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Auckland Energy Consumer Trust submission to the Electricity Authority: Default agreement for distribution services

Introductory remarks

The Auckland Energy Consumer Trust (AECT) welcomes the opportunity to provide a submission on the paper "Default agreement for distribution services" (the consultation paper) issued by the Electricity Authority (EA) dated 26 January 2016.

The AECT is an elected body owning more than three quarters of the shares in Vector Ltd. As its name implies the Trust's beneficiaries are the electricity consumers in the old Auckland Electric Power Board area. This means it has a strong interest in the welfare of consumers.

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The EA wishes to address the question of "whether to introduce a default distribution agreement to achieve the benefits from more standardisation of use-of-system agreements. The Authority considers that more standardisation of use-of-system agreements will enhance retail competition and lead to more efficient operation of the electricity industry." [from EA website 6 April 2016]

This submission covers two areas:

- Justification for this work; and
- Difficulties the proposal creates for the Trust carrying out its trust deed duties.

The justification for this work

The current consultation is the latest stage in a stream of work that has been underway since the 2010 Electricity Industry Act, which, in section 42(2)(f)[1], required the Authority to amend the Code to facilitate more standardised use-of-system agreements (UoSAs), or consider alternative methods by which more standardisation may be provided for.

The rationale for more standardisation was a desire to improve retail competition and efficiency by reducing transaction costs.

[1] "42 Specific new matters to be in Code
(1) Before the date that is 1 year after this section comes into force, the Authority must either—
(a) have amended the Code so that it includes all the matters described in subsection (2) (the new matters); or
(b) to the extent that the Code does not include all the new matters, have delivered to the Minister a report described in subsection (3).
(2) The new matters are as follows: […]
(f) requirements for all distributors to use more standardised use-of-system agreements, and for those use-of-system agreements to include provisions indemnifying retailers in respect of liability under the Consumer Guarantees Act 1993 for breaches of acceptable quality of supply, where those breaches were caused by faults on a distributor's network: […]
(3) A report provided under subsection (1)(b) must—
(a) identify which new matters are not included in the Code; and
(b) explain why the Authority has not amended the Code to include those matters; and
(c) suggest alternative methods by which the matters are or may be provided for; and
(d) set out if, when, and how the Authority proposes to provide for the matters."

In October 2011 the EA concluded that the appropriate route to take was facilitation[2].

This supported the announcement in the September EA document[3] that:

> "The MUoSAs and the drafting guidelines are voluntary (as participants are not required to use them), instead they constitute 'market facilitation measures' and have been under development for a number of years."

This position seemed to continue to reflect the view the EA restated that there were advantages in allowing innovation (and thus individuality) in the negotiation of UoSAs.

While there is provision for the parties looking for a UoSA (traders and distributors) to "negotiate" an opt-out alternative, the short timetables imposed together with the need for unanimity in this process, have made this a path that is not easy to pursue. Indeed the EA seems to have reacted to perceived monopoly power of the distributors in such negotiations by giving the traders the whip hand; if there is no agreement in the prescribed 20 business day period the default option comes into force.

As the consultation paper says, the EA has moved away from the broad approach signalled earlier and discussed above. It has abandoned the facilitation/ voluntary style to move to a formulation that contains elements that are not voluntary. In fact, large sections of the default agreement are compulsory.

We previously said[4] that the case for this type of action was not established. We see the current move as confusing ends and means. The test for consumer benefit should be whether consumers are gaining welfare, not whether some intermediate process is in line with the EA's views; similarly the test for the vibrancy of retail competition should relate to what is happening in that market, not an examination of input markets.

The nearest we can see for a stated case for this action is the claim that the stock of UoSAs is not becoming sufficiently standardised quickly enough[5]. This fails the tests suggested above.

We continue to see the problem tackled here as poorly defined. It is not enough to keep saying that the lack of standardisation creates transaction costs; nor to make a series of general claims that the EA views the proposal having a net benefit – even when this is rounded out by some figures[6].

All transactions have costs. To justify an intervention these have to be set against the offsetting benefits. Previous consultation rounds have shown the EA that there are potential offsetting advantages in allowing innovation and variety.

Sound policy-making demands that the new proposal be assessed against current practice in a robust cost-benefit manner to show that the restricted pathway to any alternatives and the high levels of compulsion now being prescribed are worthwhile.

The discussion of the problem[7] seems to confuse the stated problem (competition and efficiency) with a proposal the EA has long sought to pursue - adopting the model UoSA (MUoSA) or its terms. The further discussion rests heavily on an assessment that distributors are using monopoly power to create a variety of UoSAs, and thereby harm the interests of consumers. We cannot agree that this claim is justified in the paper.

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[2] Electricity Authority *(2011) Report on Completion of the Section 42 New Matters in the Electricity Industry Act 2010* page 9. It was noted in the body of the report that the EA would be monitoring developments.

[3] Electricity Authority (2011) *Information Paper and Summary of Submissions Standardisation of distribution arrangements - model use-of-system agreements* page 3

[4] AECT (2014) *Auckland Energy Consumer Trust submission to the Electricity Authority: More standardisation of use-of-system agreements*

[5] We note this choice is not forced on the EA, as there is provision in the Act for alternatives.

[6] Consultation paper pages D/E.

[7] Consultation Paper page 6.

We are pleased that this paper has undertaken a cost benefit analysis, as we recommended in the previous consultation. But the cost benefit analysis presented in the consultation paper is broad brush. It makes sweeping claims without clear support and particularly downplays the value of the benefits of possible innovation in the distribution/ trader market while overplaying those in the retail market[8]. Hence the proposal deliberately restricts the way UoSAs might contribute and relies heavily on a bureaucratic review process which does not promise to be responsive.

Our previous submission said:

> "…. the case for adopting a more enforced level of standardisation around the MUoSA is not able to be established via a general discussion of the situation. It is not a simple position to establish. In the general language of policy assessment this type of indeterminacy demands a well-worked through consumer welfare based cost-benefit analysis to resolve the matter. In particular, the social "value" of each choice of wording and the associated trade-offs made when selecting the version that becomes the model, needs to be carefully evaluated; and then the net result compared with the overall contributing factors, such as standardisation's potential for saving transaction cost on the one hand, and the accompanying potential loss from fixing the shape and content of the agreement, on the other. The method for updating is also vital and must form part of such an investigation."

We think this is just as valid now and that the examination in the Consultation paper is insufficiently grounded to establish the real worth of this new proposal. We are particularly concerned about the claims about the welfare of consumers, which are loosely assessed and not well-sourced. We base this on a consideration of the claim in 4.4.27 that the claims about consumers' welfare are:

> "Based on feedback from interested parties during the various consultations …as well as the Authority's understanding of the existing UoSAs…."

A quick review of the submissions published during the four previous rounds of consultation on the topic of MUoSAs (2012, 2011, 2011 and 2007) unearthed only three bodies (aside from AECT) that might be seen as representing consumers[9]. But as they were two administrators of embedded networks and MUEG, they were hardly typical electricity consumers. Without further evidence we would not take these views as a sound evidence base for assessing the preferences and welfare of the wider group of consumers'.

Further we note the EA itself said[10] about this process in 2011:

> "The Authority did not propose any additional Code amendments because an overly regulated approach to standardise distribution tariff structures risks creating a number of negative effects. Significantly, it could restrict to too great an extent the ability of distributors to tailor and provide for innovative pricing structures, which is likely to become increasingly important as smart meters become more prevalent. The Ministerial Review was very careful to recommend "more standardisation" and not "standardisation" for precisely these reasons."

Again we think these points were well made and should only be overridden on the basis of sound evidence, well put together. We do not see such material in the consultation document.

Difficulties the proposal creates for the Trust carrying out its trust deed duties

An example of why standardisation of terms as proposed should not pursued is the impact that this would have on the AECT and other bodies in performing their duties. The proposal limits what terms can be included in the Default Distribution Agreement (DDA). Only default core terms can be included

[8] This is explicit in the section that says the distribution market should be standardised so traders in the retail market compete to provide variety and innovation to benefit consumers– page 49.

[9] Others were typically industry participants.

[10] Electricity Authority (2011) *Report on Completion of the Section 42 New Matters in the Electricity Industry Act 2010*.

and there are significant limitations on what operational terms can be included and what these terms are. These restrictions fail to take into account the particular circumstances of some distributors or other participants involved in the electricity industry, such as the AECT.

The AECT is a trust and is bound by its own legal setting and the content of its deed. Changes in the legal environment can only be made by Parliament; changes in the deed require the approval of the High Court.

A crucial part of the workings of a trust is its ability to carry out its duties with respect to its beneficiaries. In the AECT case the beneficiaries are determined at a given time as those connected to the power within a defined location.

Originally when AECT was established the names of beneficiaries were readily available from the retailer/ distributor Mercury Energy.

Changing regulations over the years forced as the retailing arm to be divested leaving Vector Ltd as a distribution company. More recently Vector moved to the network-wide interposed model where there is no direct contract with the consumer / beneficiaries. The cooperation of the relevant retailers is required to allow access to information about their consumer connections. This data is fundamental for the trust to execute its duties to beneficiaries under the deed.

The EA proposal that only "distribution services" can be included in the Default Distribution Agreement (DDA) offered to retailers would distance the AECT from the existing methods of data acquisition. If a retailer did not agree to amend the DDA and enter into an alternative agreement, this would render AECT unable to execute the requirements of the trust deed. There are no justifiable policy reasons to impose this requirement on the Trust or Vector. On the contrary, in pursuing its objectives the EA must eliminate unintended consequences on matters which clearly fall outside of its jurisdiction.

Lack of power to require the default option

We also continue to doubt whether that the EA has the power to impose an effectively standardised UoSA on distributors and retailers alike. Requiring each distributor to develop a Default Distribution Agreement (DDA) within narrow confines, with the EA setting default core terms and limiting the scope for developing operating terms, forcing the distributor to offer each retailer such a DDA, giving a short time for distributor and retailer to come to an alternative agreement, and then in the absence of any agreement imposing the DDA as the agreement goes too far.

The EA is seeking to do this under the auspices of promoting "efficiency" and "competition". As set out above, we do not consider that there is sufficient justification for such a proposal.

In any event, we do not consider that such extensive control over UoSAs was intended to be given to the EA. As noted above the EA was empowered to make amendment to the Code to provide for "more standardisation" rather than "standardisation". Requiring the default option goes too far into standardisation; something with the EA had earlier said "risks creating a number of negative effects"[11]. Further, if the EA was intended to have these powers to prescribe default core terms and limit operating principles as well as to force distributors and retailers to accept the DDA in the absence of any agreement, the Electricity Industry Act would have had a similar provision for UoSAs as it has for transmission agreements (s 44). The absence of any such provision is telling.

Conclusion

While there are claims in the consultation paper about the net benefits associated with the default agreements they are not well evidenced and do not take seriously the potential benefits, including innovation, of the ability of distributors and traders to produce their own agreements in their own

[11] Electricity Authority (2011) *Report on Completion of the Section 42 New Matters in the Electricity Industry Act 2010* at page 33.

time. The claims made about consumer welfare also appear poorly grounded. The AECT therefore is strongly of the view that the proposal for default agreements is not sufficiently justified to be persisted with. It should be put on hold.

However, if the proposal is to be implemented, it must be amended to allow adequate provision for the traders to be obliged to pass consumer data through to distributors in a manner that allows the AECT to execute its deed effectively.