

Open letter – ensuring our energy and airports regulation is fit for purpose

Submission on the Commerce Commission's open letter

28 May 2021

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1. INTRODUCTION

1.1. PRELIMINARY

1. We welcome the opportunity to submit our views on the Commerce Commission's (**the Commission**) Open letter – ensuring our energy and airports regulation is fit for purpose (**the Open Letter**).
2. No part of our submission is confidential.

1.2. SUMMARY

3. As an electricity distribution business (**EDB**), serving more than 92,000 homes and businesses in the Dunedin and Central Otago regions, we agree that the energy sector is in a period of change and uncertainty, and that the pace of change may accelerate.
4. We are seeing rapid evolution as technology advances in what has traditionally been a “poles and wires” industry. As new technology comes to the fore, and consumers’ expectations around how they utilise electricity change, EDBs that are subject to price-quality path regulation under Part 4 of the Commerce Act 1986 (**Part 4**) may find themselves unable to deliver to those expectations or keep up with the pace of change if the Part 4 framework is incapable of accommodating rapid change.
5. To ensure that non-exempt EDBs are in a position to support the delivery of the Government’s decarbonisations goals, the regulatory framework must be co-ordinated, flexible, and structured so as to incentivise innovation and investment.
6. While it is encouraging that the Commission has welcomed this feedback now, it will be important for the Commission to engage in a targeted and meaningful way with EDBs sooner rather than later, and during future stages of regulatory development, so that it can understand the practical challenges that EDBs are experiencing and to ensure the workability of any proposed regulation. There may not be time for ineffective regulation to be addressed once every five years, in the case of price-quality path resets, or seven years, in the case of input methodology (**IM**) reviews, therefore getting it right at the outset is now crucial.

2. KEY ISSUES

2.1. FLEXIBLE REGULATION

7. In order to keep pace with the changing environment, we consider that the Commission should prioritise ensuring that the regulatory framework is flexible enough to change and adapt outside of regulatory resets.
8. The Commission may need to consider whether five-yearly resets of the default-price quality path (DPP) are providing enough flexibility for EDBs to adapt to changes as they arise and, if not, whether there are other mechanisms that it could introduce so that EDBs have opportunities to access additional revenue in advance of the next regulatory control period.
9. The Commission could consider whether relying on the customised price-quality path (CPP) mechanism as a means for EDBs to access additional funding for decarbonisation is still appropriate given the changing environment. The Commission may like to consider whether there are other more flexible and timely mechanisms that it could introduce into the Part 4 framework that are less complex and resource intensive than the current CPP mechanism. That complexity and resource intensiveness could deter EDBs from seeking additional allowances for necessary future innovation funding.
10. It is equally important for the Commission to be alert to any impediments that are not yet evident and ensure that it responds as they become apparent.

2.2. INCENTIVES TO INNOVATE AND INVEST

11. A key consideration for the Commission should be whether the Part 4 framework, in its current form, is promoting outcomes that are consistent with outcomes produced in competitive markets, so that non-exempt EDBs have incentives to innovate and to invest, including in replacement, upgraded and new assets¹. Innovation within the sector is going to be critical to achieving a low-carbon future; however, in the absence of effective incentives to innovate and invest, the traditional infrastructure solution could make achieving that future unaffordable and unattainable.
12. The current Part 4 framework contains a number of regulatory mechanisms that are designed to incentivise innovation and investment. The Commission should revisit those mechanisms in the forthcoming IM review to establish whether they are inadvertently creating barriers to investment and innovation, which will hamper EDBs' efforts to provide low-carbon infrastructure.
13. The challenges of decarbonisation will mean that EDBs need to plan and invest now for a future that has some uncertainties. This means that EDBs will need to make decisions now about how scenarios might unfold and their associated risks and timing. The Part 4 framework needs to encourage and facilitate timely and collaborative research, development and investment. This will require

¹ Section 52A(1) of the Commerce Act 1986

alignment with broader policy objectives and collaboration with stakeholders, which we discuss further below. This will facilitate investment and position networks for the future, while protecting investors from stranding risks if scenarios turn out differently than anticipated.

14. While the Commission incorporated an innovation project allowance in DPP3, the framework misses the potential to unlock and make available funds for research and innovation at a wider industry level, where the benefits can be shared. The Australian Energy Regulator (AER) is proposing a “regulatory sandbox” toolkit, and the Office of Gas and Electricity Markets in the United Kingdom (Ofgem) provides funding for innovative projects and has recently published its innovation vision for the 2021 to 2025 period².
15. We have also previously raised concerns with the Commission, together with Orion, Powerco, Unison, Vector and Wellington Electricity, regarding the Commission’s current approach to inflation forecasting and associated issues regarding debt compensation. If this issue is not addressed by the Commission, it creates a real risk of disincentivising investment in EDBs at a time when investment is critical to support the shift to a low-carbon future.
16. Increasingly, we are also hearing from consumers seeking to decarbonise, either because it makes good business (marketing or financial) sense to do so, or because they want to make a contribution to environmental sustainability. Ultimately, EDBs seek to meet the balanced expectations of our communities, and good regulation should facilitate or incentivise these outcomes. With the rapid change in consumer expectations emerging over the last year or so, and the recent release of the Climate Change Commission’s (CCC) report³, waiting for the DPP4 reset to make any changes may be too late. The Commission should consider what could be done in the interim to incentivise investment to enable customer service and to meet the Government’s goals.

2.3. EARLY ENGAGEMENT WITH STAKEHOLDERS

17. Significant work is being undertaken by industry-led working groups to provide regulators with good insight into workable opportunities for regulatory reform, and to highlight practical challenges that exist for EDBs within existing regulatory frameworks. Examples include the Electricity Networks’ Association’s (ENA) Smart Technology Working Group (STWG) and the Electricity Authority’s (EA) Innovation and Participation Advisory Group (IPAG).
18. While we appreciate the Commission engaging with stakeholders through the Open Letter, we consider that more targeted, meaningful engagement with EDBs will apprise the Commission of challenges that EDBs are facing. It is also important that the Commission engages with EDBs on proposed regulation to ensure that it is workable and will not result in a poor regulatory outcome.
19. An example of a poor regulatory outcome from lack of early engagement, within Part 4, is the “Class B notified interruptions” framework introduced under DPP3. A series of very prescriptive conditions

² Office of Gas and Electricity Markets. (2021). Ofgem Innovation Vision 2021 – 2025. Available from https://www.ofgem.gov.uk/system/files/docs/2021/05/innovation_vision_2021-2025_final_24may2021.pdf

³ Climate Change Commission. (2021). 2021 Draft Advice for Consultation. Available from <https://www.climatecommission.govt.nz/get-involved/our-advice-and-evidence/>

were introduced in relation to “*additional notice*” without the opportunity for consultation and have resulted in a conflict with the Electricity Authority’s well-established electricity information exchange protocols for planned outages (EIEP5A). Had these been considered, and had the Commission engaged with EDBs, prior the introduction of the regime, this conflict, and other practical challenges associated with the framework, would have been brought to the attention of the Commission. The Commission would then have had an opportunity to incorporate regulation that met the policy intent without being unnecessarily complex and inefficient.

20. We encourage the Commission going forward, to invest time and resource in engaging with EDBs, whether it be through targeted workshop-style forums, or engagement with working groups that have been established by the ENA.
21. Given that we are hearing from consumers seeking to decarbonise, the Commission should also consider how it remains in touch with consumer expectations and how these impact on the EDB sector.

2.4. COLLABORATION BETWEEN GOVERNMENT AGENCIES

22. In addition to the Commission, there are a number of government agencies that contribute to the regulatory framework within which EDBs operate, in particular the EA, Ministry for Business, Innovation and Employment (MBIE), the CCC, and the Ministry for the Environment.
23. In our view, it will be imperative for the Commission to collaborate with these agencies to ensure that the broader, collective regulatory framework is enabling EDBs to meet the Government’s decarbonisation objectives.
24. To achieve this, there needs to be effective co-ordination between the agencies and regulators. In addition, the Commission needs to be cognisant of other policy settings so that its own policies support those of other regulatory bodies, as opposed to being in conflict (the “*Class B notified interruptions*” framework discussed at section 16, and the suggestion by MBIE that the industry (including price-quality controlled EDBs) essentially fund the removal of the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004, being current examples of conflicting and misaligned policies).
25. In particular, the Commission should work closely with the EA to understand its expectations of EDBs in enabling decarbonisation. We support the Commission’s current involvement as an observer at the EA’s IPAG meetings and consider that it would be useful if this role was expanded to contribute to EA decision making, ensuring alignment of initiatives and prioritisation. A key objective of this collaboration should be to reduce regulatory risk for EDBs, provide strategic direction, and facilitate investment confidence around the role of EDBs in a changing landscape.
26. Drawing upon our comments at section 2.3 above, collective engagement by the EA and the Commission with the ENA (in particular the ENA’s STWG and Regulatory Working Group) is likely to be useful to test regulatory proposals before wider consultation.

2.5. INFORMATION DISCLOSURE

27. Harnessing opportunities presented by the information disclosure (ID) regime will provide the Commission with useful insight into the information that EDBs can capture, which can then form a basis for regulatory change.
28. Despite signalling in its DPP3 final decision reasons paper that it intended to consider changes to the ID requirements⁴, the Commission has still not set a date for a review of the ID regime. We strongly encourage the Commission to undertake this review without further delay. The Commission acknowledged the benefits of testing the workability of new measures through information disclosures first in the DPP3 final reasons paper. We are concerned that the Commission is not making resources available to undertake this review now, and that if information disclosure reviews now, and in the future, are continually de-prioritised, opportunities to gather data to inform future regulation will continue to be missed.
29. The ENA has established a working group dedicated to providing input into the Commission’s review, and EDBs are keen to ensure that there is sufficient opportunity for data to be captured that can be used by the Commission to inform any new regulation, ahead of DPP4.

2.6. INTERNATIONAL APPROACH

30. Grappling with a rapidly changing environment is not unique to New Zealand. Regulators in other jurisdictions are also facing the same challenges and considering how best they can respond to changing times. Both Ofgem and the AER are actively exploring ways in which their regulatory frameworks can adapt.
31. In its forward work programme for 2021/2022, Ofgem has identified the need for it to take an active role in facilitating investment in electricity distribution networks and is continuing to develop an agile approach to the operation of regulatory incentive mechanisms. It has also highlighted the need for it to work collaboratively with government to enable and encourage their industry *“to prepare for the future, by setting frameworks to help manage uncertainty, and to maximise the opportunities to enable a smart, lower cost zero carbon future.”*⁵
32. The AER has identified the need to adapt to an evolving market and is supporting network transformation by offering incentives for distributors in Australia to manage demand on their networks in ways that will reduce the need to invest in traditional, expensive network assets.
33. Collaborating on a global scale with regulators facing similar issues may present insightful opportunities for regulatory reform here in New Zealand.

⁴ Commerce Commission. (2019), Default price-quality paths for electricity distribution businesses from 1 April 2020 – Final decision, Reasons paper. 27 November 2019. Paragraph N3.

⁵ <https://www.ofgem.gov.uk/publications-and-updates/forward-work-programme-202122>