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Cross-submission on default price-quality paths for electricity distribution businesses from 1 April 2020

Genesis Energy Limited (**Genesis**) welcomes the opportunity to provide a cross submission to the Commerce Commission (the **Commission**) on the issues paper, "Default price-quality paths for electricity distribution businesses from 1 April 2020", dated November 2018 (**Issues Paper**).

Following our review of the submissions provided to the Commission in response to the Issues Paper, we are concerned the electricity distribution businesses (**EDBs**) have not adequately assessed the impact on customers when proposing their preferred approach for the default price-quality path (**DPP**) reset and we agree with Meridian Energy that more assessment is needed on potential customer impacts before final decisions can be made.

Our primary concern is, whilst the majority of EDBs cite the need for 'step changes' in operating costs (**opex**) over the DPP period, there is no reflection on the impact this will have on prices. Further, a number of submitters dismiss proposals for enhanced quality measures, citing the principle of low-cost regulation underlying the DPP without having regard for whether some costs may be justified to deliver long-term benefits for consumers.

It is widely accepted by submitters that the distribution sector is facing an increasingly uncertain future from new technologies and that this increases the risk of inefficient investment and price volatility. Our strong view is that it is unreasonable to reduce such risks for EDBs by simply passing them on to retailers (and ultimately consumers).

We consider that EDBs are best placed to manage these risks themselves and must ensure they have the right capabilities within their businesses to do so. We are pleased to see evidence that some EDBs are appropriately addressing these risks through more sophisticated approaches to asset management planning and would encourage the sector to collaborate more; sharing skills and knowledge between EDBs will reduce risks and minimise cost duplication.

The Commission should be wary of increasing operating cost forecasts

We noted the common assertion amongst EDB's that the sector is facing increasing cost pressures that will require step changes to be embedded in opex forecasts. This is concerning, as little is known about the quantum of these step changes and the total impact on customer bills. We do know that the consequence of opex step changes is almost certainly price increases above inflation, which directly conflicts with customer expectations for flat or decreasing prices[1].

In our view it is not appropriate to simply accept real opex increases as inevitable. This demonstrates a lack of effective competitive pressures on EDBs. We consider it part of the regulator's remit to ensure appropriate competitive pressures are present and operate to incentivise cost efficiencies amongst EDB's. Upward cost pressures, similar to those noted by EDBs, exist for all businesses and therefore will largely be captured in the input price escalation rates used to trend opex forecasts, rendering step changes unnecessary.

Further, any exceptional increases on costs should be more than offset by efficiency gains from employing new technologies and streamlining business processes. Except for software licences and non-wire alternatives, opex does not have future service benefits for consumers and therefore should be subject to the strongest cost disciplines. Budgetary challenges, competitive procurement practices and joint-service models are all tools utilised extensively in businesses with competitive pressures and the Commission should be expecting and incentivising greater adoption of these measures by EDBs.

Industry wide challenge and assessment of new quality measures is needed

Submitters are divergent in their views on the effectiveness of proposed new quality measures. Although Genesis is strongly of the view that urgent changes are needed, given the poor health of many distribution assets and deteriorating network reliability, we are not in a position to know exactly what enhancements are most practical and would deliver the quickest improvement. This really should come from EDBs but they should be mindful that robust solutions can only be achieved if they are willing to work closely with retailers as key stakeholders and be open to challenge.

As Mercury expressed in its submission, it is disappointing that retailers have not been involved in the Electricity Networks Association (**ENA**) Quality of Service Working Group (**QSWG**)[2] and we recommend retailer representation in that forum going forward. Both EDBs and retailers recognise that there is a trade-off to me made between price and quality but, without engaging with retailers we consider it will be difficult to strike the appropriate balance and ensure alignment across the industry.

We also note that, a number of respondents opposing new quality measures, highlight the rising cost of regulation and point to the low-cost principle underlying the DPP. What is missing from this argument is the opportunity cost of not applying stricter quality measures or stronger efficiency incentives. As Powerco stated, *"The gap between default price-quality paths (DPPs) and customised price-quality paths (CPPs) may be constraining prudent and efficient expenditure that is in the best interests of consumers".*[3] Further detailed cost-benefit analysis is needed before proposals are rejected, rather than just applying a principle that is becoming less fit for purpose in an industry facing so much uncertainty.

Capabilities needed to manage businesses risks

Finally, we observe that it is becoming even more important for the Commission to assess whether there are appropriate capabilities employed across the sector and, if not, how this can be achieved. Technology disruption is inevitable and this will bring increased uncertainty and risk of both over and

[1] Electricity Price Review, first report dated 20 August 2018
[2] Mercury submission, page 2
[3] Powerco submission, page 2

under investment. Further, as regulation develops to remain effective and reflect future market conditions, there is a greater risk of unforeseen consequences or transitional price spikes. This new environment is complex and riskier and, as ENA has highlighted in its submission,[4] EDBs will need new skills to navigate this effectively and ensure that consumers' expectations are met.

We are pleased to see some EDBs are adapting their practices to manage the new risks they face, such as Vector, which demonstrates in its submission that it recognises the importance of demand forecasting and scenario modelling[5] in developing robust asset management plans.

Genesis is of the view no New Zealander should miss out on the benefits of more efficient pricing that more robust planning will bring but we also question the efficiency of all 29 networks employing the new skills required individually. This is why it is essential that the sector is collaborating effectively and employing joint service models to the greatest extent possible.

If you would like to discuss any of these matters further, please contact me by email: eleanor.briggs@genesisenergy.co.nz or by phone: 09 951 9350.

Yours sincerely

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[4] ENA submission, page 12
[5] Vector submission, page 7