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Draft default price-quality path for 2020 – 2025

Meridian appreciates the opportunity to comment on the Commerce Commission's draft default price-quality paths (DPP) for non-exempt electricity distribution businesses (EDBs) from 1 April 2020.

Meridian has read and supports the submission from the Electricity Retailers Association of New Zealand (ERANZ).

In addition to the points made by ERANZ, Meridian would like to draw the Commission's attention to the section 52A purpose of the Commerce Act:

> (1) The purpose of this Part is to promote the long-term benefit of consumers in markets referred to in section 52 by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services—
>
> (a) have incentives to innovate and to invest, including in replacement, upgraded, and new assets; and
>
> (b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and
>
> (c) share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and
>
> (d) are limited in their ability to extract excessive profits.

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Under this purpose the Commission must promote the long-term benefit of consumers "by promoting outcomes that are consistent with outcomes produced in competitive markets". Meridian's submission on the DPP Issues Paper raised concern with the Commission's apparent lack of acknowledgement that each of the section 52A(1)(a) to (d) outcomes needs to be pursued to a degree consistent with that which occurs in competitive markets.

In the Reasons Paper the Commission states that:

> In general, we agree with Meridian that it is important to highlight the importance of outcomes in workable competitive markets as a benchmark against which to measure the incentives we create for suppliers.

Meridian encourages the Commission to keep this benchmark in mind when considering the proposed innovation incentive. An innovation recoverable cost would not result in outcomes consistent with outcomes in competitive markets because in competitive markets innovation is high risk and emerging technologies may succeed or fail and be quickly abandoned, generally at the expense of investors rather than consumers. An innovation recoverable cost on the other hand would guarantee a risk-free return on any innovation, regardless of its success, at the direct expense of New Zealand consumers. Meridian therefore believes the Commission should abandon the proposed innovation recoverable cost in its final determination. The outcomes produced would not only be inconsistent with outcomes in competitive markets but would also be so much of a leg up over other participants in competitive markets (who do not enjoy regulated allowances or incentives for innovation) that innovation in those markets would be stifled.

Even under the status quo, EDBs can take advantage of the Incremental Rolling Incentive Scheme (IRIS) for any innovation, they can also recover innovative operating expenditure, and include innovative capital expenditure in the regulated asset base for future return of capital and return on capital. This enables distributors to guarantee a return in what is otherwise a high-risk emerging market for innovative services and infrastructure. The services and assets involved are often not "natural monopoly" assets like traditional poles and wires and can instead be provided by a growing number of industry participants and, in many instances, by consumers themselves.[1]

The proposed innovation recoverable cost would, to an even greater extent:

[1] For example, batteries might be considered a network innovation as they can be charged and discharged to flatten network demand peaks.

- de-risk EDB investments in high-risk emerging markets;
- be contrary to outcomes in competitive markets; and
- result in costs to consumers in the long-term by over-incentivising investments that can be made more efficiently by competitive markets.

Meridian suggests that the Commission carry out and publish a systematic analysis of the way IRIS has operated and the effect of IRIS on various EDBs investments and revenues. A finding that IRIS has failed to adequately incentivise innovation should be one of the prerequisites to implementation of any proposed innovation recoverable cost.

Nothing in this submission is confidential. Please contact me if you have any queries regarding this submission.

Yours sincerely

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