each schedule should set out principles for what the schedule is intended to achieve.
    - The majority of clauses in Part III – Operational Requirements of the DDA should be moved from core terms to operational terms. Most of these clauses relate to operational detail that can reasonably vary between industry participants.

13. We note that these comments on the DDA are preliminary. The introduction of a default agreement with only limited scope to amend it makes it essential that the terms of that agreement are robust. The Authority should consider providing a further opportunity for stakeholders to review and submit on the DDA template if the proposal goes ahead.

Problem definition

The proposal

14. The proposal in the Consultation Paper is to amend the Electricity Industry Participation Code 2010 (the Code) to require each distributor that has an interposed operating model to develop a new DDA. This must include all core terms included in the DDA template.

15. Operational terms will be able to vary from the DDA template, but must be subject to consultation between retailers and distributors. The Consultation Paper proposes that retailers are able to appeal to the Rulings Panel where they disagree with an operational term included in a DDA.

16. A DDA must be offered by the distributor to all retailers operating on that distributor's network. An alternative agreement can apply, but only where both the retailer and distributor agree. If the retailer and distributor cannot reach agreement on an alternative, the DDA will apply.

17. These DDA requirements apply to all distributors operating under interposed arrangements, irrespective of whether they have recently signed UoSAs with retailers on their network based on the Authority's model UoSA.

What problem is the Authority trying to solve?

18. The Consultation Paper states that the proposal is beneficial because:[2]

- it will reduce transaction costs for retailers and distributors in reaching contractual agreements with each other
- new entrant retailers will face more consistent terms across all networks they are seeking to enter and all retailers will have equal access to each distributor's network; thus lowering barriers to entry and enhancing competition
- it will create an opportunity to replace legacy contract terms with updated and more standardised terms
- it will reduce the ability of distributors to impose terms that inhibit competition and innovation in the retail market and related markets.

Are these problems material?

19. We now consider each of the points listed above in turn.

Transaction costs

20. We agree the proposal may reduce transaction costs for all parties that have not yet entered into UoSAs but will need to in the future. A default agreement may reduce costs for industry participants in that situation. However, this will not reduce costs for everyone. Under the Consultation Paper's proposal there remains an option for parties to seek to negotiate alternative terms. Therefore some parties are likely to spend time and resources identifying core term clauses they wish to change and seeking to negotiate for those terms. Whether these negotiations are successful or not the costs will still have been incurred.

21. The proposal would also increase transaction costs for parties that have already recently agreed UoSAs and are happy with their current contractual terms. These parties would be required to enter into a

[2] Consultation Paper, Executive Summary pages E-D.

further process, as they will need to actively choose to 'opt-in' if they want to retain their current contractual terms, otherwise the default terms will apply. This will create costs for all of these parties in the following ways:

- Retailers and distributors will have to compare the default terms to their current UoSA terms and then decide which option they prefer
- Retailers and distributors will then need to engage in some level of negotiation to agree what option will be adopted.

22. Additionally, retailers and distributors will need to negotiate separate agreements in relation to additional services (see below), whereas under the model UoSA those services are covered in the same agreement.

23. None of these costs would be incurred under the status quo.

24. Additionally, many distributors and retailers have recently invested significant time and resources in agreeing to new UoSAs, based on the Authority's model UoSA. Distributors who have recently agreed new UoSAs based on the model UoSA, or are currently part-way through negotiations on new UoSAs, strongly object to having to incur new costs to develop, offer and negotiate new contractual terms so soon.

Enhancing competition

25. The distributors which support this submission consider the Consultation Paper has over-stated the competition problems it is trying to address, for the following reasons:

- Variation in network contract terms is not, in and of itself, necessarily anti-competitive. Variation can allow for unusual circumstances and requirements to be catered for and thus facilitate niche and innovative offerings more readily than standardised terms.
- It is not clear that variation in contract terms has any material effect on new entrant retailer decisions. Our experience suggests that UoSA contract terms are not a material concern for new entrant retailers when considering whether to enter a network. The most significant concerns relate to the ability to secure appropriate hedge contracts and the probability of attracting sufficient new customers to be profitable. Terms within a UoSA do not materially affect either of these outcomes. Perhaps the most costly variation across networks is the different billing methodologies that apply, but the Authority has correctly realised that the costs of standardising billing methodologies would be excessive and has excluded the billing section from the core terms of the DDA template.
- All retailers already receive equal access onto distributors' networks. Clause 4 of the model UoSA requires equal access and even-handed treatment to be provided to retailers. Also, any contract agreed between a distributor and a retailer must then be made available to all other retailers operating on the distributor's network.[3] The distributors which support this submission request that the Authority provides some evidence to demonstrate that equal access is not currently being provided before relying on this point in any decision to mandate a DDA.
- If a lack of equal access was a problem, a more proportionate and targeted solution would be to mandate this in the Code (similar to the prudential requirements provisions) rather than implement the DDA process.

[3] We note this clause has been deleted from the proposed DDA template. This seems to imply that distributors could offer one retailer on their network more favourable terms than apply under their default agreement. We don't believe any distributor would do this, but it seems that preferential treatment for a particular retailer would be more permissible under the DDA proposal than under the status quo.

- Distributors do not have incentives to reduce competition on their networks. In fact, increasing the number of retailers on a network reduces the risk of revenue losses for the distributor, should any one retailer encounter financial difficulties and fail to pay distributors for lines services.
- Variation in practice is likely to happen even if a mandated contract is imposed. Because the parties will have not negotiated many of the terms there is a strong possibility that some could choose to act differently to what the DDA requires. The result could be that the industry contracts do not represent actual industry activities, which is likely to be problematic in the long-run, but is a plausible outcome of regulation of this nature.
- Other safeguards against anti-competitive behaviour exist, such as those in Part 2 of the Commerce Act.

Opportunity to replace legacy contracts with updated terms

26. The distributors which support this submission agree that the DDA proposal would result in legacy contracts being replaced with updated terms. However, this is happening anyway as parties update legacy contracts with UoSAs based on the model UoSA.[4] This process has been impeded due to concerns the Authority would intervene with a regulated solution, as has now been proposed. The distributors which support this submission do not consider it appropriate to assign the benefit of updating legacy contracts to the DDA proposal when this result was already occurring as a result of the model UoSA.

Reduce distributors' abilities to impose terms

27. The Consultation Paper raises concerns that "distributors can use their market power as monopolies to include terms in UoSAs that may have the effect of inhibiting competition and innovation in the retail market and in related markets".[5]

28. The distributors which support this submission object to the implication that they would intentionally impose terms that would inhibit retail competition or innovation. We support retail competition and consider that a vibrant retail market is likely to deliver benefits to our customers.

29. We note the Consultation Paper presents no evidence that this problem actually exists. If it did exist, we suggest that resolving this concern could be achieved through targeted Code amendments (as was introduced for the prudential requirements). It is not necessary to develop an entire default contract and associated processes to fix an issue that would at most relate to a few discrete sections within a UoSA.

30. The distributors which support this submission also disagree that they are able to impose terms on retailers. Any monopoly power, in this instance, is fully countered by the inability of distributors to cease supply to customers of retailers who refuse to agree to a proposed contract. Retailers' customers will continue to be supplied whether or not the retailer signs the contract. As operating on a network without a contract in place is undesirable for both distributors and retailers, both parties are motivated to negotiate in good faith to reach agreement.[6]

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[4] In September 2015 the Electricity Networks Association wrote to the ENA with results of a survey on its members' progress in negotiating new UoSAs. This showed steady improvement from the previous survey (March 2015) in terms of new UoSAs being agreed between distributors and retailers.

[5] Consultation Paper, paragraph 2.4.3.

[6] For new entrants that have not yet started supplying any customers on a distributor's network, this countervailing power would not apply. However, under the equal access and even-handed provisions of the model UoSA, any new entrant retailer would be able to sign up to a contract that an existing retailer has already signed up to; thus the distributor would not be able to impose unfavourable terms onto the new entrant.

31. If the Authority continues to rely on monopoly power as a justification for the DDA proposal, we request it explains precisely how distributors could utilise their monopoly power to require retailers to sign up to terms they do not agree with when the distributors are not able to cease supplying the retailers' customers.

Regulation of non-price terms of access is heavy handed

32. The distributors which support this submission consider that a high hurdle must be reached before any regulation is applied to contractual terms between commercial entities. In the year ended March 2015, nearly $2.5 billion of lines charge revenue was received by distributors, a revenue transfer that was overseen by existing UoSAs. Lines charge revenues constitute a very high proportion of total revenues and profits for most distributors. For a regulator to decide how to structure terms such as liability and force majeure for such material contracts (i.e. to regulate the non-price access terms for networks) is heavy handed regulation.

33. The distributors which support this submission consider that regulators should be very cautious before implementing such heavy handed regulation. It should only be implemented where there is a clear and material problem to be addressed. We do not believe the problems identified by the Consultation Paper, if they even exist, are sufficiently material to justify the imposition of contractual terms onto independent commercial entities. The cost-benefit analysis included in the Consultation Paper does not appear to have considered the dynamic efficiency costs of overturning existing contracts and imposing its own.

34. Additionally, when heavy-handed regulation of this type is imposed it is likely to result in unintended and unforeseen consequences. The Authority should think very carefully about the nature of the regulation being imposed and the potential outcomes. We would suggest the cost-benefit analysis also needs to account for this.

Conclusion: there is no strong case for a DDA and the model UoSA approach should be retained

35. The distributors which support this submission are concerned that the Consultation Paper's justification for the DDA appears to be built on assertions and assumptions regarding potential problems. With the exception of statements regarding the large number of UoSAs currently in place, no evidence has been presented in the consultation paper to demonstrate the problems identified are real or, even if they are real, that the regulatory response is proportionate.

36. The distributors which support this submission recommend the Authority does not progress with its DDA proposal. Instead, we recommend a solution in which the Authority:

    - recognises there has been some progress towards standardisation as many distributors and retailers have adopted new UoSAs based on the model
    - retains the current approach where industry participants can agree updated contracts between themselves based on a model UoSA (whether the current model or an updated version, see below)
    - monitors uptake of new UoSAs over a timeframe that is sufficient for substantial negotiations to take place; we suggest 1-2 years would be appropriate
    - provides clear guidance of its expectations regarding uptake rates and variations from the model UoSA.

37. The way forward outlined above could be progressed using the current model UoSA or the Authority could develop an updated model with industry input, recognising the improvements that have been made through negotiations to date and building on that experience and learning. We do not anticipate that updating the model UoSA would take very long given the work that has gone into developing the

DDA template. The Authority could then publish the updated model UoSA for parties to use and this should make it more likely that contracts closer to the updated model will be agreed. However, if parties have already concluded agreements under the 2012 model UoSA they should not be required to update their agreements to the new UoSA unless they choose to do so.

38. We consider that this approach is appropriate considering the lack of justification for regulation in this area. It would also be more consistent with the Principles set out in the Authority's Consultation Charter[7] for use where there is some doubt about the best way forward, in particular:

    - Principle 4 - Preference for small-scale Trial and Error Options
    - Principle 7 - Preference for flexibility to allow innovation
    - Principle 8 - Preference for Non-Prescriptive Options.

[7] Electricity Authority, Consultation Charter, 19 December 2012.

Comments on the DDA process

Introduction

39. The last section considered whether the DDA proposal is justifiable. This section considers the detail of the proposed process for developing and agreeing DDAs and what agreement should be regarded as the default. As discussed in the previous section, the distributors which support this submission oppose the DDA proposal and support retention of the model UoSA. The comments made in this section on how to improve the DDA proposal are made without prejudice to that position.

The default agreement should be the existing updated UoSA

40. As noted above, many distributors and retailers have invested significant time and resources to develop, negotiate and agree UoSAs based on the model UoSA. While those costs are now sunk, the distributors which support this submission do not agree that they should be required to now spend more time developing operational terms, negotiating them with retailers and then agreeing a new contract so soon. This is not an efficient use of industry resources.

41. The distributors which support this submission recommend that where a UoSA has been signed between a distributor and a retailer since September 2012, based on the 2012 model UoSA, that UoSA should be seen as the default. Distributors or retailers should remain on the previously agreed UoSA unless they both agree to adopt the agreement based on the DDA template.

42. This approach would maintain existing, commercially agreed, contractual terms and would reduce transaction costs for the industry by removing the need to re-agree a contract so soon after the last agreement was signed.

Timeframe for adopting new contracts

43. The Consultation Paper proposes that distributors and retailers that already have a UoSA in place have 2 months to agree an alternative agreement before the distributor's DDA becomes the agreement between them by default. Our interpretation of the draft Part 12A is that this 2 months is intended to occur after the 60 or 120 working days which distributors have to negotiate and agree the operational terms for their DDAs.[8]

44. The distributors which support this submission consider that these timeframes are insufficient. In order to reach agreement on the operational terms and on any alternative to the DDA the parties will need to:

    - engage in negotiations
    - undertake legal and commercial reviews undertaken of the terms of the DDA and any alternative agreement that is proposed
    - seek Board approval of these contractual decisions, which means there will be a need to accommodate time to prepare and submit Board papers and hold a Board meeting.

45. 120 working days may be sufficient for a few motivated parties to reach an agreement. However, what the DDA proposal would require is all 29 distributors to simultaneously negotiate operational terms with all retailers on their networks. The large number of parties to negotiate with will be challenging to manage and a few key staff members in each organisation will be required to engage in multiple

[8] As discussed in the detailed drafting comments in the Appendix (see Table 1), this is not quite what the draft clauses currently say, but we assume that is an error and have suggested an amendment in the Appendix to resolve the issue.

negotiations at the same time. We do not believe it will be feasible to carry out meaningful negotiations of this nature in this timeframe. It will also be a material distraction from other, more value-adding, business activities.

46. While some distributors are well advanced in agreeing their UoSAs and can build on those for their operational terms, others have deferred negotiations while the Authority's review process continued. These distributors need enough time to develop workable operational terms that will deliver good outcomes for customers, retailers and distributors.

47. Even more challenging is the Consultation Paper's proposal to only provide 2 months for parties with existing UoSAs to agree to an alternative before the DDA applies. In theory some of the 120 working days could be used for this purpose but, for the reasons discussed in the previous paragraph, there is unlikely to be sufficient time available. Two months is unrealistic for parties to negotiate, agree and seek Board approval of such important contracts. The effect will be that all parties end up on the default agreement for lack of time to negotiate anything better.

48. The distributors which support this submission consider that the Authority should provide sufficient time for meaningful negotiations to take place. As noted above, our preference is for the Authority to provide 1-2 years for all parties to reach agreement on a UoSA based on the model. If the Authority intends to push ahead with the DDA, we consider that it should also provide 1-2 years for parties to agree operational terms and agree an alternative to the default. While this will delay uptake of the final contracts it will allow better-quality agreements to be reached.

Appeal to Rulings Panel on operational terms

49. The Consultation Paper proposes that retailers will have the ability to appeal to the Rulings Panel where they do not agree with an operational term included by a distributor in their DDA.

50. The distributors which support this submission do not agree there should be appeal rights to the Rulings Panel. As discussed in paragraph 30, distributors do not have real monopoly power to impose terms as there is no scope for them to cease supply to customers of retailer that refuse to sign. Therefore there is no reason to believe that an unreasonable operational term could be included in a distribution agreement.

51. Additionally the DDA, like the model UoSA, contains a Dispute Resolution Procedure section that governs how disputes regarding contractual terms are to be handled. The distributors which support this submission consider that this standard commercial arrangement should be sufficient to ensure all terms within a distribution agreement or UoSA are appropriate. The Rulings Panel is a very heavy-handed tool to deal with what could be quite technical disagreements.

52. Setting up the Rulings Panel as an adjudicator of contract disputes also creates risks that:

    - the Rulings Panel makes a decision that is simply operationally impossible for the distributor to deliver
    - Rulings Panel decisions for one distributor create a precedent that may then be expected to apply for all other distribution agreements and the ruling may not translate well to other networks. This could result in multiple parties seeking to be joined as parties to a Rulings Panel appeal.

Balance between distribution and retailer interests

53. Clause 12A.3(2)(b) states that operational terms must:

> *"reflect a fair and reasonable balance between the legitimate interests of the distributor and the requirements of traders trading on the distributor's network" [emphasis added]*

54. It is not clear why the different terms "legitimate interests" and "requirements" are being used in this clause for the different parties to the agreement. If the aim is to ensure a reasonable balance between the needs of the parties, we would expect this to refer to the "legitimate interests" of both the distributor and the trader, or the "requirements" of both the distributor and the trader. As written it seems that "legitimate interests" may be a narrower term than "requirements" and thus this clause may have a bias against the interests of the distributor.

55. Further, it is unclear why the clause uses the term "requirements" rather than "reasonable requirements" as is used in clause 12A.3(2)(d). This could imply that under clause 12A.3(2)(b) the operational terms need to reflect all of a retailer's requirements, whether reasonable or not.

56. We recommend the clause refers to the "legitimate interests" or "reasonable requirements" of both parties.

Application to conveyance

57. The distributors which support this submission note that conveyance remains a valid option for the sector that is capable of delivering good outcomes for consumers. We would not support any move to limit the scope for distributors to operate under a conveyance model.

58. The distributors which support this submission consider it is important to re-state the value of the conveyance option because the Consultation Paper and draft DDA template are unclear regarding the extent to which they deal with conveyance agreements. Our reading of the DDA template is that the new Part 12A does not apply to any conveyance agreement at all. However, the heading above paragraph 3.6.24 implies that some aspects of Part 12A will continue to apply to conveyance. We understand the heading is incorrect and Part 12A is not intended to apply to conveyance agreements at all. Confirmation of this would be helpful.

Amendments to the DDA

59. It is uncontroversial that the DDA should facilitate innovation and efficient adoption of new technologies. This is particularly important given the current rate of technology change in the electricity sector. If the Authority could identify amendments to the DDA that would promote this outcome it would be likely to make those amendments. The problem is that nobody can be certain what changes are going to occur, let alone draft the perfect contractual clauses to deal with the changes ahead of time. In normal circumstances, and under the model UoSA approach, there would be scope for contracts to be amended where circumstances changed to the extent that they were no longer fully relevant or up to date.

60. A challenge with the DDA proposal is that it will be difficult for amendments to be made to the DDA. We are aware of concerns that were raised with the Authority at least 4-5 years ago about terms in mandated contracts: the unity power factor requirement in the Benchmark Agreement and the distributed generation pricing principles in Part 6.4 of the Code. As far as we are aware, the Authority is still considering what changes, if any, should be made to these provisions. This does not inspire confidence that the DDAs will be updated promptly to reflect changes in technology, market conditions or other factors.[9]

61. We recommend a process is established for the Authority to log, review, respond to and action any changes that are proposed to core terms by stakeholders. In particular, the Authority should:

    - keep a log of recommended changes publicly available on its website
    - provide a response to each recommended change within a set timeframe, e.g. 1 month

[9] It would be possible in theory for all distributors and retailers to move away from the DDA and agree alternative terms to reflect the new technology or other change. However, this is unlikely to be practical for all participants in practice.

- undertake to update DDA template core terms where a change is justified. For urgent changes this should be done as soon as practicable. For non-urgent changes this could be done in a staggered way, perhaps making groups of amendments once every 1 or 2 years.

62. We think a process of this nature would make it transparent where concerns are about terms within the contract, what the Authority's position on those concerns is and what the process would be for making changes to the DDA template where necessary. We expect this process may be used for a short time after the DDA requirements first come into force and parties identify problems with the terms. It is then unlikely to be needed until technology or market changes render some aspect of the DDA template obsolete.

63. For clarity the recommendation above relates to keeping the DDA template up to date. However, an updated DDA template should not automatically flow through to all distributor agreements. Or, to put it another way, every change to the DDA template should not be accompanies by a mandated regulatory process for all parties to update their agreements. Updated DDAs could be used for any new agreements signed and for voluntary uptake by distributors and retailers but should not be imposed by the Authority at each amendment. This appears to be consistent with clause 12A.11(4).

Comments on the DDA template

Introduction

64. This section considers the key terms within the DDA template and makes recommendations for improvements. More detailed drafting comments are contained in the Appendix. The comments made in this section on how to improve the DDA proposal are made without prejudice to our view that the model UoSA should be retained.

65. These comments and those in the Appendix are preliminary. The introduction of a default agreement with only limited scope to amend it makes it essential that the terms of that agreement are robust. The Authority should consider providing a further opportunity for stakeholders to review and submit on the DDA template if the Authority chooses to progress the proposal.

Additional services, including distributor rebates, discounts and dividends

66. The Consultation Paper proposes that the DDA does not include any services that are not 'distribution services' and considers that these should be agreed separately between retailers and distributors where necessary. As a result, the draft DDA template does not include Schedule 2 of the model UoSA, which provided for additional services to be agreed between the parties. Additional services that could be agreed under Schedule 2 included:

    - load management services
    - enhanced information services
    - services by retailers to distribute distributor discounts, rebates and/or dividends and provide related information
    - retailer to provide information to the distributor to enable a rebate to be distributed by cheque
    - distribution of informational material to consumers on behalf of distributors
    - revenue protection
    - billing of consumers if the distributor had a distributor agreement in place

67. The distributors which support this submission do not agree with the deletion of this schedule and recommend that it is reinstated within the DDA, particularly as it relates to distributor discounts, rebates and dividends.

68. The process for retailers to assist with the distribution of rebates, discounts and dividends has been in place since the separation of the retail and distribution business activities. The process is established and works well. It would be most unhelpful to remove this from the standard distribution services contracts.

69. We consider that the Authority is taking an overly narrow view of the scope of distribution services – the return of dividends, including through discounts or rebates, is appropriately seen as part of the core service that distributors provide. There is no basis to exclude it from the DDA template. Importantly, without this provision in place many distributors will have no way of transferring dividends to trust beneficiaries and this places their entire business model at risk.

70. The effect of removing this schedule is that most distributors will need to reach additional agreements with their retailers. That implies separate negotiations between many distributors and all of their

retailers to agree to continue doing something that has been standard practice within the industry for around a quarter of a century. The additional costs of reaching these additional agreements should not be underestimated and appear to have been excluded from the Consultation Paper's cost-benefit analysis.

Liability

71. The DDA, like the model UoSA, puts forward a per-event liability limit for each retailer of the lesser of $10,000 per ICP or $2m. A problem with this is that a distributor's total potential liability for the same event can double if the number of retailers on the network doubles (or halve if the number of retailers on the network halves). We do not think it is appropriate for the number of retailers on a network to materially influence distributors' total liability exposure, especially as the number of retailers will have no relationship to the total damage suffered by customers.

72. The use of a fixed cap value also creates perverse effects across the industry. The $2m per event cap would apply both to a retailer with 200 ICPs and to a retailer with 10,000 or 100,000 ICPs on a network. It is conceivable that an event could:

    - affect 1,000 ICPs at a cost of $10,000 per ICP, and
    - 200 of those ICPs are supplied by Retailer A while 800 of those ICPs are supplied by Retailer B.

73. In this scenario, Retailer A would receive sufficient compensation to fully refund all of the losses of its customers, while Retailer B would receive sufficient compensation to refund only a quarter of the losses of its customers. There is no clear reason why the level of compensation per customer should vary so widely depending on the relative size of the customers' retailers.

74. Similarly, from the distributor's perspective, the total liability it faces in the scenario above is $4m. However, if Retailer C had entered the market and won 200 customers from Retailer B just before the event, then the same event would create a total liability exposure for the distributor of $6m.

75. A $2m cap may also create greater financeability risks for smaller distributors than for larger ones from a single event, as $2m would be a substantial cost to a small distributor but may be more easily absorbed by a larger entity.

76. The distributors which support this submission consider that a key principle for designing liability caps is that an event should lead to consistent liability limits per customer affected irrespective of the size, scale or number of the industry participant(s).

77. We recognise it is likely to be unduly complex to develop a mechanism that perfectly delivers the same amount of compensation irrespective of the number or size of the participant(s). However, the current "one-size-fits-all" approach in clause 24.7 is too blunt. The distributors which support this submission consider that the approach taken in the Vector UoSA is worthy of consideration and recommend that something similar is included in the final DDA (or any updated model UoSA).

78. The distributors which support this submission also support the inclusion of an annual cap on total liability that may be incurred. Including annual caps would provide certainty for both distributors and retailers and make it more straightforward to obtain insurance cover for the liability risk.

Termination of the agreement

79. The model UoSA clause that permitted either party to terminate the agreement by giving at least 120 days' notice has been removed from the DDA. The distributors which support this submission recommend re-instating this clause in the final DDA. It seems the DDA proposal does not fully appreciate the implications of removing the termination right.

80. A termination right is a standard feature of all contracts. A lack of a termination right would be problematic as it would enable any retailer on a network to prevent contractual or operating model changes in the following situations:

    - Where a distributor chooses to move from an interposed model to a conveyance model.
    - Where a distributor purchased or merged with another distributor and seeks to merge the contractual terms across the new, larger, network.
    - Where a distributor decided that it needed to update its operational terms (e.g. to reflect technology changes).

81. In each of these scenarios a distributor would still consult with retailers and consider their feedback. However, if one retailer refused to accept the changes it may not be possible for the distributor to run both models or both contracts simultaneously, meaning that all retailers would effectively have a veto over such changes. This would not be sensible or commercially acceptable.

82. Without an ability to make changes, legacy contracts can be left in place with clauses that are meaningless in current market contexts. For example, we are aware of a few contracts still in force that refer to obsolete arrangements such as MARIA. The DDA should be flexible enough to avoid similar outcomes and a termination clause would assist with that.

Operational terms

83. The proposed DDA template contains quite detailed "example" operational terms. The distributors which support this submission are concerned that these terms will be perceived as best practice by retailers and/or the Rulings Panel and will become embedded in agreements by default. We recommend these example clauses are removed from the DDA template and instead, in each schedule, the DDA template sets out principles for what the schedule is intended to achieve. Distributors and retailers can then negotiate on a set of terms that works well for each network area. As UoSAs already exist in all network areas, it is unlikely that distributors or retailers would require draft clauses to guide them – they can use existing operational terms as the starting point instead.

84. In particular we do not see any need to specify draft penalty payment amounts in the DDA schedules.

85. The Consultation Paper proposes that the largest four distributors will develop their operational terms first and then the remaining distributors will leverage the terms developed by the 'big 4' in preparing their own operational terms. The distributors which support this submission do not agree with this proposal for the following reasons:

    - There is a risk that terms that are acceptable to the 'big 4' are locked in with retailers before other distributors have been able to negotiate those terms. This could make it challenging for remaining distributors to seek different operational terms on their networks.
    - Operational terms for larger network companies can be supported by technology that is not available for smaller distributors, so using the terms of the larger companies may be unhelpful. Also, there is no reason to think that the larger distributors necessarily have the best operational procedures.
    - Perhaps most importantly, the intent of the proposal seems to be to promote information exchange within the industry. However, it is inappropriate and unnecessary for the Authority to regulate for this outcome. There are other ways for the industry to share ideas and practices; for example the Electricity Networks Association could convene a working group during the negotiation process or operate a secure website where distributors can share terms that have been agreed. This is simply not an area where regulation is required.

86. The set of operational terms needs to be wide enough to include all areas where there is necessary operational diversity across networks. The distributors which support this submission consider that

the majority of clauses in Part III – Operational Requirements of the DDA should be moved from core terms to operational terms. Some of these clauses relate to sharing of costs between parties (or responsibility for damages), which may be suited for core terms. However, the majority of the clauses relate to operational detail that can reasonably vary between industry participants.

Appendix: Detailed drafting

87. The comments made in this section on how to improve the drafting of the new Part 12A and the DDA template are made without prejudice to our view that the model UoSA should be retained.

88. Table 1 provides comments on the detailed drafting of the proposed new Part 12A of the Code.

Table 1: Drafting comments on new Part 12A

Clause	Comments
12A.1(a) 12A.13(a) 12A.21(a)	The wording of these clauses is somewhat convoluted and may not deliver the outcome that was intended. They state that they apply to each distributor that: *(i) conveys electricity to 1 or more consumers on the distributor's local network; and* *(ii) does not have a contract in respect of the conveyance of electricity with 1 or more of those consumers.* Many distributors have conveyance agreements in place with a few large customers. The wording of the clauses implies that they do not apply to any distributor with a conveyance agreement with 1 customer, even where the rest of the distributor's customers are supplied under interposed arrangements. We assume this was not the Authority's intention.
12A.3(2)(b)	For the reasons discussed in paragraph 54 above, we recommend the clause refers to the "legitimate interests" or "reasonable requirements" of both parties.
12A.4(4) 12A.6(3)(a) 12A.7(1)(a) 12A.11(1)	All of these clauses require a DDA to be made available "prominently" on a distributor's website. We recommend deleting the term "prominently" from each of these clauses, for the following reasons: • The term "prominently" is not defined and will be impossible to enforce given the wide range of website designs within the industry. Also, for the Authority to regulate the layout of distribution websites is excessive. • Distributors are required to contact each trader on their network and each participant that may be affected by the DDA within 2 business days of placing the DDA (or amended DDA) available on their website. Therefore all relevant industry participants will be notified of the agreement. • It is unlikely that the primary route by which traders will find a DDA will be by routinely checking a distributor's website to see if the DDA has been posted or recently amended. Instead distributor notifications and contact points will be the primary route by which traders will receive the DDA and any DDA amendments. The relative "prominence" of a DDA on a distributor's website will have very limited effect on its accessibility to traders.
12A.5 12A.6 12A.7	These clauses set out the process for appealing to the Rulings Panel against an operational term and for subsequent procedural requirements. As discussed in paragraph 50, we do not support the ability to appeal to the Rulings Panel on operational terms. The dispute resolution procedure within the DDA will be sufficient. We therefore recommend deleting these clauses from the new Part 12A.

Clause	Comments
12A.9	This clause does not consider circumstances in which a trader has previously defaulted. The distributors which support this submission recommend that distributors are not forced to offer a DDA to a trader that has previously defaulted unless they have remedied their previous default.
12A.9(3)	This clause refers to subclause (2). It should refer to subclause (1) as the notice referred to under subclause (3) is given under subclause (1).
12A.4(4) 12A.12(5)	As recommended in paragraph 41, we do not agree that the DDA should be the default when an existing UoSA, based on the model UoSA, is in place. Instead the default option should be the existing agreement unless one party actively chooses to move to the DDA. This clause would need to be changed to give effect to this recommendation. Also as discussed in the section starting at paragraph 43, the 120 day and 2 month timeframes are inadequate for all parties to negotiate new agreements. We recommend this timeframe is extended to 1-2 years. Whether this change is made or not, the drafting of clause 12A.12(5) may need to be amended. The clause provides that the DDA applies if the distributor and trader cannot agree on an alternative within 2 months of the clause coming into force. This appears to conflict with clause 12A.4(4), where distributors must make a DDA available 60 or 120 days after that clause comes into force. Unless the Authority plans to bring the different clauses into force at different times, this will not be workable as DDAs will be required to be signed before the DDA is made available to traders. Instead, clause 12A.12(5) should refer to 2 months (or, preferably, a much longer timeframe) after the DDA template has been made available to traders in accordance with clause 12A.4(4).

89. Table 2 provides comments on the detailed drafting of the proposed DDA template.

Table 2: Drafting comments on the DDA template

Clause	Comments
2.2 2.3 4.1 4.3 Schedule 1	These clauses create obligations for the distributor and trader that are stated in absolute terms "the distributor/trader must…". Given the nature of electricity as a product it will not always be feasible to deliver services to the exact standard specified in the agreement, or it may be very expensive to do so. A more balanced set of requirements would be created by instead using the term "the distributor/trader will endeavour in accordance with Good Electricity Industry Practice to…" We recommend this phrase is used in these clauses. Good electricity industry practice is a well understood term and a reasonable standard of performance for industry participants to be held to.
5.1	Paragraphs D15 and D16 of the Consultation Paper state that this clause has been amended in the DDA from the model UoSA version to reflect the improved approach taken in the Vector UoSA. However, this has not been done and clause 5.1 continues to reflect the approach taken in the model UoSA (i.e. it still refers to the customer electing to take up the retailer's price option that corresponds to the controlled load option).
6.5 and 6.6	We welcome the new clause requiring the trader to investigate and minimise, in accordance with good electricity industry practice, non-technical losses. The distributors which support this submission consider that the majority of losses experienced are non-

Clause	Comments
	technical in nature and it is important for the DDA to recognise this. As the majority of losses are likely to rest with the trader it would be more appropriate for the traders to take the lead in investigating adverse trends in losses under clause 6.6.
8.5, 8.7	These clauses appear unbalanced. Under clause 8.5 the distributor is required to compensate the trader for incorrect price category information. However, there is no such requirement for the trader to compensate the distributor under clause 8.7 if the trader has incorrectly allocated a price category. There is no basis to treat distributors and traders differently in this regard – either both parties should be required to pay compensation or neither party should.
10.10(a)	The penalty interest rate of 15% above the Bank Bill Yield Rate that is applied under this clause was punitive when it was introduced but is arguably even more excessive now in the current low interest rate environment. We recommend reviewing this rate to reconsider whether it remains justifiable.
10.11(b)	The word "is" seems to be missing from between "good faith" and "necessary".
19.1	As discussed in paragraph 79, the distributors which support this submission recommend re-instating the right of either party to terminate the agreement by giving 120 working days' notice. This is necessary to ensure sensible commercial changes can go ahead efficiently.
22	The clause that enabled de minimis changes to the agreement to be made by either party by way of notice to the other has been removed from the draft DDA template. While the Consultation Paper is correct that minor changes should be able to be agreed between the parties, that overlooks the additional cost and effort involved in the amendment process. We support retaining the ability to make de minimis changes to the contract by notice. If there is any dispute regarding a de minimis change the dispute resolution procedures would apply. Including this clause would be helpful for addressing small unforeseen problems that may arise due to the drafting of particular clauses, that would be cumbersome to have to negotiate an amendment to address.
24.7	For the reasons discussed in the section starting at paragraph 71, the distributors which support this submission consider that the $2m per event liability cap should be deleted. It should be replaced with a new approach to setting a maximum liability cap that better meets the principle that an event should lead to consistent liability limits per customer affected irrespective of the size, scale or number of the industry participant(s).
Clauses 7, 8 and 33.1.	The draft DDA template has replaced the term "tariff structures" in the DDA with the term "pricing methodologies". This is confusing as the term pricing methodologies is used in Commerce Commission regulation to mean something different. The distributors which support this submission agree that moving away from the term "tariff" is appropriate. However, we recommend using the term "price structures".
33.2, definition of 'Working Day'	The defined term Working Day excludes, among other things, regional anniversary days applying to the head office of the party to an agreement. This can cause problems where the anniversary day of a retailer falls on the 20th of a month but the distributor is in a different region. In such circumstances the distributor is paid one day late and needs to carry additional funding to cover that scenario, which is generally not efficient.

Clause	Comments
	We recommend removing the reference to regional holidays from this defined term. This is an example of the kind of issue that could be resolved through the de minimis provision in clause 22, if that were to be re-instated.
All Schedules	As discussed in paragraph 83, we consider the detailed italicised terms in the schedules should be replaced with high-level principles for what each schedule should achieve. This will avoid the risk that the drafting in the DDA Schedules effectively becomes default wording that parties are expected to sign up to. The schedules contain both core terms (non-italicised) and operational terms (italicised). It would reduce confusion if all core terms were in the main section of the DDA and all non-core terms were in the schedules.
Even-handed treatment, clause 4 of model UoSA (deleted from DDA)	The DDA does not include clause 4 of the model UoSA, which required distributors to provide equal access to distribution services and treat all retailers even-handedly. The view expressed in the consultation material is that this clause is no longer necessary as either party may choose the default agreement. The distributors which support this submission recommend this clause is re-instated. Some distributors have found this clause helpful in persuading smaller retailers that they are being treated equally to the larger and incumbent retailers. This is a standard type of clause found in many agreements relating to network access (eg telecommunications) and, at worst, does no harm.
Additional Services, Schedule 2 of model UoSA (deleted)	For the reasons discussed in the section starting at paragraph 66, the distributors which support this submission strongly recommend this schedule is re-instated within the DDA.