Electricity Retailers Association of New Zealand

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By email: submissions@ea.govt.nz

19 April 2016

Dear Craig

ERANZ supports a default distribution agreement

1. The Electricity Retailers' Association of New Zealand (ERANZ) strongly supports the Electricity Authority's (the Authority's) proposal to create a Distributor Default Agreement (DDA) for retailers and electricity distribution businesses (distributors). ERANZ considers that creating a DDA will result in a significant improvement that will provide static and dynamic efficiency benefits for New Zealand's retail market, and end-consumers.
2. ERANZ considers that distributors and retailers will naturally converge to the DDA, particularly as the decision to move to the DDA can be triggered by either party. For this reason, we see no added benefit from the forcing parties to move to a new agreement (whether the DDA or an alternative). In fact, we consider this compulsion adds unnecessary cost to the proposal overall.
3. ERANZ responses to the questions in the consultation paper are in Appendix 1 to this letter. We make some recommendations on specific changes to the proposed Code and DDA text in Appendix 2. Appendix 3 is a report prepared by Castalia Strategic Advisors (Castalia) for ERANZ that evaluates the impacts of default distributor agreements.

Introduction: Who is ERANZ?

4. ERANZ members are Genesis Energy, Contact Energy, Mighty River Power, Meridian Energy, Trustpower, Nova Energy, Pulse Energy, and Prime Energy. ERANZ represents over 99% of the retail market in New Zealand by ICP count. ERANZ was established in August 2015 to promote and enhance a competitive and sustainable electricity market that delivers value to New Zealand electricity consumers.
5. ERANZ members are at the coal face of negotiating distribution agreements with distributors. Based on this extensive experience, ERANZ supports the DDA as a timely intervention that will increase the efficiency of the retail market.

Problems with the Model Use of System Agreement (MUoSA)

6. ERANZ agrees with the Authority's 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 a number of distributors following the publication of the

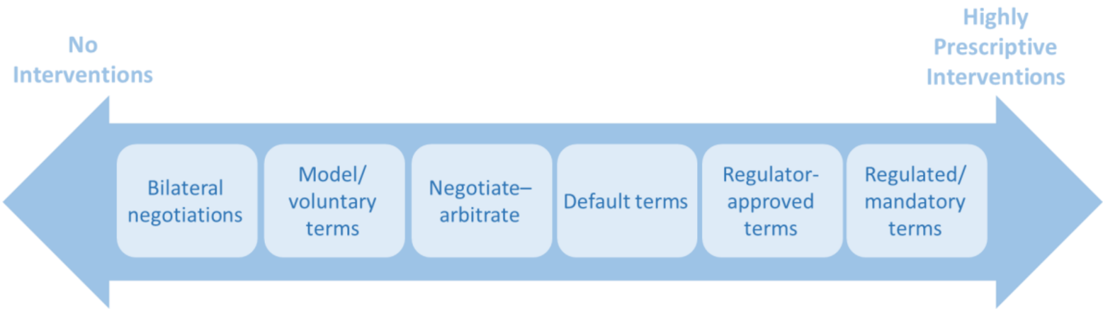
MUoSA in September 2012. However, the level of improvement has not been consistent nor has there been a significant increase in standardisation. Negotiating agreements can still take a significant commitment of retailer and distributor resources, and can still be a long process.

7. ERANZ asked Castalia to evaluate the potential competition benefits of the DDA. Their report, attached as Appendix 3 to this submission, identifies the underlying problem with the status quo bilateral negotiations: namely, it does not reflect the natural monopoly characteristics of electricity distribution businesses where distributors have monopoly negotiating power and the service retailers need. Retailers are unable to negotiate on, and distributors are not incentivised to offer, a level playing field. ~~.~~This is a particular problem for new and emerging retailers, but one that will be increasingly important as retailers compete with distributors in ancillary markets. Castalia's report also notes the transaction cost reductions from DDA that will benefit both retailers, and distributors. These static efficiency benefits will add value to consumers.

Addressing the contractual imbalance

8. ERANZ considers there are significant benefits from greater standardisation of distribution agreements as proposed in the DDA. It is ERANZ's view that a DDA will lead to a more competitive retail market that delivers greater value to consumers by reducing transaction costs and creating more equal and open access to distribution services. ERANZ agrees these benefits are unlikely to be achieved on a voluntary basis.

9. As shown below, Castalia's report outlines a range of approaches to this problem, ranging from allowing bilateral negotiations, through to regulated terms.



- Value in tailoring contract terms to the specifics of the particular relationship.
- Ability to alter terms to suit changing circumstances over time is important.

- An inherent power imbalance or incentive problem for one party not needing to agree terms.
- It is important to ensure level playing field among competing users of the network

10. Overall, ERANZ favours an approach which is more prescriptive than the status quo. We consider there is more value to consumers from ensuring the current contracting power imbalance is corrected, and we want to see all retailers provided level playing fields across distribution regions.

11. 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 different contractual provisions.

A DDA strikes the right balance

12. ERANZ considers the Authority's DDA proposal provides an appropriate balance between standardisation and flexibility. 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. Allowing for alternative agreements and providing for default operational terms to be 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.

13. We also note that this approach is consistent with the approach taken in other 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, and Castalia's report identifies an international trend to strengthen regulatory control over monopoly contract power.

Existing agreements should continue

14. 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 replacement of all existing agreements. In our view, retailers and distributors should be free to maintain their current agreements if both parties so choose.

15. This particular aspect of the proposal would not be justifiable under cost-benefit analysis, and indeed likely undermines the overall net positive benefit of the introduction of the DDA. Firstly, there is no evidence that mandating replacement of existing distribution agreements would yield any discernible benefit, as there is no evidence of existing agreements impacting competition. Secondly, mandating replacement of existing agreements would simply discard all the effort the industry has expended over recent time, add unnecessary cost and distraction to new-entrant and established retailers alike and divert them from their roles increasing innovation and competition in the market.

The CBA undervalues future static and dynamic efficiency benefits

16. ERANZ broadly agrees with the Authority's net positive benefit in the cost-benefit assessment (CBA) of this proposal. Given the recent flux of new entrants in the New Zealand retail market, and the potential for existing retailers to expand, we consider the Authority's estimate of productive efficiency benefits to be reasonable, and potentially conservative.

17. In our view, the paper undervalues the benefits of the change for existing historical distribution agreements. We suggest there are a high number of historical distribution agreements that pre-date the MUoSA or even the Authority itself. 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.

18. We agree that the dynamic 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 clearly enhance the competitiveness of the retail market.

19. 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 terms under the MUoSA, and where appropriate, customise terms to individual networks. We therefore consider that additional cost to develop and publish a DDA will be incremental.

20. But, as discussed above, we believe the net positive benefit in the CBA would be increased materially 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. This requirement would simply serve to increase costs, with little (if any) discernible benefit.

Next Steps

21. 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.

J Cameron

Jenny Cameron
Chief Executive
Electricity Retailers’ Association of New Zealand

Response to Questions

Question	ERANZ response
Q1. What is your view of the Authority's assessment of the arrangements that are currently in place governing the way distributors and retailers develop, negotiate, and agree UoSAs, and of the issues that the Authority has identified? Please provide your reasons.	ERANZ members feel the MUoSA has delivered insufficient benefit to consumers, retailers or distributors. Whilst it has shortened negotiation timeframes in some instances, it has not addressed the monopoly negotiating power imbalance with bilateral agreements. As outlined in the attached paper by Castalia Strategic Advisors, this monopoly contracting power can have significant impacts on the competitiveness of markets – and consumers.
Q2. What feedback do you have on the information in section 3, which describes the Authority's proposed new Part 12A of the Code, which includes a DDA template, requirements to develop a DDA, and provisions that provide that each distributor's DDA is a tailored benchmark agreement?	ERANZ supports the DDA. But we oppose the proposed transitionary measure that would require all agreements to be replaced with either the DDA or an alternative agreement. We also 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. Please see cover letter for further information.
Q3. What are your views of the Authority's assessment of the likely levels of demand for new and replacement UoSAs in coming years? Please support your response to this question with reasons and your alternative quantified assessment, if any.	ERANZ considers the Authority has underestimated potential future demand for new distribution agreements. The paper's analysis appears to assume that completed agreements are still fit-for-purpose. This may be the case in general, but parties to many of the existing agreements may also prefer to move to the DDA. However, as discussed in our cover letter, moving to the DDA or an alternative should not be mandated if both parties are in fact happy to remain with their existing agreement. Removing this unnecessary automatic transition will also reduce the costs associated with the introduction of the DDA and lead to a higher net benefit.
Q4. What are your views on the regulatory statement set out in section 4?	Please see cover letter.

Question	ERANZ response
Q5. What are your views on the detailed drafting of the Code amendment provided in Appendix B and Appendix C?	ERANZ's specific comments on the detailed drafting of the proposed Code and DDA are in Appendix 2 to this letter. In general, ERANZ is happy with the example operational provisions set out in annexes in the consultation document. However, we suggest the Authority should clearly separate the purpose of the individual clauses from the example terms.

Appendix 2: Comments on specific drafting

The Code

Draft Rule	ERANZ comments	Suggested Amendment
12A.3(2)	The criteria in 12A.3(2) could be simplified. In (d) the ability of the distributor to meet a trader's requirements should not be a separate relevant consideration if the trader's requirements are otherwise 'reasonable'. The assessment of 'reasonableness' must necessarily take into account how easy or hard it would be for the distributor to comply with the relevant requirements. If the word 'reasonable' is added to (b) then (d) can be deleted entirely.	(b) reflect a fair and reasonable balance between the legitimate interests of the **distributor** and the reasonable requirements of **traders** trading on the **distributor's network**; and Delete (d) entirely.
12A.5(1)	The appeal timeframe in 12A.5(1) should run from when the distributor notifies a participant under clause 12A.4(5)(b). Otherwise there is no 'consequence' for the distributor of failing to comply with the notification requirement in 12A.4(5)(b) and in fact the appeal timeframe could run out before participants are notified by distributors of the availability of a DDA. Also it's not clear what "participated in the consultation" means. Suggest that this is clarified.	(1) No later than 10 **business days** after a **distributor** ~~makes its~~ advises a participant in accordance with 12A.4(5)(b) that a **default distribution agreement** is available on its website, a **participant** that made a written or verbal submission to the **distributor** ~~participated~~ in the consultation under clause 12A.4(5)…

12A.12	The proposal suggests a very short transition period – of only two months – for distributors and retailers to decide whether to continue with their existing agreements or adopt the new default agreement. As discussed in our cover letter, ERANZ does not see a need for this time-bound transitional requirement. In our view, retailers and distributors should be free to maintain their current agreements with the ability to change to the DDA. Similarly, if either party chooses to, with appropriate notice. Over time, we suggest that it is likely both parties will move to the DDA as existing agreements come to term. We also suggest the appropriate notice period is at least 20 business days, to allow for internal processes to be adjusted.	(1) This clause applies to a **distributor** and a **trader** that have an agreement for **distribution** services that was entered into before the date on which the **distributor** made its **default distributor agreement** available on its website under clause 12A.4(4) ("existing agreement"). (2) The **distributor** must, no later than 10 **business days** after the date on which the **distributor** makes its **default distributor agreement** available on its website, offer to contract with the **trader** on the terms set out in the **default distributor agreement**. (3) At any time after the offer to contract has been made under subclause (2) ~~before the **default distributor agreement** applies as a binding contract between the **distributor** and the **trader** under subclause (5)~~, either the **trader** or the **distributor** may give the other party notice that the **trader** or **distributor** wishes to contract with the other party on the terms set out in the **default distributor agreement**. (4) If either party gives a notice under subclause (3), the **default distributor agreement** applies as a binding contract between the **distributor** and the **trader** with effect from the ~~5~~20th business day after the date on which the notice is given, or any other date agreed by the parties. ~~(5) Subject to subclause (4), if the **distributor** and the **trader** cannot agree on the terms of a **distribution agreement** to replace the existing agreement at the expiry of 2 months after the date on which this clause came into force—~~ ~~(a) the **default distributor agreement** applies as a binding contract between the **distributor** and the **trader** with effect from the expiry of that period; and~~ ~~(b) the provisions of the existing agreement that directly or indirectly relate to **distribution** services are deemed to have been terminated with effect from that date.~~ (6) Clause 12A.10 applies in respect of any **distribution agreement** that the parties agree to replace an existing agreement that is not the **default distributor agreement**.

12A.14	Draft Rule 12A.14 introduces a new obligation for traders to have a distribution agreement in place. ERANZ **supports** this insofar as it relates to local networks. However, the definition of "distribution agreement" includes embedded networks. This means Draft Rule 12A.14 (1) requires Traders to enter into distribution agreements with embedded network owners. As noted by the Authority's consultation paper, the issue of embedded network agreements remains under consideration. ERANZ encourages the Authority to push ahead with an embedded network workstream as we consider there are significant benefits for consumers and retailers from regulation of this area.	Amend Draft Rule 12A.14 to read: 12A.14 Obligation to enter into distribution agreement (1) A trader trading on the distributor's network must have a distribution agreement with the distributor. (2) A trader must ensure that a distribution agreement comes into force on or before the day on which the trader commences trading on the distributor's network. (3) A trader that wishes to trade on a distributor's network must give notice to the distributor of that fact at least 20 business days before the trader proposes to commence trading on the distributor's network. (4) For the purposes of subclauses (1) and (2), **distribution agreement** excludes an **embedded network**.

The DDA Template

Clause	ERANZ comment	Suggested Amendment (marked)
Deleted clause 3.1	A fundamental precept of the New Zealand electricity market structure is that distributors will be neutral to the different retailers that operate on their networks. This allows retail competition to deliver value to consumers. Section 3.1 of the MUoSA codifies this requirement. It requires distributors to ensure all retailers have equal access and are treated even-handedly. However, this provision has been deleted from the proposed DDA. We suspect this deletion was because the DDA will be open and accessible to all Traders. However, the ability to enter the agreement is not a guarantee to equal treatment under the same agreement. ERANZ's concern is ensuring that distributors are obligated, by the agreement, to treat all retailers in a similar way. This may be a particular issue for energy service providers who may be competing with distributor owned services or businesses (e.g. solar or battery storage). ERANZ asks the reinstatement of MUoSA clause 3.1 (or words to a similar effect). We suggest this clause should be part of the general obligations of a distributor (Clause 2.3).	Reinstate MUoSA clause 3.1 into DDA clause 2.3: 2.3 (j) **Equal access and even-handed treatment**: The Distributor will give all Traders equal access to the Distribution Services and will treat all Traders even-handedly.
Clause 21	Clause 21.1(c) may be used to thwart the CGA indemnity referred to in clause 25. For example, ERANZ members are aware of situations where distributors have attempted to use a force majeure exemption on the basis that they acted in accordance with 'Good Electricity Industry Practice'. In ERANZ's view, this contradicts the CGA indemnity referred to in clause 25. ERANZ suggests this unintended outcome can be prevented by specifically exempting Clause 25(1) from Clause 21.	Insert a new clause 21.6: **21.6 Application to the acceptable quality guarantee.** There will not be a Force Majeure Event if the conditions for a Distributor indemnity set out in clause 25(1) are satisfied.

Clause 22	Clause 22.1 allows for amendments to the DDA in particular circumstances. Potentially, the broadest of these amendment circumstances is the ability to change the agreement "by the written agreement of the parties". Clause 18.16 of the MUoSA has a clear process whereby such changes are notified and agreed by the parties to the agreement. This detail is not in the DDA. New Rule 12A.11 of the Code codifies the amendment powers for a distributor. However, there is no similar process that allows Traders to request an amendment. ERANZ suggests this omission will limit the ability of DDA's to adapt to change and may render them static – perhaps even disadvantaging new innovations which may not be contemplated under the current DDA approach. As a solution, ERANZ suggests modifying MUoSA Clause 18.16 into a DDA change request process. This will enable retailers to suggest change proposals to the distributor for further consideration via the requirements of Rule 12A.11.	Insert a new Clause 22.1A: **22.1A Trader Change Requests.** The Trader may suggest a change to the operational terms of this Agreement by notice to the Distributor: (a) A notice of change request will: (i) set out the reasons for the proposed change; and (iii) set out the change in the form that the change is proposed to be incorporated in this agreement; (b) The parties will negotiate the change request in good faith; (c) If the Distributor sees merit in the change request they will promptly initiate an amendment to the operational terms in accordance with Rule 12A.11 of the Code.
Clause 22	Related to our comment on Clause 22 above, it appears the "amendment" provisions in Clause 22 are not consistent with the requirements of new Rule 12A.11 of the Code.	Need to be reviewed for consistency with new Rule 12A.11.

Clause 25	The Consumer Guarantees Act 1993 indemnifies retailers for some failures of acceptable quality in the supply of electricity to a consumer. Section 7A of the CGA describes the acceptable quality obligation, and Section 46A sets out the process and criteria for establishing the indemnity. Most of the provisions in Section 46A are replicated in Clause 25 of the DDA. However, the replication is incomplete in that the definition of a failure, under paragraphs 46A(1)(a)(i) through (iii) of the CGA, have been excluded. ERANZ is of the view that the DDA should either be a simple cross reference to Section 46A of the CGA, or accurately replicate the entire provision.	Preference is to delete Clause 25 and replace it with: 25.1 **Distributor acceptable quality indemnity.** The Distributor indemnifies the Trader from failures of the acceptable quality guarantee in the supply of electricity, as set out in Sections 7A and 46A of the Consumer Guarantees Act 1993. Or, alternatively, amend Clause 25.1(a) to read: 25.1 **Distributor indemnity:** The Distributor indemnifies the Trader as follows. If: (a) there has been a failure of the acceptable quality guarantee in the Consumer Guarantees Act 1993 in the supply of electricity to a Customer by the Trader, as determined - (a "Failure"); (i) by the trader; or (ii) if the trader does not make a determination or if the trader’s determination is challenged, by the dispute resolution scheme following a complaint made under section 43EA of the Gas Act 1992 or under section 95 of the Electricity Industry Act 2010 (as the case requires); or (iii) in accordance with clause 23, if the dispute is not accepted by the Electricity and Gas Complaints Commissioner; and

Clause 26	Clause 26 suggests a contractual process for determining liability and managing claims where there has been a breach of the acceptable quality guarantee, established by Section 7A of the Consumer Guarantees Act 1993 (CGA). Section 46A of the CGA sets out a clear process for determining when a retailer is indemnified by a distributor for a failure to meet this acceptable quality obligation. Furthermore, Section 46A sets out a process for resolving disputes between the retailer and the distributor via a dispute resolution service. ERANZ considers that Clause 26 of the DDA provisions goes substantially beyond the requirements of section 46A of the CGA. It purports to establish additional reasons for a distributor to resist indemnity (e.g. failing to let the distributor manage the claim). It unnecessarily delays resolution of the customer's problem by requiring the distributor's approval, or requiring the consumer to take legal action against the retailer. Therefore, ERANZ strongly suggests the Authority delete this clause and allow the processes set out in Section 46A of the CGA to retain their primacy.	Delete Clause 26.

Clause 31.2	We suggest the exchange of information provisions need to be improved to ensure that customer information, requested by an distributor, is for lines service purposes. That is, it is only information directly related to the provision of the lines services as defined by the DDA. It is difficult to see circumstances under which individual consumption information is relevant to the distribution company providing lines services to a particular customer. Furthermore, if a distributor desires this information, they are able to request permission from the customer directly in accordance with Rule 11.32A of the Code. Clause 29 enables the distributor to share any consumer information to third parties. This creates significant privacy risk for retailers. ERANZ suggests this be clarified to required explicit permission from the retailer – which can be denied – if the distributor wishes to share any consumer information. Our proposed amendment adopts some of the structure negotiated for the Clause 6.10 of the current Vector Agreement. ERANZ considers this clause reflects the current industry best practice on exchange of consumer information for energy lines services.	Amend Clause 31.2 to read: 31.2 Customer information: The Trader must on reasonable written request from the Distributor, and within a reasonable timeframe, provide the Distributor with such Customer information held by the Trader and necessary to enable the Distributor to fulfil its obligations in accordance with this Agreement. The information must be treated by the Distributor as Confidential Information and the Distributor expressly acknowledges and agrees that it is not authorised to, and must not, use such information in any way or form other than as permitted by this clause 31.2. For the avoidance of doubt: (a) The Trader must comply with such requests as soon as practicable, subject to its obligations under the Privacy Act 1993 and under the terms and conditions of its Consumer Contracts; (b) The format for Consumer information will be the relevant regulated or agreed EIEP, or as otherwise agreed between the Distributor and Trader; (c) The Distributor must only use the Customer information it holds or obtains from the Trader to the extent required for: (i) customer surveys in relation to the provision of Distribution Services; (ii) communicating with Customers in relation to Planned Service Interruptions or Unplanned Service Interruptions; (iii) engagement regarding construction of new assets and network configuration (excluding those relating to solar, batteries, or other competitive products); (iv) network complaints; (v) tree trimming requirements; (vi) safety concerns; or

(vii) for any other reason agreed between the Distributor and the Trader.

(d) The Distributor must not use this information for the purpose of electricity retailing or any other non-network service offering (including solar, batteries, or other competitive products);

(e) The Distributor may only pass the Customer information it holds or obtains by virtue of this clause to other entities or business operations, whether or not part of the Distributors' group of companies, where it is necessary for the Distributor to fulfil its obligations provided for in sub clause (c); and

(f) The Distributor must pay the Trader's (or third party authorised by the Trader) reasonable costs in providing Customer's demand or consumption information.

Evaluating the Impacts of Default Distributor Agreements

18 April 2016

1 Introduction and Scope of this Paper

Distributor agreements (also known as use of system agreements) specify the terms for providing distribution services to electricity retailers. These agreements are currently agreed through individual negotiations between distributors and retailers, with those negotiations typically anchored around standard terms specified by the distributor.

The Electricity Authority (EA) has identified that the current approach to negotiating agreements creates inefficiencies that make outcomes worse for consumers. To address these inefficiencies, the EA proposes to implement a Default Distributor Agreement (DDA) to provide standard terms for distribution services. The EA has identified that the proposed DDA will help:

- Minimise the transaction costs of negotiating distributor agreements
- Support competition in the retail electricity market by ensuring that retailers are treated equally by distributors.

The EA's quantitative analysis of the proposal to introduce a DDA focuses on the impacts of minimising transaction costs. However, the EA acknowledges that the benefits for retail competition (dynamic efficiency gains) are likely to be more significant.

Scope of this paper

The Energy Retailers Association of New Zealand (ERANZ) has engaged Castalia to evaluate the potential competition benefits of the proposed DDA.

This paper:

- Provides a conceptual framework for determining when default agreements are likely to provide net benefits and which aspects of distributor agreements should be default core terms, and which should be determined at a network-specific level (operational terms) (Section 2)
- Positions the proposed DDA in the context of regulatory interventions used in infrastructure sectors in New Zealand and abroad (Section 3), and
- Draws some key conclusions from the conceptual framework and experience in other sectors and countries (Section 4).

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2 Framework for Evaluating Default Agreements

Regulators do not determine default contract terms in every market. However, there is a strong rationale for regulating contract terms in markets that have characteristics that do not enable competition to serve the long term interests of the consumer.

The identified problems with distributor agreements reflect the natural monopoly characteristics of electricity distribution

A natural monopoly can take advantage of market power by increasing prices or submitting counterparties to inefficient contract terms.

In New Zealand, concerns about monopoly pricing are addressed under Part 4 of the Commerce Act. Part of the contracting problem has also been addressed to some extent. In the electricity sector, the Electricity Industry Act places restrictions on vertical integration between monopoly and competitive parts of the supply chain. Other industries with natural monopoly characteristics in New Zealand have also responded in a similar way—for example, through the structural separation of Telecom and through ring-fencing/arms-length dealing provisions in gas operating codes.

These interventions remove much of the incentive to impose inefficient terms on contract counterparties by removing any risk of favouring affiliated retailers. However, the EA has identified that part of the problem of contracting with distributor monopolies remains. We think it is worth distinguishing between three types of remaining issues:

- **Negotiating power imbalances.** Distributors can insist on particular terms by adopting a "take it or leave it" approach to contract negotiation. In addition to leading to outcomes that are weighted towards distributors' interests, these imbalances can also lead to a situation when contract terms are not updated and revised over time (where distributors have insufficient incentive to modify contract terms)
- **Discrimination between retailers.** Distributors are likely not to offer the same terms to all retailers. This is particularly problematic when combined with the problem of negotiating power imbalances because it means that larger retailers are likely to have access to better contract terms, potentially distorting competitive offerings in the retail market
- **Transaction costs.** The process of developing, negotiating and executing bespoke agreements imposes transaction costs

These problems are commonly experienced in monopoly industries that are subject to access regulation (such as telecommunications and rail), where the focus is on regulating the interaction of access seekers with a single access provider.

As mentioned in the introduction to this note, the EA cost benefit analysis focuses more on the third problem (transaction costs) than the first two problems. In fact, the first two problems are likely to be more important than transaction costs (a fact recognised by the EA in its paper). This is because negotiating power imbalances and discrimination between retailers can affect dynamics in the competitive retail electricity market.

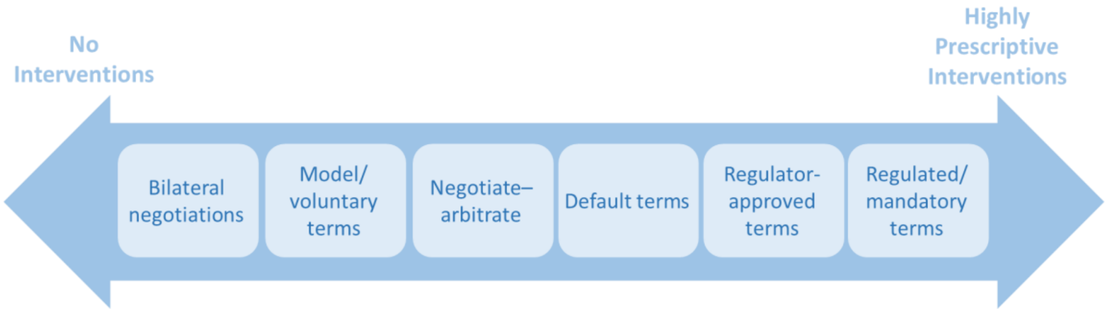
Regulatory interventions can be designed as fit-for-purpose

Regulators can take a range of different approaches to ensure retail competition through access regulation. Approaches range from, at a minimum, taking a "hands off" approach where firms are expected to come to efficient outcomes through bilateral negotiations. At the other extreme, regulators can directly regulate the non-price terms in access agreements.

Figure 2.1 presents the different approaches available to regulators on a spectrum from the minimum to maximum level of intervention in the market. In between the extremes noted above, there are at least four other approaches:

- Model agreements, where terms are suggested and promoted by the regulator, but not enforced,
- Negotiate-arbitrate models, which provide the right to negotiate and have any failure to agree backstopped by an independent decision making process,
- Default terms, which provide a framework for negotiations and act as fall-back for terms that are not negotiated, and
- Approval of access terms by regulator (usually following an application by the access provider).

Figure 2.1: Range of Regulatory Interventions on Non-Price Terms



What factors should determine the choice of regulatory intervention?

The optimal landing point on this spectrum depends on the particular characteristics of the sector involved—the relative value of flexibility and responsiveness on the one hand, and power imbalances and impacts on retail competition on the other.

Table 2.1 summarises the main factors that should be used to determine the optimal regulatory response in each case. This effectively sets up a "test" for evaluating a proposed level of regulatory intervention.

Table 2.1: Factors Determining the Choice of Regulatory Intervention

Weaker regulatory intervention should be preferred when…	Stronger regulatory intervention should be preferred when…
▪ There is value from tailoring contract terms to the specifics of a particular relationship ▪ The ability to alter terms to suit changing circumstances over time is important	▪ There is a clear power imbalance or incentive problem from one party not needing to agree terms (take it or leave it) ▪ It is important to ensure a level playing field among competing users of the network

Determining what qualifies as a 'core' term

If a regulator decides to set default or approved terms, then decisions also need to be made on the scope of those regulated terms. Allowing contract terms to have different levels of regulatory prescription enables default arrangements to capture some of the flexibility benefits of less prescriptive regulatory approaches. We think it is useful to distinguish between three categories of contract terms:

- Default "core" terms, which establish the standard terms for distribution services and must be included in each distributor's DDA – effectively a set of terms that apply nationwide
- "Operational" terms included in each distributor's DDA. These terms will reflect each distributor's day to day business arrangements (which can vary from distributor to distributor). Each distributor will develop operational terms that comply with the requirements in the DDA template, and distributors must publish their DDA – effectively a set of terms that apply to every retailer operating on the particular network involved.
- Non-regulated terms. Parties will be free to agree to other terms that are not core or operational and reflect specific distributor-retailer relationships.

To determine the category that different contract terms fit into, we recommend a two-stage approach:

- **First, considering whether a particular contract term should be regulated.** This involves a balancing of the factors listed in Table 2.1. If there is a high level of concern about negotiating power imbalances or discrimination across retailers, then parties should not be left to negotiate these terms individually.
- **Second, considering whether a particular term should be core or operational.** Once a decision has been made on the set of terms that should be regulated, the question on type of regulation comes down to the appropriateness of reflecting particular network characteristics in the contract. We think that a sensible approach is to start by defining the set of items that should have nationwide consistency. At a high level, we would expect this to include approaches and metrics used to define performance obligations, reporting processes, and methods of assigning liability. While the particular obligations may be specific to each network, the requirement to commit to particular benchmarks and follow particular processes should be consistent.

3 Regulatory Experience with Non-Price Contract Terms

The EA's DDA proposal is not unique for access regulation. Using the spectrum of possible interventions presented in Figure 2.1, the proposed DDA would fit in the middle of the range of models used internationally, and is consistent with a general trend to apply more regulatory oversight of non-price contract terms.

The proposed DDA would move negotiations from model agreements to default terms

Currently, a model use of system (MUoSA) agreement has been developed to provide a standard for distributor agreements. The proposed DDA would move from a voluntary model to using default terms.

The terms in the DDA proposed by the EA still allow for parties to negotiate different terms. However, the DDA provides a framework for negotiations, and provides default terms where these are not specifically identified in negotiated agreements. This addresses any power imbalance in negotiating with monopolies.

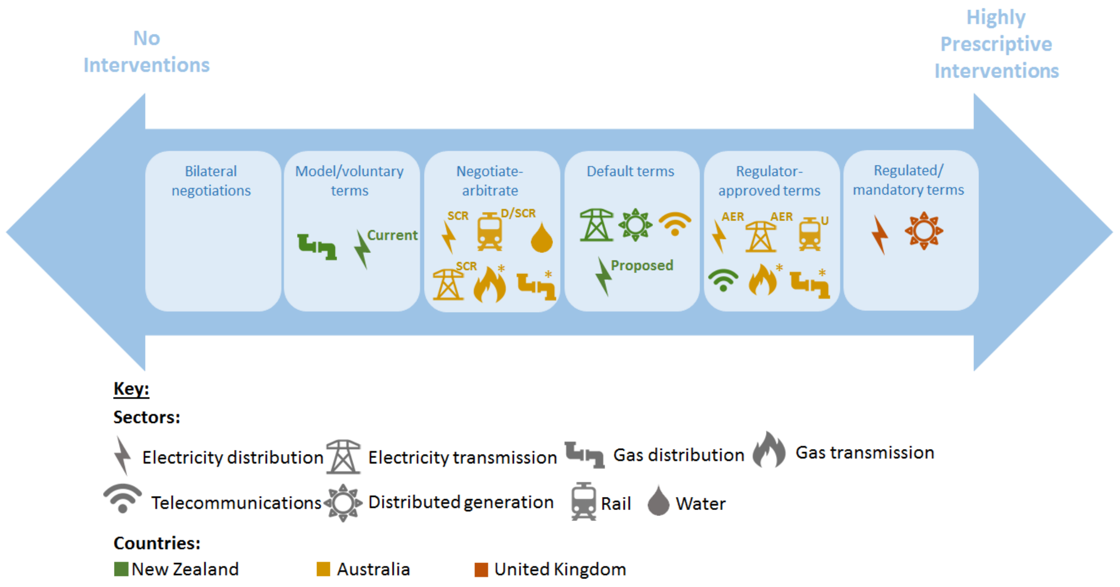
Regulation of non-price terms is common in infrastructure sectors globally

The spectrum presented in Section 2 of this paper can be used to illustrate examples from other industries—showing that the EA's proposal is not particularly unique, and the impacts found in other industries are likely to apply equally.

Figure 3.1 identifies which interventions are used in different infrastructure sectors in New Zealand, United Kingdom and Australia. Appendix A provides further details on the regimes. In some cases, judgment has been required to place particular regimes on our spectrum—and experts in the sector may differ in the specific location where different regulatory approaches are placed.

This shows that several different forms of interventions are used in regulating access to infrastructure. Most regulatory approaches are clustered around moderate levels of regulatory intervention—either negotiate-arbitrate systems, default terms or approved terms. Australian regulatory practice largely divides into negotiate-arbitrate and regulator-approved terms, whereas default terms appear more common in New Zealand (across the electricity sector). The two examples from the United Kingdom have contract terms mandated by regulation.

Figure 3.1: Mapping Access Regulation Regimes in Infrastructure Sectors in New Zealand, Australia and the United Kingdom


No Interventions
Highly Prescriptive Interventions
Bilateral negotiations
Model/voluntary terms
Current
Negotiate-arbitrate
SCR
D/SCR
SCR
*
*
Default terms
Proposed
Regulator-approved terms
AER
AER
U
*
*
Regulated/mandatory terms
Key:
Sectors:
Electricity distribution
Electricity transmission
Gas distribution
Gas transmission
Telecommunications
Distributed generation
Rail
Water
Countries:
New Zealand
Australia
United Kingdom

$^{\text{SCR}}$ State certified regimes, $^{\text{D}}$ Declarations, $^{\text{U}}$ Undertakings, $^{\text{AER}}$ Australian Energy Regulator

* For gas distribution and transmission in Australia, the National Competition Council recommends to the Minister whether light negotiation (negotiate-arbitrate model) or "full" regulation where a regime is submitted to the regulator (which is the AER, except in Western Australia) for approval

Internationally the trend is to strengthen this form of regulatory control

Where there has been movement along the spectrum, this tends to have been from left to right. Some notable cases include New Zealand's telecommunications shifting from bilateral negotiations (pre-2001) to a negotiate/arbitrate model between 2001 and 2006, to now using default terms. We note that the Commerce Commission has just embarked on a review of the terms for regulated Unbundled Bitstream Access (UBA).[1]

The movement of Australian telecommunications access regulation from negotiate/arbitrate model to default terms is described in Box 3.1. This example sets out the benefits that can be expected from following a default agreement model. However, this example also highlights some of the issues with default agreements—notably the need to ensure that default agreements do not unnecessarily restrict the retail services that they support.

Box 3.1: Access Regulation in Australia's Telecommunications Sector

The telecommunications regime in Australia has progressively moved towards standard non-price terms. Telstra (formerly government-owned) owns the copper network infrastructure. Until 2011, telecommunications services were subject to a negotiate–arbitrate framework under Part XIC of the Competition and Consumer Safeguards Act 2010. Those seeking access to Telstra's network stated at a Senate inquiry that incumbents were able to stall negotiations, raise the costs of competitors and limit competition. There was also suggestion that Telstra used the arbitration process to prolong access disputes.

Amendments to Part XIC set up a telecommunications-specific access regime to ensure competitors have access to Telstra's networks. Under this regime, the Australia Competition

[1] See http://www.comcom.govt.nz/regulated-industries/telecommunications/regulated-services/standard-terms-determinations/unbundled-bitstream-access-uba-services/unbundled-bitstream-access-uba/

and Consumer Commission (ACCC) can declare particular telecom carriage services. The ACCC must make an access determination for all declared services that sets out default terms and conditions of access (including prices). Without any negotiated agreement between the access provider and an access seeker, the conditions contained within the access determination will apply. Alternatively, a service provider of a non-declared service may submit a voluntary undertaking to the ACCC.

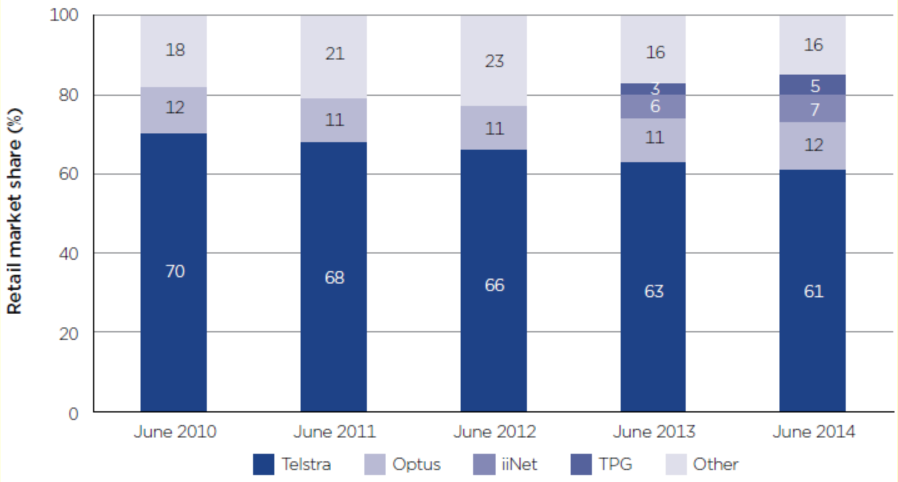
Stakeholders recognise the benefits of moving to a default terms regime

There is evidence that this model in telecommunications has provided benefits. In a statutory review of the Part XIC changes, submissions from stakeholders noted that the changes:

- Ensure the regime is fit-for-purpose and flexible (ACCC)
- Provided greater certainty to network providers and access seekers through fixed principles and special access undertakings (which allows the provider of a new service to propose its declaration and set the terms and conditions to its access). In turn, this certainty promotes competition in downstream markets by regulating access to the essential input, and supports investment effectiveness (ACCC)
- Enabled regulated outcomes that are timely (Macquarie Telecom)
- Provided a level playing field for access (Nextgen)

Market performance indicators also suggest increased competition. Since 2010 (prior to the amendments to Part XIC), Telstra's market share has fallen from 70 percent to 61 percent, and two new players have entered the market: iiNet and TPG. Changes in market share are shown in Figure 3.2. While other factors, such as technology change, may have also influenced this improvement in competition, the new access regime has supported a more competitive downstream retail environment.

Figure 3.2: Retail Fixed Voice Service Market Shares



Source: Data obtained from the ACCC Division 12 RKR for named carriers and from the ACMA *Communications Report 2013–14* for the 'other' category.

Notes: Market share calculations are based on the number of subscribers.[41]

Totals do not add up to 100 per cent in all years due to rounding.

Source: ACCC, Telecommunications competitive safeguards for 2013–14, February 2015

There are also some risks from moving to a default terms regime

However, there are also some risks with the changes:

- The product offered by the carrier does not always align exactly with the non-price terms and conditions of the access determination, which limits the access seeker's ability to rely on it (TPG)
- There is a risk of regulatory error in setting the terms and conditions (VHA)

4 Conclusions

The main conclusions from this paper can be summarised as follows:

- There are sound reasons for regulating the non-price terms in agreements to use natural monopoly infrastructure. While the Electricity Industry Act means that distributors do not have strong commercial incentives to favour affiliated retailers, the risk of inefficient contract terms remains. Distributors can insist on particular contract terms by adopting a "take it or leave it" approach to contract negotiation, and may have reasons to agree more favourable contract terms for particular retailers.
- This risk has led to a trend both internationally and across other infrastructure sectors in New Zealand to increase the level of regulatory intervention in influencing or determining non-price contract terms. The evidence we have collected from the telecommunications sector demonstrates that increased standardisation of contract terms through regulation is associated with more retail competition in that sector.
- In determining the most appropriate form of regulatory intervention on non-price contract terms, we suggest that two factors need to be weighed against each other. These factors are the concerns about negotiating power imbalances and discrimination across retailers, and the value of tailoring contract terms to the specifics of a particular relationship or changing terms over time.
- In determining whether a particular contract term should apply nationwide (core terms) or just to a particular network (operational terms), we suggest defining a set of terms that call for nationwide consistency. This should include approaches and metrics used to define performance obligations, reporting processes, and methods of assigning liability.

Appendix A: Access Regulation Regimes in New Zealand, Australia and the United Kingdom

Section 3 provided a summary of the kinds of regimes used to regulate access and non-price terms in New Zealand, Australia and the United Kingdom. Table A.1 provides further details on these regulatory regimes that explains their position on the spectrum in Figure 3.1.

Table A.1: Background Detail on Access Regulation Regimes in New Zealand, Australia and the United Kingdom

Country	Sector	Type of regime	Description
New Zealand	Electricity distribution (current)	Model/ voluntary terms	The Model Use of System Agreement provides guidance on what terms should be included in the agreements between retailers and distributors
	Electricity transmission	Default terms or regulator-approved terms	▪ Any individual transmission agreement by Transpower and a customer must be either consistent with the benchmark agreement, or negotiated and then approved by the EA ▪ The benchmark agreement acts as a default agreement, and includes: – Technical obligations – Information provision obligations – Payment obligations – Service definitions, service levels, and service measures
	Gas distribution	Model/ voluntary terms	▪ The Gas Distribution Contracts Oversight Scheme (a voluntary and industry-agreed scheme) identified a set of distribution principles that should be reflected in standard distribution service agreements ▪ These principles cover non-price contractual (and inferred) terms ▪ The principles provide a high-level context for negotiations between distributors and retailers
	Distributed generation	Default terms	▪ Part 6 of the Electricity Industry Participation Code mandates the application and approval process for connecting distributed generation to distribution networks ▪ The Code includes default terms for the connection and operation of distributed generation. These include the dispute resolution process, pricing principles and information disclosure guidelines (parties can contract out of these by mutual agreement)

Country	Sector	Type of regime	Description
	Telecom	Default terms	Different regimes have been tried over time: ▪ **Pre-2001**: Bilateral negotiations, in hands-off regulatory environment (no industry specific regulation) ▪ **2001-2006**: Negotiate-arbitrate (review found that this regime locked small players in to sub-optimal agreements and allowed discrimination) ▪ **Post-2006**: Commerce Commission issues Standard Terms Determinations that set out the access terms on which telecommunications providers must provide wholesale services to other providers. The Commission can also accept and enforce voluntary supply commitments from access providers in lieu of regulation
Australia	Electricity transmission and distribution	Regulator approved terms	▪ Access to electricity networks in the National Electricity Market is governed by the National Electricity Law and Rules ▪ The Australian Energy Regulator (AER) has the ability to determine whether, and what form of, access regulation applies to electricity services, which could include price/revenue regulation or requirement to negotiate with access seekers and provide cost-based offers ▪ There is a use of system agreement that is essentially a standard for all networks, as the model agreement is set out in the rules and the AER approves the actual agreement as containing the model standard terms and conditions ▪ When the AER carries out its duties, it favours the release of determinations on pricing methodologies, negotiating frameworks and negotiated transmission service criteria ▪ Variations from the model terms are minor, if any ▪ Most regulation relates to price, while negotiate-arbitrate is largely used for second order issues, such as streetlights or actual connections
	Electricity distribution and transmission	Negotiate-arbitrate	▪ Western Australia (where the incumbent is a vertically integrated utility) and the Northern Territory have certified regimes ▪ Under the Competition Principles Agreement, regimes should encourage negotiation, and establish a right for access seekers to negotiate access where agreement cannot be reached ▪ Regimes should also require access providers and seekers to appoint and fund an independent body to resolve any disputes (whose decisions are binding)

Country	Sector	Type of regime	Description
	Gas distribution and transmission	Negotiate-arbitrate or regulator approved terms	The National Competition Council (NCC) recommends to the relevant Minister what regulation should apply to pipelines, which is either: ▪ "Full" regulation: Submitting an access arrangement for approval by AER (except in Western Australia, where the regulator is the Economic Regulation Authority) ▪ "Light" regulation: Allowing parties to negotiate with the ability to arbitrate (either AER or the Western Australian Energy Disputes Arbitrator provide arbitration), and parties must publish certain information about the pipeline
	Telecom	Default terms	▪ The ACCC can declare particular telecom carriage services. The ACCC must make an access determination for all declared services that sets out default terms and conditions of access ▪ The conditions contained within the access determination will apply in the absence of any negotiated agreement ▪ Service providers of a non-declared service can submit voluntary undertakings
	Rail (varies by jurisdiction)	Negotiate-arbitrate	▪ Through state certified regimes: – State certified regimes are assessed by the NCC and the designated Minister to ensure consistency – Under the Competition Principles Agreement, regimes should allow for access seekers and providers to set agreed terms through negotiation, and to establish right for access seekers to negotiate access. Regimes should also require access providers and seekers to appoint and fund an independent body to resolve any disputes (whose decisions are binding) – In place in Queensland, South Australia, Western Australia (excludes BHP Billiton and Rio Tinto rail lines) and the Northern Territory ▪ Through declarations: – Declaration gives access seekers the right to negotiate terms and conditions of access, and a right to seek arbitration in the event of a dispute – The Goldsworthy rail line and Tasmanian rail network are declared under Part IIIA of the Competition and Consumer Act 2010

Country	Sector	Type of regime	Description
		Regulator-approved terms	▪ These were the result of previous government legislation in Hunter Valley and the interstate rail network operated by Australian Rail Track Corporation ▪ These require the owner of the infrastructure to submit an undertaking to the necessary authority for approval ▪ The authority must consider the submissions on the undertaking made by interested parties
	Water	Negotiate-arbitrate	▪ Applies in New South Wales only ▪ Any party can apply to the Independent Pricing and Regulatory Tribunal (IPART) to have a water or sewerage infrastructure service covered ▪ Access seekers in covered services have the right to negotiate with the service provider, with IPART providing arbitration
United Kingdom	Electricity distribution	Regulated/ mandatory terms	▪ The Distribution Connection and Use of System Agreement (DCUSA) is a multi-party contract that relates to the connection to and use of the electricity distribution networks ▪ All licensed electricity distributors and suppliers are required to become parties of the DCUSA ▪ The DCUSA replaced numerous bi-lateral contracts
	Distributed generation	Regulated/ mandatory terms	Charges and arrangements for distributed generation are covered by the DCUSA

Sources:

New Zealand: Electricity Authority; Gas Industry Company; Elwood Law; Vector Transmission Services Agreement; Vector Transmission Code; Ministry of Business, Innovation and Employment; Electricity Industry Participation Code; New Zealand Commerce Commission.

Australia: Australian Government Productivity Commission; National Electricity Rules, Chapters 6 and 6A; Australian Energy Regulator, Determinations & Access Arrangements; Chamber of Commerce and Industry, Western Australia.

United Kingdom: Ofgem; dcusa.co.uk; Anaya, K. L. & Pollitt, M. G., "Distributed Generation: Opportunities for Distribution Network Operators, Wider Society and Generators" Cambridge Working Paper in Economics, Energy Policy Research Group Working Paper 1510, March 2015.