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Input Methodologies review draft decisions – cross submission

Final

Submission to the Commerce Commission

From the Electricity Networks Association

Contents

1. Introduction....3
2. Form of control....4
3. CPP requirements....5
4. Emerging technologies....6
5. Related party transactions....14
6. Risk allocation....15
7. Appendix....16

1. Introduction

1. The Electricity Networks Association (**ENA**) appreciates the opportunity to make a cross-submission to the Commerce Commission (the **Commission**) in respect of submissions received on the 2016 **Input Methodologies review draft decisions** published by the Commission on 5 August 2016. This cross submission covers all draft decision topics other than cost of capital, which we will respond to in a subsequent cross-submission.

2. The ENA represents all of New Zealand's 26 electricity distribution businesses (**EDBs**) or lines companies, who provide critical infrastructure to NZ residential and business customers. Apart from a small number of major industrial users connected directly to the national grid and embedded networks (which are themselves connected to an EDB's network) electricity consumers are connected to a distribution network operated by an ENA member, distributing power to consumers through regional networks of overhead wires and underground cables. Together, EDB networks total 150,000 km of lines. Some of the largest distribution network companies are at least partially publicly listed or privately owned, or owned by local government, but most are owned by consumer or community trusts.

3. This cross-submission responds to selected parts of the following submissions made to the Commission regarding the draft decisions:

    - Contact Energy, *Input Methodology Review*, 4 August 2016 (**Contact submission**)
    - Electricity Retailers Association of New Zealand (**ERANZ**), *ERANZ submission to the Commerce Commission on Input Methodologies for Emerging Technology*, 4 August 2016 (**ERANZ submission**), supported by:
        i. A legal opinion by Alan Lear, *Input Methodologies Review: Treatment of Emerging Technologies in the Electricity Industry under Part 4 of the Commerce Act 1986: legal definition and interpretation of electricity lines services*, 2 August 2016
        ii. Castalia Advisors, *Getting the Policy and Regulatory Settings Right for Emerging Technologies in the Electricity Sector*, August 2016 (**Castalia report**)
    - Genesis Energy, *Input Methodologies review draft decisions – Topic Paper 3: The future impact of emerging technologies in the energy sector*, 4 August 2016 (**Genesis submission**)
    - Major Electricity Users' Group (**MEUG**), *Submission on Input methodologies draft review decisions*, 4 August 2016 (**MEUG submission**), with supporting reports:
        i. NZIER, *Form of control for EDB – draft decision*, 3 August 2016 (**NZIER report**)
        ii. Ireland, Wallace & Associates (**IWA**), *Input methodologies review draft decisions Risk Allocation between Suppliers and Consumers*, 4 August 2016 (**IWA report**)

- Mercury, *Input methodologies review draft decisions, Topic paper 3: The future impact of emerging technologies in the energy sector*, 4 August 2016 (**Mercury submission**)
- Meridian Energy, *Submission on Input Methodologies (IM) draft decisions papers (including the Report on the IM review)*, 4 August 2016 (**Meridian submission**)
- Trustpower, *Trustpower Submission on the Input Methodologies Review Draft Decisions*, 4 August 2016 (**Trustpower submission**), with supporting reports:
    i. Allan Carvell, *Electricity Authority Review of Distributed Generation Pricing Principles: Incentives Report*, 24 July 2016 (**Carvell report**)
    ii. HoustonKemp, *Assessment of the Electricity Authority's proposal to remove the distributed generation pricing principles*, 26 July 2016 (**HoustonKemp report**).

4. We respond to selected parts of these submissions in the order of the topic papers that formed part of the draft decisions.

2. Form of control

5. The draft decision proposed changing the form of control for EDBs from a weighted average price cap (WAPC) to a revenue cap. As a general point, the information received in submissions from retailers and large consumers on this topic was not new (it was considered by the Commission when it developed the draft decisions) and was largely theoretical and not supported by robust analysis. The ENA and its members have already addressed many of these submission points in our original submissions on the draft decisions form of control topic paper.

Quantity forecasting risk

6. The MEUG submission, supported by the NZIER report, argued that the form of control should continue to be a WAPC. MEUG considered that the quantity forecasting risk inherent in the use of a WAPC (which is a key reason for moving to a revenue cap) could be lowered through moving away from kWh-based tariffs to demand or capacity-based tariffs.[1]

7. We note that forecasting revenue from demand tariffs would be likely to require forecasting of peak demand; as peak demand is largely weather driven this is likely to be just as challenging as forecasting kWh demand.

8. Also forecasting demand on the basis of new tariff structures would be difficult for the Commission as there would be limited historical information and no previous regulatory forecasting approaches to draw on, meaning that forecasts of these quantities would likely be less accurate. Additionally, even if the forecast accuracy increases, the risk (certainty) of error remains and this creates the prospect of windfall gains and losses for suppliers and consumers depending on the direction of the error.

[1] MEUG submission, paragraph 13. NZIER report, page 12.

Linkage of revenue cap with demand tariffs

9. The Contact submission supported moving to a revenue cap, provided this was linked to cost-reflective pricing (which Contact considers to be demand tariffs, but not capacity charges).[2]

10. The ENA supports a move to more cost-reflective pricing where this is supported by consumer engagement and consultation. As the Commission is aware, the ENA's distribution pricing working group is leading the industry efforts to move existing pricing in this direction. As discussed in our previous submission, a revenue cap will support a move to more cost-reflective pricing by removing compliance and cost-recovery risks associated with price restructures under a WAPC.[3]

11. We understand Contact's view but doubt there is any regulatory route that could explicitly require the adoption of more demand tariffs as a result of changing the form of control. Such a regulation traverses both the Commission's and the Authority's jurisdictions and could also have some unintended consequences because, depending on how it defined a cost-reflective tariff, it may result in a lack of flexibility in designing new tariffs. For example we note the Low-Fixed Charge Tariff Regulations have had unintended consequences in terms of limiting EDBs' and retailers' abilities to change their tariff structures.

Effect of a revenue cap on efficient price structures

12. The Meridian submission agreed with the letter from the Electricity Authority to the Commission regarding the form of control, which proposed that a revenue cap may weaken incentives for efficient price structures. The Contact submission considered that "moving to a revenue cap too early may remove some of the short term incentives on EDBs to move to efficient pricing".[4]

13. As discussed in our August 4 submission, the ENA considers that these concerns are theoretical and not borne out by current practice. EDBs, including exempt EDBs, are actively engaged in work to improve pricing efficiency and the long-term incentives on EDBs continue to support cost-reflective tariffs under a revenue cap.

3. CPP requirements

14. The draft decision puts forward a large amount of relatively technical changes that were intended to make CPP applications better targeted and more cost effective although, as discussed in our submission, there remains room for improvement.

15. The MEUG submission recommended further changes to the CPP requirements in relation to customer consultation. The MEUG submission recommended:[5]

[2] Contact submission, page 6.

[3] ENA, *Input methodologies review – Topic paper 1, form of control and RAB indexation*, 4 August 2016, paragraph 13.

[4] Meridian submission, pages 1-2. Contact submission, page 6.

[5] MEUG submission, pages 5-6.

- A separate verifier with expertise in public consultation should be engaged to review the consultation process (because an expert on EDB cost proposals may not necessarily have expertise in public consultation);
- More prescription in specifying consumer consultation requirements. The MEUG submission is concerned that consultation material could be either too high level or too complex for consumers to be able to make informed responses. MEUG suggests the IMs specify a tabular format showing price and quality effects for each tariff category for each year of the CPP period.

16. The ENA agrees consumer consultation is important and EDBs should put effort into ensuring any consultation associated with a CPP is well-designed so that consumers can make informed and useful comments on the proposed CPP application.

17. We do not consider that consumer consultation is such a specialised area that there are credible experts readily available to be 'consultation verifiers'. We expect most potential verifiers would be able to reasonably assess whether a consultation process has been effective. In addition, a good understanding of the proposal – which the verifier will have – will be very helpful in assessing the consultation, as the verifier will be able to assess if the important issues in the application were addressed. If they felt it was necessary, a verifier could perhaps themselves engage an advisor to focus on the consultation process.

18. The ENA opposes MEUG's suggestion for prescriptive consultation requirements. EDBs have strong incentives to get their consultation correct and the proposed changes to the IM consultation requirements clarify what the Commission is seeking in regard to customer consultation. MEUG's proposal seems like it would require a fairly complex set of tables that may not be very intuitive for consumers or suitable for all CPP proposals. A better approach is to permit EDBs some flexibility to design the most effective consultation process, based on the needs of their customer base and the details of the CPP proposal. Provided the required objectives of the consultation process are clear and the consultation is reviewed by the verifier, there is no reason to think that EDBs would fail to provide sufficiently clear information to consumers about their CPP proposal.

4. Emerging technologies

Scope of the regulated service

19. The ERANZ submission included a legal opinion by Alan Lear on the definition of electricity lines services. This opinion disagreed with the Commission's draft decision that assets beyond the point of supply could be included in EDBs' regulatory asset bases (RABs). The interpretation in the ERANZ legal opinion is novel and is not consistent with the expectations and interpretations of ENA members. The ENA asked Russell McVeagh for its views on this issue - the interpretation of electricity lines services, and especially the opinion obtained by ERANZ. Russell McVeagh's conclusions are:

> *"In our view:*
>
> *a) The Commission's interpretation of regulated service is correct - Part 4 regulates the service not the type of assets used to provide the service. The wording of the Act is*

unambiguous in this regard. The extent to which an asset is used to support a regulated or unregulated service is appropriately addressed by way of the cost allocation IM.

b) *The Lear opinion is based on the incorrect premise that batteries must be included in the statutory definition of "line" in order to be included in the RAB.*

c) *Even if batteries must fall within the definition of "line" in order to be included in the RAB, the Lear opinion wrongly concludes that batteries are excluded from the definition and that the exception to the exclusion ("in association with") is limited to conveyance related fittings. As we explain in this advice we consider the exception to the exclusion captures batteries.*

d) *The view that these arguments do not undermine the basis for including other non-line assets in the RAB is not persuasive. If it is correct that assets not within the definition of "line" cannot be in the RAB, then that approach needs to be applied consistently, regardless of the analysis used to conclude an asset is not within the definition.*

The Lear opinion states that its interpretation is consistent with the context of Part 4 because batteries and EV batteries are well positioned to be a competitive part of the electricity market. In our view:

a) *This position confuses the type of asset (which could have multiple uses) with its specific use. By way of analogy, IT and office equipment are assets that can be provided and used in a competitive market, however, when used to support the ELS, they are included in the RAB (or as an operating cost) of the electricity distribution business ("EDB").*

b) *There does not appear to be any dispute that using batteries for demand management purposes is a use connected with the effective provision and operation of the ELS. For example, ERANZ accepts that, if demand management services were provided to the EDB by a third party or on an arms-length basis, this would be a legitimate regulated operating cost for that EDB (meaning it is wholly attributable to the ELS under the cost allocation IM).*

c) *The Commission is correct that the concerns of ERANZ and others appear to be primarily concerned with structural change, where certain types of assets would be excluded from EDB ownership (irrespective of their use) in order to facilitate other competitive markets. This type of change is outside the scope of Part 4 and would require policy and legislative change. Further, we also agree with the Commission that anti-competitive behaviour can be addressed under Part 2 of the Act.[6]"*

20. We also find it difficult to reconcile the view that beyond-the-meter assets are excluded from the regulated service with the view that EDBs should contract to procure these services and then recover those costs through regulated opex. If an activity is excluded from the regulated service, then presumably this would apply for both capital and operating expenditure.

21. The Contact submission appreciates "that issues relating to competitive markets are not directly within the Commission's jurisdiction".[7] We agree. The Contact submission also argues that treating emerging technologies as regulated assets conflicts with the purpose of Part 4.[8] We consider that this misconstrues the nature of Part 4 regulation. The draft decision indicates that where emerging technologies are used to supply a regulated service they are regulated assets.

[6] TPS at [181] - [183].

[7] Contact submission, page 14.

[8] Contact submission, page 9.

But where the technologies are used to supply a different service, they are not regulated assets. This is a sensible approach that is consistent with the intent of regulating a service rather than particular asset types.

Emerging technologies and competitive markets

22. The main concern raised by generator-retailers regarding EDB investment in emerging technologies seems to be that EDBs will leverage their monopoly position to dominate the emerging technology markets.[9] ERANZ seems to consider that any investment EDBs make in this area is likely to be cross-subsidised and inefficient.[10] The ENA considers these concerns are overstated, because:

    - The market has yet to take shape and it is not clear what the leading products or who the leading service providers will be. We note the statement in the Contact submission that "Waiting for a market failure before acting risks creating a self-fulfilling prophecy".[11] This appears to concede that there is currently no market failure. The ENA does not support regulating on the basis that some parties expect a market failure to occur. The market failure should be clearly identified before regulation is applied; if for no other reason than this would make the regulation better targeted – as it will focus on the actual, rather than the expected, problem.
    - If EDBs were to leverage their monopoly positions to distort a competitive market, this would be subject to the Commission's powers under Part 2 of the Commerce Act 1986 (**the Act**). Given the degree of interest in emerging technology markets, it seems unlikely that anti-competitive behaviour would go un-noticed.
    - EDBs do not operate under rate of return regulation and would not expect or receive a "guaranteed return"[12] on emerging technology investments. This is because EDBs subject to price control are limited in the prices they can charge (or, from 2020, the revenues they can receive) while they are also required to deliver minimum service quality standards. If EDBs were to use regulated capex to invest in emerging technologies without a commensurate network benefit, they would need to continue spending capex on traditional network solutions. In effect EDBs would spend more than their capex allowances and thus suffer reduced profits and penalties under the capex incremental rolling incentive scheme (IRIS). EDBs that are exempt from price control have fewer limitations but are still subject to disclosure scrutiny and pressure from owners/consumers to keep prices to a reasonable level.
    - Current deployment of emerging technologies by EDBs has been limited to small trials. If EDBs are able to use regulated returns to fund (supposedly risk free!) investments in emerging technologies, we wonder why a larger scale deployment

[9] For example, Mercury submission, page 2. Genesis submission, page 3.

[10] ERANZ submission, page 3.

[11] Contact submission, page 11.

[12] Contact submission, page 13.

hasn't happened yet. The answer is that EDBs are capital constrained like any other business and will only invest in emerging technologies where it is the best use of the available funds. We also find it implausible that small scale trials of the type undertaken by some EDBs so far are material impediments to competition emerging in solar and battery technologies.

23. The ENA agrees with the Contact submission that EDB investment in emerging technologies will mean consumers benefit from lower prices than if EDBs just invested in traditional assets.[13] Preventing or restricting EDBs from investing in such technologies would prevent these lower prices being delivered.

24. The Contact submission agreed with the Electricity Authority that EDB investments in emerging technologies may negatively affect the spot market and ancillary reserves market.[14] As we understand it, the competition concerns raised by retailers are focused mainly on small-scale batteries that can be installed at residential or small commercial premises. For these to have any noticeable impact on the spot or ancillary reserves market, a large number would need to be deployed and they would then need to be co-ordinated to make offerings into these markets. Given that only a handful of batteries have been deployed in New Zealand so far, we think any concerns about the spot or ancillary reserves market are premature. It is not clear how the battery market will develop or what the effect of batteries on these markets will be. At present, this concern is simply speculation.

ERANZ proposal

25. Notwithstanding the concerns raised by the Commission in its draft decision, ERANZ continues to favour its ring-fencing proposal. This proposal would use the asset valuation input methodology (**IM**) to require certain asset types to have a RAB value of zero where a long list of criteria is met.

26. The ENA continues to agree with the Commission's view in the draft decision that the ERANZ proposal is effectively a possible structural intervention in the industry, and that Part 4 is not the vehicle to introduce structural remedies.[15] The Russell McVeagh opinion also supports this Commission view (that Part 4 is not the appropriate legal vehicle for structural change) but goes on to suggest that any IM which operated to exclude assets from the RAB for purposes other than regulating in accordance with Part 4 would arguably be ultra vires.

27. We also refer to our August 4 submission which highlighted additional policy, practical and legal problems with the ERANZ proposal.[16] The ENA maintains that the proposal is unworkable and should not be taken further.

[13] Contact submission, page 44.

[14] Contact submission, page 10.

[15] Input Methodologies draft decision Topic paper 3, paragraph 181.

[16] ENA, *Input methodologies review – Topic paper 3, impact of emerging technologies*, 4 August 2016, paragraphs 12-17.

Administrative costs of ring-fencing

28. ERANZ questioned whether the administrative costs of ring-fencing were material.[17] Arm's-length rules as required under Part 3 of the Electricity Industry Act 2010 (**EIA**) are certainly material as these would require a separate management team and Board for each related party of an EDB that invested in emerging technologies. The salaries of these individuals would then need to be borne fully by the emerging technology business, which may be challenging for a start-up to bear. Retailers seem to be suggesting a level of cost-loading is applied to EDB-owned emerging technology businesses that would not apply to their competitors (i.e. we assume retailers would support their own emerging technology businesses by sharing management and corporate overhead costs where appropriate, at least until the new businesses reached a sufficient scale – but retailers seem concerned to prevent EDBs doing the same).

29. ERANZ, supported by Castalia, is now suggesting a lower cost form of ring fencing could be applied (although ERANZ's preference seems to be for stronger ring-fencing rules). The Castalia report suggests an option of using the cost allocation rules in the Information Disclosure Determination instead of the arm's-length rules in the EIA to govern transactions between EDBs and related party providers of emerging technology services.[18] The ENA notes that any EDB which intended to provide emerging technology services in a competitive market would likely do this through a related party, in which case these rules would apply anyway. Where an EDB uses emerging technologies for network services only, it may do this as part of the EDB, which is appropriate as only regulated services are being provided. We are therefore not sure this alternative option would change the status quo.

ACAM methodology

30. The Contact submission and the ERANZ submission both recommended the removal of the avoidable cost allocation methodology (**ACAM**) option from the cost allocation IMs. They appear to be concerned that it enables the allocation of too many shared costs to regulated consumers.

31. The Contact submission discusses some examples of problems that it considers have arisen as a result of ACAM:[19]

    - ACAM can permit substantial investment in batteries (e.g. Contact states that "Vector could invest in $260m of batteries under ACAM" and "Powerco could invest in $130m of batteries under ACAM")
    - EDBs have generated $15m since 2009 from use of ripple control systems with no benefit to consumers who pay for the technology
    - EDBs' solar and battery trials are leveraging regulated funding by making all consumers pay for them.

32. The ENA is not convinced these examples are indicative of any failures in the IMs. Taking each one in turn:

[17] ERANZ submission, page 5.

[18] ERANZ submission, page 35. Castalia report, 13.

[19] Contact submission, pages 12-15.

- The concern regarding battery investment has not considered feasible commercial scale considerations. The amount of $260m and $130m may sound like large numbers but, at $20,000 per battery, would procure 13,000 or 6,500 batteries respectively, sufficient to be deployed at approximately 2.5% of Vector's ICPs or 2% of Powerco's ICPs.

  Having deployed batteries on a network up to the point where the ACAM threshold is met (which is still a small proportion of the network), an EDB would then have to start applying ABAA if it wanted to deploy any additional batteries. If the business case for the batteries relies on using ACAM, the business will never reach a full competitive scale and thus EDBs would be unlikely to target opportunities in reliance on this IM approach.

- EDBs may have generated $15m of revenues from ripple control systems since 2009, but this is a very small sum (an average of approximately $80,000 per year per EDB). Total regulated EDB revenues for the 2015 year alone were $2.5b. It seems unlikely ripple control is a material unregulated commercial consideration for any EDB. The primary benefit EDBs obtain from load management is to manage network constraints and defer investment requirements where appropriate; this is clearly part of the regulated business. The marginal cost of using ripple control to bid into the Interruptible Reserves market is nearly zero for EDBs, but provides benefits to consumers through overall lower costs for reserves.

- It is correct that some EDBs' solar and battery trials are leveraging regulated funding. This is entirely appropriate because these trials are part of providing the regulated service. Solar and battery technology is still relatively new and its effects on distribution network performance and stability is something ENA members are still learning about. It is prudent for EDBs to invest in trialling the effects of these technologies on their networks so they understand the likely impacts that can occur if and when consumers start investing in this technology at a large scale. Trials are just that - trials. They are small scale involving only a few units and we find it difficult to believe that these trials constitute a material barrier to other parties offering commercial solar and battery products to consumers.

33. The ENA considers that the ACAM option is operating as it should – facilitating investment in start-up and growing businesses, but once these businesses reach a certain scale they will need to carry a larger portion of shared costs.

Section 52T(3) and related party rules

34. The Contact submission argues that section 52T(3) of the Act may not be in the long-term interest of consumers. This is because it supports the use of ACAM, which Contact considers permits too much cost sharing between regulated and unregulated activities of EDBs.[20]

[20] Contact submission, page 10.

35. As a result, the Contact submission recommends precluding EDB investments in emerging technologies and then using the related-party transaction provisions, rather than the cost-allocation IM, to restrict cost sharing between regulated and unregulated activities.[21]

36. The ENA submits that section 52T(3) is a legal requirement the Commission must comply with and is consistent with the government policy intent of the time as expressed through the 2006 Government Policy Statement on Incentives of Regulated Businesses to Invest in Infrastructure[22]. It clearly reflects the will of Parliament and it would be inappropriate for the Commission to seek to circumvent this intent through the cost allocation IM or any other IM. Any change to the policy intent underpinning the Act would need to be progressed through primary legislation.

37. Additionally, Contact's proposal to preclude EDB ownership of emerging technologies would be inconsistent with the Act, as discussed above and in the Russell McVeagh legal opinion.

Transpower's demand response programme

38. ERANZ considers that "Transpower's expansion into competitive markets through its demand response programme to help its monopoly network service is accompanied by safeguards to minimise distortions to those markets".[23] ERANZ considers that this is a relevant precedent for emerging technologies in the electricity distribution sector.

39. The "safeguards" applied to Transpower's demand response programme seem to have been driven by the Authority rather than by the Commission. In relation to the expansion of the demand response programme in 2013, the Commission considered that the cost allocation IM which applies to Transpower "addresses any issues that may arise in relation to regulated assets that we are required to assess".[24]

40. Additionally, a demand response programme for transmission is quite different from network deferral activities at a distribution level. Providing a demand response service at the distribution level is likely to incur higher transaction costs compared to transmission, given the need to co-ordinate more and smaller parties to obtain the demand management. These challenges make it less likely that significant demand response would be provided by non-network companies to distributors.

Arrangements between EDBs and distributed generators to provide network services

41. The Trustpower submission, supported by the Carvell report and the HoustonKemp report, noted that Trustpower and other parties own distributed generation technology that can provide equivalent network support services to batteries. Trustpower is not convinced that the incentives in Part 4 are sufficient to encourage network companies to contract with, and adequately compensate, third-party providers of network support services.[25]

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[21] Contact submission, page 11.

[22] Quoted at paragraph 52 of: ENA, *Submission on IM review: emerging technologies, Response to Pre-Workshop Paper and Emerging Technologies Workshop – Final*, 4 February 2016.

[23] ERANZ submission, paragraph 69.

[24] Quoted in ERANZ submission, paragraph 72.

[25] Trustpower submission, pages 3-5.

42. The ENA agrees there is potential for distributed generators to provide some useful network support services to EDBs. Arrangements for these services are appropriately developed through contracts between EDBs and distributed generators. Part 4 regulation provides incentives for EDBs to find the most cost-effective means of delivering the regulated service; we expect that where the most cost-effective option is to use distributed generation then EDBs would have incentives to procure such services.

43. Whether or not more specific incentives should be in place is not a question for the Commission to address. We do not think Part 4 regulation should go down the route of providing incentives for EDBs to use more or less of a particular solution – this would be likely to distort decisions and result in higher costs for consumers overall.

Accelerated depreciation

44. Some submitters disagreed with the Commission's proposal to permit EDBs to apply to reduce asset lives by up to 15% due to asset stranding risk caused by consumer uptake of emerging technologies.[26] In their submission Contact was unconvinced that emerging technology will cause customers to disconnect or that the risk to capital recovery has increased.[27]

45. The MEUG submission noted that the assessment should also consider whether the proposal would lead to over- investment or whether higher prices in the short term would accelerate uptake of emerging technologies and thus exacerbate the problem. MEUG suggested that in workably competitive markets, prices would not increase in a situation where a new competitive threat had emerged.

46. Both MEUG and Contact considered that the accelerated depreciation proposal lacked compelling evidence.

47. The ENA considers that these submissions do not address the problem the draft decision is trying to solve. The concern is that emerging technologies may be adopted by many but not all consumers and those consumers who do not invest in emerging technology (e.g. because they cannot afford it or do not own their own property) will eventually pay for the bulk of the costs of the network. Large-scale disconnections are not required for this to occur; significant reductions in individual usage (such as those already seen in South Australia and Queensland) would be sufficient.

48. Thus increasing prices in the short-term will reduce the risk of very high prices in the long-term, while remaining NPV-neutral over time. MEUG and Contact are concerned that supporting evidence (in terms of proof of when and how much assets will be stranded) is currently limited, this concern overlooks the nature of the emerging technology risk, which reflects rapid technology development and even more rapid price reductions. It is up to the EDB to provide evidence supporting any application to reduce asset lives and we expect this will be feasible based on the relevant technology trends. Should the price of emerging technologies continue to fall, and the take up of the technologies continue to increase, they will continue to place

[26] MEUG submission, pages 7-8. ERANZ submission, page 40.

[27] Contact submission, page 7.

significant competitive tension with network services. This is likely to be supporting evidence of an increased asset stranding risk.

49. We note MEUG's concern that the proposal may lead to inefficient investment.[28] We think this is unlikely. Accelerated depreciation will only apply where the Commission has been satisfied there is a risk associated with emerging technologies that is sufficient to justify the accelerated depreciation. In such circumstances, it is unlikely EDBs will be keen to invest in new assets.

Additional disclosure requirements for EDBs

50. A few submitters suggested additional disclosure requirements for EDBs relating to emerging technologies. These were:

    - Require EDBs to disclose information to third parties about where emerging technologies can provide network benefits (Contact);
    - Require disclosure schedules 5f and 5g to be made publicly available (ERANZ);
    - Require AMPs to explain how EDBs are investing in certain technologies in preference to others (ERANZ);
    - Require full, open and continuous disclosure of all investments by EDBs in emerging technologies (Genesis).

51. Given the interest in emerging technology, the ENA is comfortable with reviewing the disclosure requirements to ensure they are fit for purpose. We are expecting a further review of information disclosure requirements in the next few months and this topic could be considered as part of that process. Any additional disclosure requirements will need to have a positive benefit-cost ratio and ensure commercially confidential information is treated appropriately.

5. Related party transactions

52. The Contact submission suggested the cost allocation rules may be too loose. It was particularly concerned with the effect of clause 2.3.6(1)(d) of the Electricity Distribution Information Disclosure Determination 2012 which enables EDBs to allocate costs at the price paid, provided two de minimis thresholds are met.[29]

53. The Contact submission suggested that this meant Vector can contract up to $6m of network services from a single related party and up to $31m from five related parties (with equivalent numbers of $4m and $18m for Powerco and $3m and $14m for Orion). The Contact submission is concerned that such sums could have a materially negative effect on competitive markets in which these related parties operate.

54. The ENA submits that these concerns are over-stated. Theoretical maximums do not reflect actual commercial decisions by EDBs.

55. For Vector, Powerco and Orion, business units earning $4m - $6m would not have a particularly large effect on group financial performance. EDBs have little commercial interest in building such

[28] MEUG submission, page 8.

[29] Contact submission, page 19.

relatively small businesses. If EDBs were seeking to develop a strong position in emerging technology markets, they would need much bigger businesses than these and they would need to be profitable under different related party-rules (and separating units into five separate related parties to maximise the disclosable revenues would be more trouble than it is worth). Therefore the ability to determine the price paid up to these thresholds is unlikely to be a driver of EDB investment decisions.

56. The Contact submission also overlooks existing related party transactions (i.e. most EDBs already make related party transactions so would need to stop all current related party transactions to achieve the outcomes Contact is concerned about).

6. Risk allocation

57. On behalf of MEUG, the IWA report recommends "describing the risk allocated to suppliers and customers in a summary table" and "provide narrative on the reasons one or both parties are best placed to manage or share risk".[30]

58. The ENA does not believe this proposal would add value. As with any business there are many commercial, operational, health and safety, regulatory, human resource, reputational and other risks that EDBs face. Listing all of them would be quite a challenge. To then identify the risks that are affected by regulation and therefore each risk - determine how they are shared between suppliers and consumers, would in many cases be subjective.

59. Based on MEUG's earlier submissions,[31] we assume the next step would be to quantify each of these risks and thus assess the level of risk allocated to each party. This would certainly be subjective and difficult to determine.

60. Given these difficulties, we are not convinced there would be any benefits from this proposal, as any resulting list would be subjective and lack consensus. We consider that the Commission's and stakeholders' efforts would be better directed to improving the IMs in other areas.

[30] IWA report, page 8

[31] MEUG, *Submission on Input Methodologies review – Invitation to contribute to problem definition*, 19 August 2015, paragraph 8.

7. Appendix

The Electricity Networks Association makes this submission along with the explicit support of its members, listed below.

Alpine Energy
Aurora Energy
Buller Electricity
Counties Power
Eastland Network
Electra
EA Networks
Horizon Energy Distribution
Mainpower NZ
Marlborough Lines
Nelson Electricity
Network Tasman
Network Waitaki
Northpower
Orion New Zealand
Powerco
PowerNet
Scanpower
The Lines Company
Top Energy
Unison Networks
Vector
Waipa Networks
WEL Networks
Wellington Electricity Lines
Westpower