More standardisation of use-of-system agreements

Consultation Paper

Submissions close: 5pm Tuesday 20 May 2014

8 April 2014

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Executive summary

Use-of-system agreements (UoSAs) are used by distributors and retailers to formalise agreement of the terms under which each provides services to the other. The primary service covered in UoSAs is the distribution service that a distributor provides to a retailer so that the retailer may sell electricity to consumers on that distributor's network.

Industry participants began developing voluntary standard or model use-of-system agreements (MUoSAs) at the end of the 1990s, following the separation of network and retail functions.

The Authority investigated the merits of requiring distributors to use more standardised UoSAs in 2011 and 2012. The Authority published new MUoSAs in September 2012 and expected that distributors and retailers would voluntarily use the new MUoSAs to develop standardised UoSAs, to replace legacy UoSAs and form the basis of UoSAs with new entrant retailers.

The Authority also committed to monitoring the uptake of the MUoSAs. The objectives of this initiative were to promote efficiency and competition for the long-term benefit of consumers.

The Authority's monitoring of the uptake of the MUoSAs indicates the Authority's expectations for MUoSAs are not being met, meaning that the competition and efficiency objectives are not being achieved. Specifically, the Authority has found that:

- distributors are not engaging with retailers to negotiate new UoSAs that reflect the MUoSA
- retailers are not engaging with distributors who seek to negotiate new UoSAs that reflect the MUoSA
- in one case, a distributor is offering retailers a UoSA that materially varies from the MUoSA.

The Authority now considers that less voluntary measures are necessary to achieve the efficiency and competition objectives expected from introducing the MUoSAs.

The Authority's preliminary conclusion is that these objectives can be best achieved by amending the Electricity Industry Participation Code 2012 (Code) to establish the UoSA as a default set of terms that can be varied by mutual agreement between each distributor and retailers on that network.

The Authority considers a default agreement would reduce transaction costs for retailers and distributors, and improve the conditions that would lead to enhanced retail competition across more network areas in New Zealand.

The paper includes a preliminary assessment of the costs and benefits of the preferred option (counterfactual) against the status quo, and concludes that net benefits are likely to accrue to the preferred option.

Interested parties' views on this consultation paper will inform the Authority's further consideration of these issues.

Glossary of abbreviations and terms

Act	Electricity Industry Act 2010
Authority	Electricity Authority
Code	Electricity Industry Participation Code 2010
EIEP	Electricity Information Exchange Protocol
ICP	Installation control point
MUoSA	Model use-of-system agreement
UoSA	Use-of-system agreement

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1. Introduction and purpose of this paper

1.1.1 Use-of-system agreements (UoSAs) are contracts negotiated between electricity distributors and retailers relating to the services each party provides to the other.[1]

1.1.2 The primary service provided for in the majority of UoSAs is an electricity distribution service, sometimes referred to as line function service. This service allows electricity injected at a point of supply into a local network[2] to be distributed to the points of connection with each of a retailer's end-use customers, or into an embedded network.

1.1.3 A retailer must ensure there are arrangements in place to provide line function (ie distribution) services before supplying electricity to an installation control point (ICP).[3]

1.1.4 The Authority published model use-of-system agreements (MUoSAs) in September 2012 after extensive consultation in 2011 and 2012.[4] The work by the Authority followed ongoing efforts by the electricity industry to develop a standard UoSA. That work started in 2001 after the separation of network and retail functions at the end of the 1990s.

1.1.5 The efforts to develop a standard or model UoSA reflected recognition by retailers and distributors that negotiating UoSAs with multiple distributors incurred significant transaction costs and represented a barrier to entry and expansion of retailers to distribution networks.

1.1.6 The Authority expected that the MUoSAs would provide the basis for significantly enhanced levels of standardisation in UoSAs negotiated between retailers and distributors with the objective of promoting efficiency and retail competition.

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1 The majority of UoSAs in use in New Zealand are known as interposed UoSAs. The differences between interposed and conveyance UoSAs are explained starting at paragraph 2.3.1.

2 Most commonly this is the point of connection with the national grid but it may also be a point of connection with an electricity generator.

3 Code, clause 11.16.

4 Section 42 of the Electricity Industry Act 2010 required the Authority to develop requirements for all distributors to use more standardised UoSAs or report to the Minister why it had not done so and what alternative it proposed.

1.2 Monitoring of outcomes indicates MUoSA objectives are not being achieved

1.2.1 The Authority committed to regular monitoring and review of UoSAs to determine if the objectives of the MUoSAs were being achieved. The monitoring comprised a regular review of distributors' alignment with the MUoSAs and discussions with distributors and retailers about any issues encountered.

1.2.2 The first review took place in May 2013. The Authority also established a 'feedback channel' for participants to provide insights into the implementation of the MUoSAs.

1.2.3 The Authority's monitoring activities have identified evidence of behaviours that indicate a largely voluntary regime is unlikely to be successful in achieving the MUoSA objectives. The Authority considers that these outcomes are likely to have a material adverse impact on efficiency and competition. Accordingly, it has decided to investigate issues and options now, rather than wait for further reviews.

1.3 Purpose of this paper

1.3.1 The purpose of this paper is to seek feedback from parties interested in the relationships between distributors and retailers, including to seek feedback about:

(a) the Authority's view of the observed behaviours relating to the uptake of the MUoSAs and expectations of more standardisation of UoSAs

(b) the consequences and implications of these behaviours on achieving the competition and efficiency objectives of the MUoSAs

(c) a preferred option, including views on the likely costs and benefits of that option.

1.3.2 This paper does not propose an amendment to the Electricity Industry Participation Code (Code), but does outline options for achieving the Authority's objectives which, if pursued, would lead to future Code amendments. The Authority will consider the feedback it receives on the questions posed in this consultation paper in forming its views as to how to proceed.

1.4 Submissions

The Authority's preference is to receive submissions in electronic format (Microsoft Word). It is not necessary to send hard copies of submissions to the Authority, unless it is not possible to do so electronically. Submissions in electronic form should be emailed to submissions@ea.govt.nz with Consultation Paper—More standardisation of use-of-system agreements in the subject line.

If submitters do not wish to send their submission electronically, they should post one hard copy of their submission to the address below.

Submissions
Electricity Authority
PO Box 10041
Wellington 6143

Submissions
Electricity Authority
Level 7, ASB Bank Tower
2 Hunter Street
Wellington

Tel: 0-4-460 8860

Fax: 0-4-460 8879

1.4.1 Submissions should be received by 5pm on Tuesday 20 May 2014. Please note that late submissions are unlikely to be considered.

1.4.2 The Authority will acknowledge receipt of all submissions electronically. Please contact the Submissions' Administrator if you do not receive electronic acknowledgement of your submission within two business days.

1.4.3 If possible, submissions should be provided in the format shown in Appendix A. Your submission is likely to be made available to the general public on the Authority's website. Submitters should indicate any documents attached, in support of the submission, in a covering letter and clearly indicate any information that is provided to the Authority on a confidential basis. However, all information provided to the Authority is subject to the Official Information Act 1982.

2. Background

2.1 Why has a model UoSA been developed?

2.1.1 The mandatory separation of network and retail functions in New Zealand in the late 1990s triggered a period of significant contract development as newly formed distributors and retailers sought to negotiate service contracts amongst themselves.

2.1.2 Since no standard contract template existed for these agreements, distributors and retailers developed and signed their own UoSAs.

2.1.3 This involved significant duplication of effort and resulted in a variety of contract terms across different network areas governing what is essentially the same service that is provided by all distributors (with local variations in some cases).

2.1.4 Some aspects of the early UoSAs remained controversial between the parties, most frequently where some distributors were perceived to have exerted their negotiating power as local monopolies to obtain better terms.

2.1.5 A standard or model approach (a MUoSA) was proposed in the early 2000s as an industry initiative to minimise inefficient duplication of effort and achieve more balanced, efficient (for example, appropriate risk allocation) and standardised terms and conditions in UoSAs across different network areas. This was expected to result in the replacement of existing legacy UoSAs with contracts containing more efficient and pro-competitive terms, and to make it less costly and time-consuming for entrant retailers to expand operations to trade in new network areas.

2.2 Nature of distributor and retailer relationship

2.2.1 The UoSA is notionally the result of negotiations between a distribution business and a retail business. However, the interaction does not reflect the characteristics of a ‘true’ commercial interaction because distributors are natural monopoly providers of electricity distribution services within their local areas.

2.2.2 A distributor ‘needs’ only one retailer to sell electricity to the consumers connected to its network. Once that retailer has commenced trading, network access requests from new entrant retailers could be perceived as imposing additional risk, cost, and complexity for little additional benefit to the distributor.

2.2.3 In their dealings with retailers, distributors are able to adopt a take-it-or-leave-it approach to contract formation. This is a key driver of the Authority's interest, in light of its statutory objective to promote competition in the New Zealand electricity industry for the long-term benefit of consumers.

2.3 Two forms of UoSA: conveyance and interposed

2.3.1 Two variants of the UoSA were identified for development: these were referred to as 'interposed' UoSAs and 'conveyance only' (or simply 'conveyance') UoSAs.

2.3.2 Distributors more frequently adopt interposed UoSAs. Under these contracts, distributors wholesale the distribution service to retailers, who in turn bundle the services with other products and services and provide delivered energy to their customers. Under this arrangement, distributors bill retailers for the distribution service they provide and it is up to the retailers to recover the costs from their retail customers by pricing the retail products appropriately.

2.3.3 Conveyance UoSAs are less frequently used. Conveyance UoSAs reflect an arrangement in which the distributor contracts directly with end-use consumers to provide distribution services. In this case, the retailer has a separate contract with the consumer to provide electricity. A conveyance UoSA, therefore, is the contract that the distributor and retailer agree in respect of a range of ancillary services each provides the other in order to cooperate in the delivery of services to their mutual customers (for example, the retailer commonly provides billing services for distribution charges to the customer on behalf of the distributor).[5]

2.3.4 The primary difference between interposed and conveyance arrangements is whether delivery (transmission and distribution) of the electricity received by a consumer is included (interposed) or excluded (conveyance) in the contract the consumer has with its electricity retailer (regardless of how the consumer is actually billed for the two service components).

2.4 How were the MUoSAs initially developed?

2.4.1 Industry working groups made up of representatives from distributors, retailers and consumers were formed to undertake the early MUoSA development. Two such groups were convened in the early to mid-2000s,

[5] For a fuller discussion of the two UoSA variants, see Electricity Authority Consultation Paper *Standardisation: Model Use-of-System Agreements and Proposed Code Amendments*, 11 August 2011, section 3.4.

spanning the early self-regulatory period and the later period under the Electricity Commission.

2.4.2 The Electricity Commission completed the first MUoSAs in 2005, subject to a review to check their alignment with the anticipated new transmission benchmark agreement that was being developed at that time. This led to MUoSAs being published in 2008.

2.4.3 Section 42 of the Electricity Industry Act 2010 included requirements for all distributors to use more standardised use-of-system agreements as a specific new matter to be addressed by the Authority.

2.4.4 The section 42 requirements, and a number of concerns with the 2008 MUoSAs (the conveyance MUoSA was not finalised to the same standard as the interposed MUoSA at that time), led to the publication of comprehensively reviewed interposed and conveyance MUoSAs in September 2012. The new MUoSAs included a set of drafting guidelines for developing UoSAs suitable for use with embedded networks.

2.5 What were the Authority’s expectations following publication of the MUoSAs?

2.5.1 In publishing the new MUoSAs in September 2012, the Authority expected that new MUoSAs would provide the basis for significantly enhanced levels of standardisation around efficient and pro-competitive terms in UoSAs negotiated between retailers and distributors, with the objective of enhancing efficiency and competition for the long-term benefit of consumers.

2.5.2 The Authority anticipated early active engagement between distributors and retailers to negotiate new and replacement UoSAs.

2.5.3 The Authority expected that a significant number of new UoSAs would be agreed that mirrored the MUoSAs. Variations were expected where local operational circumstances warranted an alternative approach or where both parties agreed an alternative approach to a specific MUoSA provision.

2.5.4 Material variation from the drafting or terms of the MUoSAs was not expected to be necessary, given the extensive consultation that had occurred in the development process.

2.5.5 These expectations reflected the Authority’s observations of widespread and longstanding dissatisfaction with many of the legacy UoSAs. Participants had frequently commented in submissions and in other communications with the Authority that they had been waiting for publication of the new MUoSAs before commencing their own UoSA development work.

2.5.6 Authority staff provided a report to the Board in May 2013 (with further reports due each following May) which reviewed distributors’ alignment with the MUoSAs and considered any issues encountered. The Authority also established a feedback channel that distributors and retailers could use to provide information or concerns relating to current issues they encountered with the MUoSAs.

3. Emerging participant responses to publication of the MUoSAs

3.1 Feedback channel

3.1.1 The Authority reminded participants in January 2013 that they could provide feedback on implementing and adopting the MUoSAs. One retailer and a small number of other parties took up the opportunity.

3.2 Information obtained from May 2013 review

3.2.1 The Authority sought further information, in March and April 2013, on early progress of UoSA-related activity and whether MUoSAs had been adopted. The Authority approached a limited number of retailers to identify whether any issues had arisen, and to understand how participants were approaching compliance with the new Part 12A requirements.[6] The results were reported to the Authority Board in May 2013.

Authority sought further information from all retailers and distributors

3.2.2 The feedback from the May 2013 review raised questions about progress of UoSA-related activity, and whether participants were adopting the MUoSA. The Authority asked for an update from distributors and retailers about their activity and intentions. A number of participants took the opportunity to provide their view on the implementation of the MUoSA, in writing and through one-on-one meetings with the Authority.

Authority identified a number of issues

3.2.3 The Authority's monitoring during 2013 identified a number of issues with the progress of UoSA-related activity and MUoSA adoption that highlighted risks to achieving the objectives of the MUoSA initiative. The key issues are that:

(a) a major distributor offered a significantly amended version of the interposed MUoSA for negotiation with retailers

(b) retailers have refused to negotiate with a distributor that offered a closely aligned version of the interposed MUoSA for negotiation

6 Part 12A of the Code introduced new obligations on retailers and distributors in respect of UoSA negotiation, mediation, prudential requirements, distributor indemnities, tariff structure consultations and tariff rate changes.

(c) there is relatively little evidence of activity in developing new UoSAs in most distribution network areas.

3.3 A distributor offered a UoSA based on a significantly amended interposed MUoSA

3.3.1 In February 2012, just prior to the Authority's first review, Contact Energy (Contact) raised a concern with the Authority regarding the approach that Vector was taking to negotiate a new UoSA relating to distribution services on Vector's Auckland electricity networks. Contact informed the Authority that Vector had provided Contact with a draft UoSA that contained significant amendments to the Authority's September 2012 interposed MUoSA.[7] Other retailers have also raised this issue with the Authority.

3.3.2 Contact stated at that time that it was not inclined to commit significant resources to negotiating with Vector on the basis that the agreement Vector provided Contact as a starting point contained material variances from the MUoSA.

3.3.3 Contact expressed its main concern as being that it expected that distributors would offer new UoSAs based on the September 2012 MUoSA, amended only to the extent necessary to tailor the agreement to reflect local policies and processes. Contact said it considered that Vector's amendments went far beyond changes needed to reflect local policies and processes, as Vector's amendments:

(a) materially rebalanced core terms and conditions

(b) redrafted many parts of the MUoSA into Vector's preferred style.

3.3.4 Contact said that it further considered that it was an inefficient use of its commercial resources to commence negotiations on the basis of a draft UoSA that contained a fundamentally different balance of rights and obligations in what it considered should be "boilerplate" terms and conditions from those contained in the September 2012 MUoSA.

3.3.5 The Authority understands that Contact has subsequently changed its stance and has entered into a new UoSA with Vector. The Authority is unaware of any broader considerations that may have encouraged Contact to change its earlier stance. Nevertheless, the experience described by Contact is of significant interest to the Authority.

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7 Information relating to recently executed UoSAs by Vector is available at: http://www.vector.co.nz/corporate/disclosures/electricity/electricity-prescribed-terms-and-conditions-contracts.

3.4 Authority's analysis of the Vector UoSA

3.4.1 The Authority obtained a copy of Vector's UoSA[8] and determined that it contained material variations from the MUoSA that:

(a) substituted MUoSA provisions with less efficient and/or less pro-competitive terms

(b) shifted the balance of rights and obligations significantly in Vector's favour

(c) unnecessarily (and inefficiently) introduced alternative drafting without substantially altering the meaning of the MUoSA.

3.4.2 Table 1 provides examples of some, but not all, of the more material variations introduced by Vector. In total, the Authority's analysis noted 47 material changes (in addition to numerous less material changes) from the MUoSA terms and conditions, the majority of which have rebalanced the rights and obligations in the UoSA to Vector's benefit.

Table 1: Examples of material variations in Vector's UoSAs compared with the MUoSA

Vector Amendment	Comment
Clause 2. Makes services and obligations subject to the terms of the agreement and provides a caveat that the distributor will meet its obligations in accordance with Good Industry Practice.	Making every service and obligation subject to Good Industry Practice materially diminishes service obligations on Vector that had been considered at length in working groups and consultation rounds over many years. Inefficient reallocation of risk.
Clause 2.1(f). Key part of the obligation relating to helping identify abnormal loss trends is deleted.	Vector's UoSA removes this obligation, decreasing efficiency because this has been a service requested by retailers and the distributor is best placed to carry out this function. Minimising losses is efficient and in the interests of all parties.
Clause 4.1. Equal access and even handed treatment limited to retailers that have signed a similar UoSA.	This is less pro-competitive than the MUoSA term because it discriminates against retailers that may not have signed a similar UoSA for good reason.

[8] Note that there have been several UoSA versions developed by Vector. The version the Authority analysed in mid-2013 was version 1.1. The variations noted in Table 1 are still in effect in version 1.4.

Vector Amendment	Comment
Redrafted clause 5.3 defines Vector's policy for prioritising load during system emergencies as confidential information between the parties. The policy is binding on the parties and not subject to retailer consultation.	Vector's version of a load management policy is confidential to the retailer (and so could be different between retailers) and binding on the retailer without consultation in its development or amendment. The policy intent was a transparently and consultatively developed policy that all retailers and interested parties (eg consumers) can access. This is less efficient than the MUoSA provision.
Clause 6.1. Changes the establishment of load control rights by requiring only that Vector charges the retailer a Controlled Load Tariff Option.	MUoSA drafting provided for consumer choice by electing to take up the retailer's corresponding Controlled Load Option. This asserts Vector's view over the view of the retailer and/or consumer as to whether a controlled load tariff option applies.
Clause 6.10. New right to require that the retailer provide undefined information relating to consumer demand and energy.	This change amounts to a significant open-ended obligation to obtain consumer information by Vector.
Clauses 22 and 26. Removed the provision providing for unlimited liability for breach of confidentiality by either party.	Retention of this right has been strongly defended by retailers over many years of MUoSA development. Inefficient, as it weakens the compliance incentive on the party best placed to manage the risk.
Clause 24. Amendments to the agreement. Provides a new process that seeks to resolve the deadlock that can occur if some retailers do not agree with a proposed change. Provides for retailers that comprise > 75% of installation control points (ICPs) to agree to changes that are binding on other retailers.	New process may not find favour with smaller retailers, some of whom will have had to disagree with a proposed change to trigger this clause. Not pro-competitive as it favours large incumbent retailers at the expense of smaller entrant retailers.
Clause 25.5. Changes to GXPs. Removes the obligation to consult with retailers and replaces it with an obligation to notify only.	New and deleted GXPs have potentially significant market impacts on retailers. The MUoSA was developed on the basis that it is reasonable that a distributor should consult retailers prior to adding or deleting a GXP. Not consulting is less efficient than consulting because material issues may not be surfaced at an early stage.

Vector Amendment	Comment
Clause 26. Limitations of liability. Clause changed to limit liability resulting from a breach of the agreement only. MUoSA also provided for liability if negligence or failure to exercise Good Industry Practice.	Significant changes in favour of Vector. Inefficient, as it weakens the incentive on Vector to manage and reduce risks which it can control.

3.5 Some retailers have refused to engage with a distributor

3.5.1 Network Tasman informed the Authority of its experiences in seeking to develop and negotiate a new UoSA with each of the retailers currently trading on its network. Network Tasman sought to follow an open and transparent development process with a view to finalising a single agreed UoSA template that would form the basis of new UoSAs executed with each of its retailers.

3.5.2 The Authority understands that most retailers refused to engage with Network Tasman. For instance, some retailers have responded to Network Tasman noting it saw no benefit from moving to the new agreement.

3.5.3 Network Tasman has expressed significant frustration with the low level of engagement from most retailers. Although Network Tasman has executed new MUoSA-based agreements with two retailers and is in discussions with one other, most retailers remain largely disengaged.

3.5.4 The Authority obtained a copy of Network Tasman’s draft UoSA and has confirmed that it very closely followed the interposed version of the MUoSA, with changes proposed only where necessary to reflect local policies and processes.

3.6 There is little evidence of other activity around developing new more standardised UoSAs

3.6.1 Although several participants provided their views of the role of the Authority’s published MUoSAs, there was very little evidence that distributors and retailers in aggregate had afforded priority to developing new more standardised UoSAs. Few distributors are understood to be developing new UoSAs.

3.7 There is little evidence of voluntary disclosure of UoSA information on websites by distributors

3.7.1 A December 2013 review of 29 distributor websites indicated that two distributors had published on their websites some of the information relating to their UoSAs that was envisaged in the information paper.

3.7.2 The information paper envisaged voluntary publication of the type of UoSA executed with each retailer operating on the distributor's network and a copy of the executed agreement. This would provide transparency of the arrangements entered into by a retailer's competitors, underpinning a more pro-competitive regime.

3.7.3 The information described exceeded the information on distributor contractual arrangements required under the information disclosure requirements managed by the Commerce Commission.

Q1. Do you have feedback that would update the issues outlined in this section?

Q2. If you are a distributor, are you actively developing and negotiating UoSAs with retailers? If you are a retailer, are you actively engaged with any distributors in relation to UoSAs? Please provide information relating to your approach, experiences, successes and concerns.

Q3. Are you aware of any new issues that have arisen since the Authority undertook monitoring and communication with participants relating to UoSAs in early 2013?

4. The Authority considers that its objectives are not being met

4.1 What were the Authority's policy objectives and expectations for publishing the MUoSAs?

4.1.1 The Authority's objectives for retaining a largely voluntary approach to establishing more standardised terms of trade between retailers and distributors were set out in the information paper that was published with the September 2012 MUoSA.[9]

4.1.2 In summary, the outcome sought by the Authority was to achieve more standardised terms and conditions in UoSAs used by retailers and distributors. This would support the Authority's objective of promoting efficiency and competition.

4.1.3 The Authority published the MUoSAs to facilitate achievement of these objectives. The published MUoSAs provide comprehensive UoSA templates containing core terms (we will simply refer to these as "core terms") and detailed operational policy and process detail. The MUoSAs have been developed with significant retailer and distributor input over many years. The Authority considers that the resulting agreement template represents a reasonable balance of the parties' respective commercial interests in an efficient and pro-competitive manner.

4.1.4 Publication of the MUoSAs and a statement of the Authority's policy objectives for its largely voluntary approach was intended to reflect the nature of the market for distribution services in which a monopoly distributor's best alternative to a negotiated agreement is usually no agreement at all – retail competition provides additional cost and operational complexity from a distributor's perspective but little, if any, benefit. Thus, absent regulatory intervention, distributors can adopt a "take it or leave it" negotiating stance. The Authority therefore considers that it is not interfering in normal commercial negotiations between willing buyers and sellers of services. Establishing regulated terms and conditions for access to natural monopoly infrastructure is accepted competition law and public policy practice.[10]

[9] The Authority's expectations were discussed in Electricity Authority Information Paper and Summary of Submissions *Standardisation of distribution arrangements - model use-of-system agreements*, 11 September 2012, section 6 and Appendix A (particularly Table 2). The paper is available at: http://www.ea.govt.nz/our-work/programmes/market/consumer-rights-policy/model-arrangements/distribution-tariff/ .

[10] For example, in the UK the Distribution Connection and Use of System Agreement (DCUSA) provides a single centralised document which relates to the connection to and use of the electricity distribution networks. It

4.1.5 The core terms and conditions in the MUoSAs resulted from extensive stakeholder input, including through working groups established under earlier industry regulatory agencies, and several rounds of consultation over many years of development.

What the Authority expected to see

4.1.6 The Authority's expectations from publishing the MUoSAs were:

(a) the core terms and conditions provided in the MUoSAs should not be amended when developing a UoSA, unless innovative new approaches were mutually agreed by the parties that would enhance efficiency and/or competition

(b) operational policy and process detail, which varies between distributors, should be reflected in the UoSA. Model terms are included in the MUoSAs that should suit the most common arrangements covering commonly encountered practices but some redrafting is likely to be required to appropriately reflect local conditions

(c) amendments proposed by the distributor should be clearly highlighted to a retailer by tracking changes from the relevant September 2012 MUoSA,[11] which would form the starting point for UoSA development

(d) publication of the MUoSAs would trigger a significant level of engagement between existing and new distributor/retailer counterparties, as legacy UoSAs are updated and entrant retailers seek to operate in new areas. Some of the legacy UoSAs are now up to 15 years old and do not adequately provide an efficient and pro-competitive basis underpinning the provision of distribution services in New Zealand today

(e) with the objective of demonstrating that all retailers are afforded equal access to distribution services on a local network, distributors would voluntarily publish significantly more information on their websites that provides transparency over the UoSAs executed, both past and present (a guideline was presented on the type of information sought).

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includes the charging methodologies for connection to, and use of, the electricity distribution networks. See https://www.ofgem.gov.uk/licences-codes-and-standards/codes/electricity-codes/distribution-connection-and-use-system-agreement

11 Both interposed and conveyance model versions were published.

The benefits expected from uptake of the MUoSA

4.1.7 If the approach described above was adopted, the transaction costs of developing, negotiating and executing a UoSA would be significantly reduced for both parties. By adopting the MUoSA drafting unchanged in respect of the core terms, both parties could be confident of executing a contemporary, balanced agreement, which would significantly minimise the burden on their respective commercial and legal resources and streamline the negotiation phase.

4.1.8 Further, adopting this approach would give rise to competition benefits by removing one of the barriers to entry into retail electricity markets and/or expanding trading into new network areas. This is an issue that prospective entrant retailers have frequently raised. There are four key factors to attaining this competition benefit:

(a) significantly reduced transaction costs and reduced time for the retailer to negotiate and execute a UoSA for a new network area, as outlined above (ie, it is cheaper and faster to set up as a new retailer and expand operations into new network areas)

(b) significantly reduced transaction costs and reduced time for the distributor to negotiate and execute a UoSA for a new retailer, as outlined above (ie, it is cheaper and faster to admit new retailers to the distributor's network, as entrants will have gained earlier familiarity and comfort with MUoSA-based terms and conditions)

(c) significantly enhanced alignment of the terms and conditions (including inter-business policies and processes) governing distribution service across all New Zealand distribution networks (ie, it is easier to set up a retail operation to trade on multiple networks, as inter-network differences are reduced)

(d) significantly more transparent, efficient and pro-competitive terms and conditions governing the provision of distribution services that apply even-handedly to all retailers (ie, network access terms and conditions are transparently more competitively neutral for retailers and thus pro-competitive).

4.2 What are the consequences of the behaviours the Authority has observed?

4.2.1 By making both significant and minor amendments to the MUoSA in almost every clause, Vector's approach undermines the long-standing industry efforts to achieve more standardised UoSAs and is contrary to achieving the Authority's objective of efficiency and competition. For example, the Vector approach creates a new set of terms and conditions covering a large number of ICPs[12] that are no longer:

(a) standardised – they are unique to Vector's network

(b) efficient – they have required significant additional development effort and cost to create and significant additional effort and cost to negotiate with retailers, as compared with the approach the Authority described

(c) pro-competitive – Vector has varied core terms from those in the MUoSA that were considered to provide an efficient balance between the respective commercial interests of the parties, including an efficient sharing of risk. The agreements already executed with Vector's larger retailers now represent a de facto Vector standard that smaller retailers and prospective entrant retailers will be strongly encouraged to adopt.

4.2.2 Retailers refusing to engage with Network Tasman leaves non-standard, less efficient and less pro-competitive legacy agreements in place in that network area. The outcome is inefficient, as Network Tasman clearly intended to update its UoSAs in compliance with the Authority's expectations and has expended resources to achieve an outcome that it has not been able to achieve.

4.2.3 Other feedback provided to the Authority includes views that:

(a) some distributors consider their situation is sufficiently unique as to require bespoke terms and conditions across a wide range of commercial policy and process matters

(b) some distributors prefer to retain control of their own drafting of core terms within their UoSAs, including over matters of drafting style and language.

Q4. Are you aware of any new developments that would provide additional information or update the situation presented in section 4? If so, please provide relevant details.

[12] Vector supplies around 27% of total NZ ICPs.

5. The Authority is considering its options in response to observed behaviours

5.1.1 The Authority has concluded that a largely voluntary approach to more standardisation of UoSAs has not yet started to produce the expected efficiency and competition benefits and, based on observed trends, these are unlikely to materialise within the next two to four years.[13]

5.1.2 Consequently, the Authority is investigating alternative means of achieving the efficiency and competition benefits from more standardised UoSAs. The feedback received on this consultation paper will assist the Authority with this investigation.

5.1.3 Observed participant behaviours have led the Authority to the view that feasible alternatives will inevitably require less participant discretion in the way they form inter-business agreements relating to the provision of distribution services. If Code changes are subsequently determined to provide the best approach, the Authority considers it is better to develop these as soon as possible to provide participants with certainty and avoid the possibility of further inefficient development of UoSAs.

5.1.4 The Authority has previously added a number of UoSA-related requirements in Part 12A of the Code because it considered that retailers and distributors would be very unlikely to mutually agree on those important matters in a form that promoted the Authority's statutory objective.

5.1.5 In line with previous conclusions on the value of undertaking initiatives that would achieve more standardised UoSAs, the Authority considers there are likely to be material net benefits from taking further steps at this time that would more directly achieve efficiency and competition objectives. A discussion of costs and benefits is presented in section 7.

Q5. Do you agree that the Authority is unlikely to achieve its objectives for UoSAs within a reasonable timeframe by persevering with largely voluntary measures? Please state the reasons for your view.

[13] The Authority indicated in the September 2012 information paper that a period of three to five years was a reasonable expectation for completion of standardised UoSAs by distributors and retailers.

5.2 What options are available to the Authority to achieve more standardised UoSAs?

5.2.1 Starting from the status quo, which is an option under consideration, the Authority has considered a number of derivative options, in increasing order of prescription, which might better achieve its objectives. The options are briefly introduced here and explained in more detail in the following sections.

Option 0: Status quo

5.2.2 Retain the current voluntary approach to establishing new UoSAs outlined in the September 2012 information paper and the current Part 12A requirements. This option centres on the published MUoSAs and expects that distributors will update their legacy UoSAs. Distributors would also publish information relating to the UoSAs they have entered into. Monitor and assess the situation annually.

Option 1: Status quo with communication

5.2.3 Retain the status quo approach but communicate with participants to reinforce the Authority's policy objectives and expectations. Monitor and assess the situation annually.

Option 2: More Part 12A clauses

5.2.4 Extend Part 12A of the Code by codifying further core terms and deem these clauses to be part of every UoSA. If appropriate, provide discretion for parties to a UoSA to depart from prescribed terms where they agree to an alternative.

Option 3: Default core terms

5.2.5 Divide the MUoSA into two parts: (1) core terms which can be largely fixed in respect of the common aspects of distribution services and (2) operational policy and process details which tend to be, in contrast to core terms, more variable between different providers of distribution services.

5.2.6 Make the core terms a default set of core terms that are deemed to apply at the end of a specified negotiating process unless the parties agree to alternative terms. Thus, the default agreement would be deemed by the Code to apply unless the parties agree otherwise. Allow the distributor to specify explicit operational inter-business policy and process details but provide model arrangements for common policies and processes and communicate a firm expectation that the model drafting is used to the maximum extent practicable.

Option 4: Default whole agreement

5.2.7 Make the entire MUoSA a default agreement that is deemed to apply at the end of a specified negotiating process unless the parties agree to alternative terms. Thus, the default agreement would be deemed by the Code to apply unless the parties agree otherwise.

Option 5: Mandatory core terms

5.2.8 Divide the MUoSA into two parts: (1) core terms and (2) operational policy and process detail. Make the core terms mandatory under the Code, ie, the mandatory terms would not be able to be contracted out of by either party. Allow the distributor to specify explicit operational inter-business policy and process details but provide model arrangements for common policies and processes and communicate a firm expectation that the model drafting is used to the maximum extent possible.

Option 6: Mandatory whole agreement

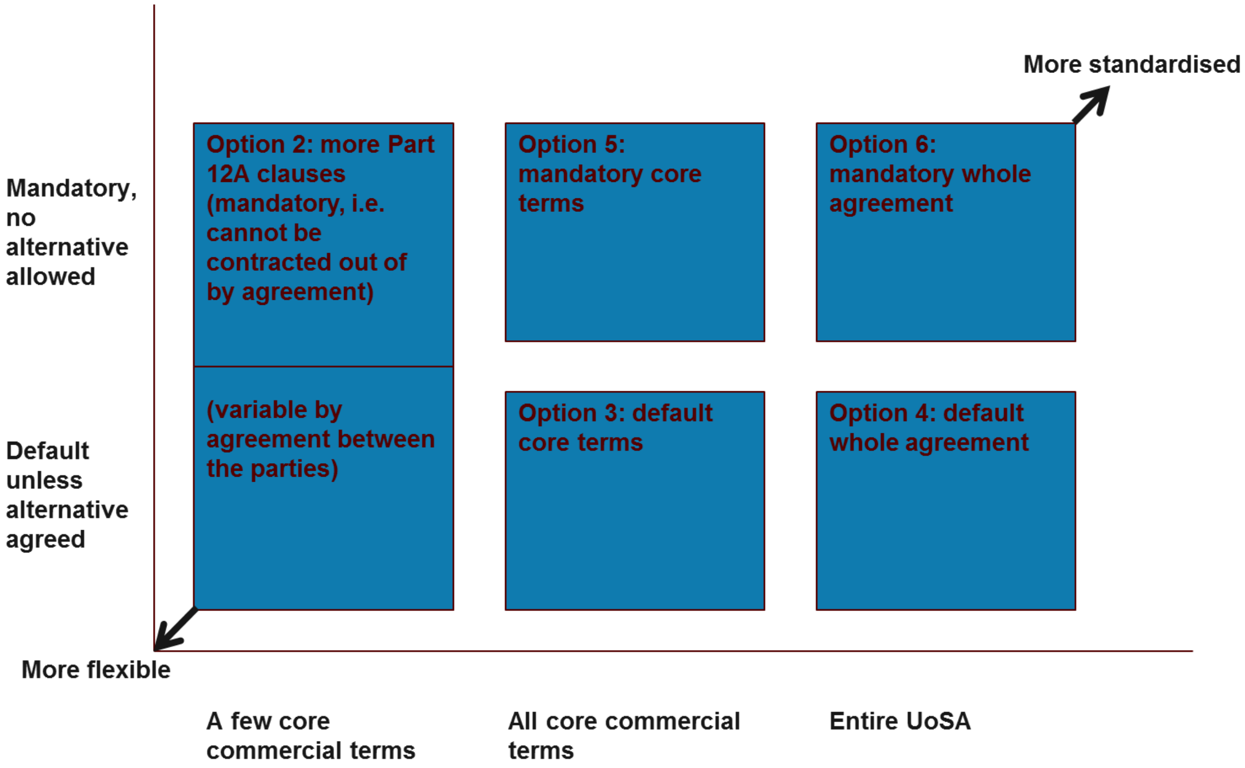
5.2.9 Make the entire MUoSA a mandatory set of terms, which cannot be contracted out of by either party.

Summary of the options

5.2.10 The options provide varying levels of prescription and require that choices are made amongst trade-offs of standardisation and flexibility.

5.2.11 Figure 1 presents options 2 – 6 in a way that demonstrates the inherent trade-offs in standardisation and flexibility.

Figure 1: Options summary



5.3 How would each of these options work?

Option 0: Status quo

5.3.1 The status quo option is essentially to do nothing more than has been done already and to continue monitoring the situation. Distributors and retailers would remain free to decide whether and when to engage on developing replacement UoSAs and prospective entrant retailers would approach individual distributors for network access in the same way as they do now.

5.3.2 The Authority considers that the behaviours observed since publication of the MUoSAs, described in section 3, would be likely to endure.

Option 1: Status quo with communication

5.3.3 Communication initiatives could include the development and publication of more specific guidelines relating to UoSAs and/or running briefing forums for participants' senior commercial managers. These would be based on, and extend, the relevant material in the earlier-referenced Information Paper, published by the Authority alongside the MUoSAs in September 2012 and publicised in the Market Brief at that time.

5.3.4 The Authority considers that its "more standardisation of UoSAs" policy objectives have been clear for a considerable period of time. The drivers of this objective include the specific new matters set out section 42(2)(f) of the Act[14] (including the option to not do this and instead report to the Minister) and the competition and efficiency objectives in the Authority's statutory objective. These objectives are consistent with those that triggered the original development of a MUoSA in the early 2000s.

5.3.5 This would be the most straightforward option (beyond the status quo option) to design and implement. An argument in favour of this option would be that distributors and retailers (in good faith) have either misinterpreted the Authority's objectives and expectations for publishing largely voluntary MUoSAs in September 2012, or have to this point simply chosen not to prioritise resources in response to the Authority's call for participant action to achieve a widespread refresh of UoSAs and significantly more standardised, efficient and pro-competitive terms than exist in current UoSAs.

5.3.6 The success of this option would be entirely in the hands of participants, particularly those participants that have previously submitted in support of retaining largely voluntary measures governing UoSAs and seek continuity of this approach.

5.3.7 The Authority considers that the observed behaviours and expressed opinions of some participants subsequent to it publishing MUoSAs in September 2012 (outlined in section 3) are not encouraging in respect of a continued reliance on largely voluntary measures. Voluntary measures have to this point failed to deliver the outcomes sought by the Authority in respect of achieving more standardised, efficient and pro-competitive UoSAs.

Option 2: More Part 12A clauses

5.3.8 Part 12A of the Code:

(a) specifies requirements that must be complied with when negotiating UoSAs

(b) specifies requirements that must be complied with if prudential requirements are included in UoSAs

14 Which states: "requirements for all distributors to use more standardised use-of-system agreements, and for those use-of-system agreements to include provisions indemnifying retailers in respect of liability under the Consumer Guarantees Act 1993 for breaches of acceptable quality of supply, where those breaches were caused by faults on a distributor's network:".

(c) requires that an indemnity is included in every UoSA unless agreed otherwise

(d) requires that distributors who do not send accounts to consumers directly consult with traders (ie retailers) about changes to the distributor's tariff structure

(e) requires that distributors who do not send accounts to consumers directly, and traders, comply with EIEP12

(f) requires distributors to use standard tariff codes.

5.3.9 Conceptually, Part 12A could be expanded to specify more of the core terms that would be included in a UoSA. Greater flexibility could be provided by allowing the parties to contract out of one or more of the specific provisions by mutual agreement.[15]

5.3.10 An advantage of this approach is that it would build on the regulation base already established in Part 12A, with which participants have presumably gained some familiarity. The option would be flexibly incremental, in that provisions causing the most problem amongst participants could be added first.

5.3.11 A disadvantage of this option is that its flexibility and incremental nature would maintain regulatory uncertainty, as existing UoSAs become increasingly "whittled down".

5.3.12 A further issue would be to decide which terms would be included. As more terms become included, the option would become increasingly similar to options 3 to 6.

Option 3: Default core terms

5.3.13 Whereas option 2 is suited to incremental expansion of Part 12A by adding more UoSA provisions that would become subject to default arrangements, options 3 to 6 represent the ultimate development of Part 12A to include all of the provisions in a complete UoSA.

5.3.14 Option 3[16] reflects that UoSAs are structured around two types of provisions:

(a) core terms that can be considered as providing standard or "boilerplate" terms and conditions governing the provision of distribution services within New Zealand

[15] See, for example, clause 12A.6(4).

[16] This also applies in common with option 5, described later.

(b) operational terms that describe a quite small number of policies and inter-business processes that tend to vary between distributors, albeit within a fairly small range of commonly encountered options (derived from experience and good industry practice).

Core terms

5.3.15 Clauses providing for core service obligations, liability, agreement breaches, events of default and force majeure are examples of core terms that are suited to becoming “boilerplate” commercial terms governing the provision of distribution services in New Zealand.

5.3.16 These types of provisions have been a primary focus of MUoSA development since 2001. In many international jurisdictions, the core terms relating to the provision of distribution services are standardised by regulation.[17]

5.3.17 In New Zealand, the transmission benchmark agreement governing the provision of transmission services by Transpower to designated transmission customers is a further example of core terms being standardised by regulation. It is likely that some of the existing Code provisions that pertain to the transmission benchmark agreement could provide a model approach for structuring a distribution “benchmark agreement” within the Code. Distributors, being designated transmission customers under Part 12 of the Code, will already have some familiarity with these requirements.

Operational terms

5.3.18 Clauses and schedules providing details of service standards, EIEPs, service interruption and connection policies, and pricing and billing information are examples of provisions relating to operational policies and processes that tend to be more variable between distributors, albeit typically within a limited range of common options.

5.3.19 The MUoSA development has sought to provide standardised drafting to provide for the most common arrangements relating to operational policies and inter-business processes. Alternative approaches have been provided in many cases, with guidance provided in practice notes and alternative clauses marked with square brackets in the MUoSAs.

[17] For example, in the UK, Ofgem administers the Distribution Connection and Use of System Agreement (DCUSA), which provides a single centralised document which relates to the connection to and use of the electricity distribution networks. For more detail, see https://www.ofgem.gov.uk/licences-codes-and-standards/codes/electricity-codes/distribution-connection-and-use-system-agreement.

5.3.20 “Default terms” means an enforceable complete set of core terms that are incorporated into the contract between a distributor and retailer if the two parties choose not to negotiate or, having undertaken a period of negotiation, fail to agree an alternative agreement. Any alternative agreement that might be agreed, even if it comes about by amending a single clause, is an “alternative agreement” by definition. This is identical to the structure adopted in Part 6 of the Code in relation to forming the terms of agreement for connecting distributed generation to a local network.

5.3.21 A key consideration for this option would be which of the MUoSA provisions would be included within the default terms, and how to finalise the remaining policy and process detail.

Option 4: Default whole agreement

5.3.22 This option is an extension of option 3 and proposes that an entire UoSA (both core and operational terms) is suitable for treatment as a default agreement in the way described for core terms under option 3.

5.3.23 This option would effectively require that a single approach is selected for each inter-business operational policy and process that is relevant to the provision of distribution services in New Zealand.

5.3.24 Options 3 and 4 can be seen as different settings on a sliding scale of provisions to be included in the default agreement and are conceptually equivalent. Option 4 assumes that everything in a UoSA can be codified and standardised.

5.3.25 Like option 3, option 4 would provide a default set of terms and conditions that would apply unless an alternative is mutually agreed.

5.3.26 This option would leave nothing unspecified in the default terms and, in doing so, would introduce a completely “standard” set of terms relating to the provision of distribution services in New Zealand. If the parties agreed, they could substitute their own alternative arrangements in specific areas. In this case, consideration would be needed as to whether the Authority should have the ability to strike out such alternative arrangements on a case-by-case basis, if the Authority considered they were inconsistent with the Authority’s statutory objective.

5.3.27 Greater standardisation, increased efficiency and a more pro-competitive environment would result because either party could veto variances from the standard and, under these circumstances, arrangements would be expected to trend towards the standard over time.

5.3.28 In the same way as UoSAs require amendment over time to reflect new circumstances, the default terms may require amendment over time. A single coordinated change to default terms would require a regulatory process that could be designed to be more or less streamlined depending on the nature of the proposed amendment. For example, law changes could be rapidly reflected in the default agreement but changes to terms aimed at increasing efficiency or competition may require a more consultative process with careful consideration of options against the Authority's statutory objective.

Option 5: Mandatory core terms

5.3.29 This option is similar to option 3 in that it relies on the content of a UoSA being divided between core terms and operational terms. It differs from option 3 by providing no option for the parties to agree an alternative.

5.3.30 This option would maximise standardisation of core terms across networks but would trade off some flexibility, compared with option 3.

5.3.31 It is conceptually feasible that a mixture of options 3 and 5 could provide a workable regime, providing maximum standardisation in some provisions and flexibility in others, where appropriate.

Option 6: Mandatory whole agreement

5.3.32 This option is similar to option 4 in that it would cover an entire UoSA and is similar to option 5 in that it would provide no option for the parties to agree an alternative.

5.3.33 This option would maximise standardisation of entire UoSAs across networks but would trade off a significant degree of flexibility as compared with all other options.

Q6. What other options can you suggest that would be worth considering alongside the options identified in section 5.2 and explained in more detail in section 5.3? Please explain the key advantages of your suggested option(s).

6. Further design considerations for options 3 - 6

6.1 Introduction

6.1.1 This section does not dismiss options 0, 1 or 2 but builds on some of the essential design themes to further develop the detail within options 3 – 6. For the purposes of this consultation paper, the descriptions of options 0, 1 and 2 earlier in this section 5 should provide sufficient detail to enable informed feedback from submitters.

6.2 Options 3 and 5 - core terms and operational terms

6.2.1 Options 3 and 5 would require that, if part of a UoSA were established as either a default or mandatory set of core terms, a decision would be needed as to what terms are appropriate as core terms.

6.2.2 A secondary question would then arise as to how agreement would be reached in respect of the remaining terms of the UoSA (ie, the policy and inter-business process detail), which we have referred to as “operational terms”. This section will address the question raised in paragraph 6.2.1.

6.2.3 The Authority has reviewed each clause in the MUoSA against an assessment criterion to determine whether it should be a core term or an operational term. The objective of this assessment is to maximise standardisation of UoSA terms (in pursuit of efficiency and pro-competitive outcomes) while providing some flexibility for operational policy and inter-business process differences between networks.[18]

6.2.4 The assessment criterion defines a term as a core term unless there is a good reason to provide for variation between distributors. Appendix B provides a detailed assessment of the interposed MUoSA clauses and schedules against the assessment criterion.

6.2.5 The assessment indicates that most of the provisions in the interposed MUoSA would be core terms in either a default or a mandated agreement. Some relatively minor amendments would be required to current MUoSA clauses, so that they could be used in either default or mandated agreements.

[18] Note that the interposed MUoSA only has been reviewed at this stage. A further question remains as to whether the conveyance MUoSA should be included in the assessment and this is addressed later in this paper.

How might operational terms be agreed?

6.2.6 Where operational terms have been identified, these could be indicated in the relevant UoSA schedule. Finalising detailed schedules relating to specific policies and inter-business and processes would remain a point of possible disagreement between the parties.

6.2.7 A similar issue arises when developing transmission agreements. Part 12 of the Code includes processes around the transmission benchmark agreement and has to provide for completing the schedules. The approach taken in transmission is to require the parties to attempt to agree in good faith and, if no agreement is arrived at within a set period of time, a dispute situation arises which is referred to the Rulings Panel.

6.2.8 The same process could be developed for what is essentially a distribution benchmark agreement. The Rulings Panel is the body specifically set up to rule on Code breaches and, supported by Authority personnel, would have, or be able to get, access to suitably qualified experts to make a decision.

What terms should be included in the operational terms?

6.2.9 We have determined the types of terms that would need to be considered as operational terms with reference to the analysis undertaken in preparing Appendix B.

6.2.10 The operational terms would need to provide for:

(a) detailed information that must be inserted to form a complete agreement (such as counterparty business and contact details) and option selection (such as role selection where either party can potentially perform a role, for example, notifying consumers of planned outages). This detail could be indicated as blank fields drafted in the default agreement

(b) aspects of distributor-determined policies included in the current MUoSA and referenced within relevant core terms

(c) distributor-determined standards

(d) referenced Authority guidelines.

6.2.11 Table 2 details the policies, standards and Authority guidelines referenced in the interposed MUoSA (items (b), (c) and (d) in the list in paragraph 6.2.10) and provides an assessment of whether the item would more appropriately be included within core terms or operational terms.

Table 2: Policies, standards and Authority guidelines

Item	MUoSA reference	Core or operational terms?	Comment
Distributor determined policies			
Service interruption communication policy	Clause 5.1	Core terms	The requirement for including a policy would be a core term.
	Schedule 5	Hybrid – retain some of schedule as core terms but allow for variation via operational terms where appropriate	Some of the policy schedule is sufficiently generic as to warrant treatment as core terms. The rest would be appropriate as operational terms, to be determined by the distributor.
Emergency load management policy	Clause 5.3	Core terms	The requirement for including a policy would be a core term.
	Schedule 2 (new)	Introductory clauses and structure would be core terms but the policy detail in the table would more appropriately be operational terms, drafted by the distributor	The schedule structure could be standardised but the policy detail would be appropriate as operational terms, to be determined by the distributor.
Pricing policy, methodology and schedule	Clause 9.1	Core terms	Pricing information, including policy, methodology and price schedules, would be core terms as they relate to the prices retailers must pay.
	Schedule 9	Operational terms	All of the detail would appropriately be operational terms – it is subject to regulatory requirements outside of the UoSA.
Connections policy	Clause 19.1	Core terms	The requirement for including a policy would be a core term.
	Schedule 6	Core terms	The entire policy schedule is sufficiently generic as to warrant treatment as core

Item	MUoSA reference	Core or operational terms?	Comment
			terms.
Distributor determined standards			
Service standards	Clause 2.1(b), also clauses 5.4(b), 8.1, 8.2(c)	Core terms	The requirement to include service standards, measures and levels would be a core term, as these relate to the service provided by the distributor. The detail of each service standard, measure and level would be appropriate as operational terms to be determined by the distributor, since, in general, distribution services necessarily apply across all retailers.
	Schedule 1	Introductory clauses and structure would be core terms but the standards detail in the table would be appropriate as operational terms, drafted by the distributor	
Network connection standards	Clause 15.1 Multiple other references	Core terms	The requirement for including network connection standards would be a core term. The standards themselves are currently appropriate as operational terms. They are only required to be published on the distributor's website currently, on the grounds that this provides flexibility in their development and adaptability to network connection needs which may change over time. Distributors have complete discretion over the content of their network connection standards (in contrast with transmission network connection standards, which have been controversial at times and are much more codified).
	Currently these are published on the distributor's website	Operational terms	

Item	MUoSA reference	Core or operational terms?	Comment
Authority guidelines			
Loss factor guidelines	Clause 7.2	Core terms	These guidelines specify good process around setting loss factors, which process has frequently been controversial. Loss factors, particularly any change to an existing loss factor, can impact retailers in the same manner as a price change. The guidelines are under review and need to be finalised to lend robustness to their requirement within a UoSA.
Tariff structure consultation guidelines	Clause 9.3(a)	Core terms	These guidelines specify good process around the price change process, which has been controversial in the past. Price structures, particularly any change to an existing approach, can significantly impact retailers.
Guidelines on arrangements to assist vulnerable and medically dependent consumers	Clause S6.19	Core terms	Consistent with the proposed treatment of schedule 6 as core terms, this requirement should be included as a core term.
Guidelines for Unmetered Load Management	Clause S6.37	Core terms	Consistent with the proposed treatment of schedule 6 as core terms, this requirement should be included as a core term.
Distribution Pricing Principles and Information Disclosure Guidelines	Schedule 7, practice note	Core terms	Referenced by clause 9.3(b) relating to the process the distributor must follow to change prices.

6.2.12 The degree of distributor discretion in respect of establishing policies, standards and Authority guidelines would require case-by-case consideration. With reference to Table 2, there are three options:

(a) The structure and much of the content of the policies and the service standards would be set in core terms but some flexibility would need to be provided to tailor the item to specific local network needs. The degree of flexibility provided would need to be resolved. As discussed in section 5.3, a process would be needed to reach agreement over the operational terms drafted by the distributor.

(b) The distributor currently determines network connection standards with no requirement to consult retailers or consumers. Some, but not all, of the content is currently subject to legal requirements (for example, safety regulations) and most of these standards will have been developed in accordance with good industry practice over a period of many years. As noted in Table 2, distributor discretion over the content of their network connection standards is in contrast with transmission network connection standards. The Authority questions whether this should remain the case. The parties that would be interested in network connection standards would include:

(i) distributors themselves (including relevant technical organisations, such as the Electricity Engineers' Association)

(ii) retailers (for example, with respect to metering requirements)

(iii) consumers, developers and a variety of technical service providers (who would ultimately bear the costs associated with more or less onerous requirements).

(c) The Authority would set guidelines (such as those described in Table 2) after consulting with interested parties and the proposed treatment within a default or mandatory agreement would effectively make the guidelines compulsory under the Code. This outcome is consistent with the objective of achieving more standardised terms in UoSAs.

6.2.13 In summary, at a first level of assessment, an approach that separates a MUoSA into core and operational terms appears to be feasible.

6.3 Options 4 and 6 reflect maximum standardisation of terms

6.3.1 Options 3 and 5 would require that the contents of the MUoSA are processed through a drafting gate to distinguish core terms from operational terms. By contrast, options 4 and 6 propose that an entire (default or mandatory) UoSA would be established within the Code. Options 4 and 6 are more comprehensive, standardised set of terms of service, policies, inter-business processes and standards relating to distribution service in New Zealand than options 3 and 5.

6.3.2 Options 4 and 6 would remove the distinction between core and operational terms but would not necessarily remove all distributor discretion over policy or conduct operations for their network area. For example, the primary responsibility for providing a 24-hour, 365-day customer fault information and notification service (the call centre available to customers for reporting of service faults) can currently be assigned to either the distributor or the retailer by mutual agreement, and is frequently subcontracted to a third party service provider. Hybrid, cooperative arrangements are also feasible.

6.3.3 A further example is the selection of billing information formats by which distributors receive periodic information from retailers, necessary for the preparation of distribution services invoices. Distributors currently use a number of options and standardisation has evolved only to the extent of selecting from four primary approaches (and a number of further variations at a detail level).

6.3.4 An option 4 or 6 (default or mandatory) UoSA could be drafted to:

(a) reflect the Authority’s choice of options and to specify which party has primary responsibility to provide the service or other arrangement (under option 4 the parties could vary this determination by agreement; under option 6 they would not have that discretion); or

(b) require that the status quo assignment of responsibility or choice of arrangement becomes the default or mandatory arrangement on a network-specific basis (and provide a means of recording and publicising that arrangement); or

(c) provide the distributor with a limited discretion over the choice of arrangement (limited, for example, in that all existing and future retailers must be the treated even-handedly) and possibly a process for changing its election over time.

6.3.5 In general for options 4 and 6, the matters listed in paragraph 6.2.10 (and included in Table 2) would need to be treated in one of the ways listed in paragraph 6.3.4.

6.3.6 Table 3 lists the role assignments, optional arrangements, policies, standards and Authority guidelines referenced in the interposed MUoSA (that is, items (b), (c) and (d) in the list in paragraph 6.2.10) and how each might be treated under an option 4 or 6 approach.

Table 3: Role assignments, optional arrangements, policies, standards and Authority guidelines

Item	MUoSA reference	Possible treatment under default or mandatory terms	Comment
Role assignments and determination of other optional arrangements			
Responsibility for providing customer fault information and notification service	Clauses 2.1(d) and 2.2(d) and 5.5	Option (b) – note: option is referenced with respect to paragraph 6.3.4. Require retention of the status quo.	Significant transaction costs would likely be created if a mandatory change from network-specific status quo arrangements were enforced.
Responsibility for notifying customers of planned outages	Clause 5.10 and schedule 5, options A and B	Option (b). Require retention of the status quo.	Significant transaction costs would likely be created if a mandatory change from network-specific status quo arrangements were enforced.
Billing information format	Clause 11.1	Option (b). Require retention of the status quo.	Significant transaction costs would likely be created if a mandatory change from network-specific status quo arrangements were enforced.
Method(s) of dispute resolution	Clause 25	Option (a). Authority determination.	Significant transaction costs would not be created and it would be feasible to adopt a common approach.
EIEPs in use	Schedule 4	Option (b). Require retention of the status quo.	Significant transaction costs would likely be created if a mandatory change from network-specific status quo arrangements were enforced.

Item	MUoSA reference	Possible treatment under default or mandatory terms	Comment
Distributor determined policies			
Service interruption communication policy	Clause 5.1 and schedule 5	Option (b). Require retention of the status quo.	Significant transaction costs would likely be created if a mandatory change from network-specific status quo arrangements were enforced.
Emergency load management policy	Clause 5.3 and schedule 2 (new)	Option (b). Require retention of the status quo.	Significant transaction costs would likely be created if a mandatory change from network-specific status quo arrangements were enforced.
Pricing policy, methodology and schedule	Clause 9.1 and schedule 9	Option (c). Distributor determines the detail, limited by the requirements of other regulation.	Pricing information, including policy, methodology and price schedules are subject to additional regulation, so the approach for default or mandatory whole agreement would be to maintain clause 9.1 and leave the structure of schedule 9 in place with the distributor to provide the detail.
Connections policy	Clause 19.1 and schedule 6	Option (b). Require retention of the status quo.	Significant transaction costs would likely be created if a mandatory change from network-specific status quo arrangements were enforced.
Distributor determined standards			
Service standards	Clause 2.1(b), also clauses 5.4(b), 8.1, 8.2(c) and schedule 1	Option (b). Require retention of the status quo.	Significant transaction costs would likely be created if a mandatory change from network-specific status quo arrangements were enforced.

Item	MUoSA reference	Possible treatment under default or mandatory terms	Comment
Network connection standards	Clause 15.1 and multiple other references	Option (c). Distributor determines the detail, limited by the requirements of other regulation.	Currently these are developed at the distributor's discretion (albeit limited by external requirements) and, under the MUoSA, published on the distributor's website. This provides flexibility in their development and adaptability to network connection needs which may change over time.
Authority guidelines			
Loss factor guidelines	Clause 7.2	Option (a). Adherence to the guidelines is mandatory and the Authority develops and maintains guidelines to meet changing needs over time.	
Tariff structure consultation guidelines	Clause 9.3(a)	Option (a). Adherence to the guidelines is mandatory and the Authority develops and maintains guidelines to meet changing needs over time.	
Guidelines on arrangements to assist vulnerable and medically dependent consumers	Clause S6.19	Option (a). Adherence to the guidelines is mandatory and the Authority develops and maintains guidelines to meet changing needs over time.	
Guidelines for Unmetered Load Management	Clause S6.37	Option (a). Adherence to the guidelines is mandatory and the Authority develops and	

Item	MUoSA reference	Possible treatment under default or mandatory terms	Comment
		maintains guidelines to meet changing needs over time.	
Distribution Pricing Principles and Information Disclosure Guidelines	Schedule 7, practice note	Option (a). Adherence to the guidelines is mandatory and the Authority develops and maintains guidelines to meet changing needs over time.	Referenced by clause 9.3(b) relating to the process the distributor must follow to change prices.

6.3.7 In summary, at a first level of assessment, UoSA provisions that were classified as operational terms under options 3 and 5 could be worked into a default or mandatory whole agreement using one of the three options discussed in this section. Thus, the option 4 and 6 approaches, which are based on a establishing a whole default or mandatory agreement, appear to be feasible.

Q7. What feedback do you have on the design detail discussed in this section? What options amongst the design detail do you think would best meet the Authority's objective?

Q8. Are you aware of any issues relating to the variation of network connection standards between distributors that the Authority should consider? Are there opportunities to provide greater standardisation of network connection standards? Why would network connection standards not be suitable for greater standardisation across distribution network areas?

6.4 What degree of compulsion should be provided in requiring distributors and retailers to transition to new UoSAs?

6.4.1 The second problem, identified in section 3.5, is that the Authority's objectives for more standardised UoSAs are not being met where incumbent retailers refuse to engage with distributors seeking to update their current UoSAs. Retailers that seek to retain UoSAs they consider are favourable to themselves will be highly unlikely to voluntarily enter into negotiations that would displace those legacy agreements.

6.4.2 However, the Authority considers that this engagement issue is more widespread than the example cited in section 3.5. As described in section 3.6, the Authority is aware that very few distributors are developing new MUoSA-based UoSAs with their retailers. Further, as described in section 3.7, just two distributors have published information relating to their current UoSAs on their websites. It appears that updating current UoSAs, some of which are very old agreements, and implementing voluntary approaches that aim to provide efficient and pro-competitive terms with increased transparency of distribution service terms and conditions, is not a priority for many distributors and retailers.

6.4.3 This situation is a problem for retail competition that should be underpinned by efficient and pro-competitive network access terms available to all retailers (which some retailers have frequently raised as an issue). In particular, incumbent retailers retaining favourable network access terms that are not available to other retailers, whether entrant or other incumbent, conflicts with the Authority's statutory objective in respect of promoting competition. As there is currently little transparency provided with existing agreements, this situation is expected to persist unless mandatory requirements are introduced.

6.4.4 In terms of the seven options identified in section 5.2, each option can be further developed to address the incumbency and engagement issues described in this section and provide for transition from legacy UoSAs to new UoSAs. The options would accordingly incorporate the following provisions in addition to those described earlier:

(a) *Option 0: Status quo*
Retain decision-making relating to negotiation of new (replacement) UoSAs at the discretion of distributors and retailers, in accordance with the terms of their existing UoSAs and their individual preferences.

This option assumes that there is no problem (or, at least, no problem that would justify regulatory intervention) and that current arrangements for forming UoSAs that provide retailers with network access are the best option in accordance with the Authority's statutory objective.

(b) *Option 1: Status quo with communication*
Retain the status quo approach but communicate with participants to reinforce the Authority's objectives and expectations. Monitor and assess the situation at subsequent scheduled review dates (May

2014, 2015 etc.).

This option assumes that the problem is related to a gap between the Authority's objectives and expectations and a participant's understanding of those objectives and expectations. It could also reflect a participant's ability or willingness to commit resources at the present time. Similar to option 0, this option reflects that current arrangements relating to the formation of UoSAs that provide retailers with network access are the best option in accordance with the Authority's statutory objective.

(c) *Options 2 – 6: Compulsory adoption of new default or mandatory UoSAs*
Starting with each option as previously described, extend each option by amending the Code so as to require all distributors and retailers to replace their UoSAs with new default, alternative (if agreed) or mandatory UoSAs.

These options assume that there is a material problem in respect of:

(i) forming the content of new UoSAs

(ii) incumbent retailers being inadequately incentivised to disclose and relinquish favourable terms of network access

(iii) distributors being inadequately incentivised to replace existing UoSAs with updated agreements that incorporate efficient and pro-competitive terms.

Q9. Do you agree that the extended options described in section 6.4 reasonably represent the range of options available to the Authority in seeking to meet its objectives for more standardised, efficient and pro-competitive UoSAs? If you disagree, please describe what other options should be considered and what advantages these options would provide?

6.5 The Authority considers that less voluntary measures are necessary to meet its statutory objectives

6.5.1 The Authority's preliminary view, based on its observations of participant behaviours described in section 3, is that there is a problem that requires consideration of less voluntary arrangements relating to network access arrangements for retailers. It is important to stress that this is a preliminary view only and that feedback received on this consultation paper will further inform the Authority's view as it considers the options available to it.

6.5.2 The Authority's preference at this stage is to develop and implement option 4, which requires compulsory adoption of a default whole agreement.

6.5.3 The rest of this section sets out the Authority's reasons in support of developing and implementing the preferred option. Costs and benefits will be considered in section 7.

6.5.4 The Authority's view is that option 0 (status quo) has not met the Authority's objectives and is unlikely to meet them. Further, the Authority's initial view is that option 1 (status quo with communication) is unlikely to significantly impact on recently observed behaviours since, under voluntary conditions, there is little or no incentive for the participants to change their adopted approach. In fact, the opposite is true in that the incentive for many distributors and incumbent retailers is to maintain the status quo and to delay further moves towards achieving more standardisation. The Authority considers that its objectives and expectations have been well communicated over a considerable period of time and that the issues relating to the current lack of standardisation of UoSAs are well and long understood by distributors and retailers.

6.5.5 Amongst the options 2 – 6, the Authority's preference at this stage is to adopt option 4 (default whole agreement) as the preferred option to govern the formation of UoSA terms and conditions.

6.5.6 Option 2 (more Part 12A clauses) is not favoured at this stage because Part 12A is structured to regulate individual contract clauses and is not ideally structured to set out a complete UoSA. While it might be technically possible, incorporating the terms and conditions of a complete UoSA within the Code is not good Code drafting practice and better options exist within the remaining options 3 – 6.

6.5.7 Option 3 is not favoured at this stage because it does not resolve the issues inherent in the status quo option in respect of agreeing a set of operational terms. The Authority considers that option 4, suitably developed, would provide less scope for disagreement and accordingly lower transaction costs in agreement formation.

6.5.8 Options 5 and 6 (mandatory core terms and whole agreement respectively) are not favoured at this stage because they don't allow parties to agree an alternative arrangement that would add mutual value (with the backstop of a complete regulated agreement if no alternative is agreed). This is consistent with established model approaches available through the transmission benchmark agreement and the arrangements under Part 6 of the Code relating to connection of distributed generation.

6.5.9 Against these shortcomings, option 4 provides:

(a) a fully standardised, efficient and pro-competitive set of core terms, based on the interposed MUoSA terms

(b) a comprehensive set of terms that has benefited from extensive development over many years and reflects a reasonable balance of the commercial interests of both parties

(c) a fully standardised set of default core terms that entrant retailers could unilaterally access when considering retail expansion, thus reducing a current barrier to retail competition

(d) a benchmark agreement that establishes a baseline for negotiation between parties that seek to add mutual value to the default terms – this arrangement would be broadly consistent with the approach adopted by the transmission benchmark agreement and the Part 6 provisions governing connection of distributed generation

(e) the ability to draft a complete set of terms that would be suitable for incorporation by reference into the Code in a way that would provide flexibility to incorporate future amendments and innovative new approaches.

6.5.10 The Authority notes that there are a number of Code design details that would require careful consideration should any of options 2 – 6 become the option selected for implementation. These include:

(a) the legal status of existing UoSAs – while some UoSAs will have termination provisions relating to agreements terminated at law, there may be some provisions in agreements that would remain unaffected. An example might be where additional services, such as Trust rebate distribution services, are provided

(b) engagement and transition – there are a large number of UoSAs in place that would require replacement. A pragmatic approach to transition would be required

(c) transparency over existing and future agreements – the Authority considers that this is a significant competition issue, particularly in respect of legacy provisions in some existing UoSAs and the objective of assuring even-handed treatment of existing and future retailers

(d) selection of a suitable implementation date.

6.5.11 In summary, the Authority considers at this stage that option 4 (compulsory adoption of a default whole agreement) offers the best balance between prescription (to achieve the Authority's objective in respect of more standardised UoSAs) and flexibility (to cater for genuinely unique local needs and future innovation).

Q10. Do you agree with the Authority's initial assessment that option 4 (require reset of all existing interposed agreements and introduce a default agreement for distribution service into the Code) is the best approach to meet its objectives?

Q11. What other Code design details should be considered if option 4 were subsequently adopted for development?

6.6 What about the conveyance model?

6.6.1 The options considered in this section have been focused on the interposed UoSA. In contrast with the interposed contractual approach, distributors that have implemented a conveyance approach contract directly with consumers for provision of their distribution services.

6.6.2 Under conveyance arrangements, a distributor and a retailer will typically provide services to each other that are related to distribution services (but not the distribution services themselves). The primary service normally (but not always) provided in this arrangement is the billing service provided by the retailer on behalf of the distributor, which the distributor requires for billing of its distribution services to its consumers. Thus, the purpose of the conveyance UoSA agreement is quite different to that of an interposed UoSA.

6.6.3 Other services may also be provided in the context of a parallel supplier relationship within which consumers contract for electricity with a retailer and for delivery of that electricity with the distributor.

6.6.4 Although a MUoSA has been developed for the distributor/retailer contract relevant to conveyance arrangements, it is not clear at this stage that problems exist in either:

(a) distributor/retailer contracts for services or

(b) the contracts that distributors have with consumers for distribution services.

6.6.5 Before considering whether a problem might exist in respect of efficiency or competition, the Authority would like to receive feedback on this question from distributors that have adopted the conveyance approach and from retailers and consumers that contract with these distributors.[19] Distributors understood to use the conveyance approach are The Lines Company, MainPower and Vector (although Vector is understood to be moving away from this approach).

Q12.	**What information do you have that a problem exists in the way that distributors that adopt the conveyance approach establish contracts with retailers and consumers? Should standardisation of conveyance UoSAs be pursued as well?**

6.7 What about embedded networks?

6.7.1 The Authority is aware that issues have arisen when retailers have sought to establish retail operations involving consumers connected to embedded networks.

6.7.2 The Authority has previously published a set of drafting guidelines to assist in the development of suitable UoSAs for embedded networks.

6.7.3 At this stage, while more information is required to consider embedded networks, the Authority's initial view is to treat local networks and embedded networks on equal terms, unless there are compelling reasons to do otherwise. Submitters' views are sought on this question.

Q13.	**What information do you have that a problem exists in the way that embedded network owners establish contracts with retailers? Should standardisation of embedded network UoSAs be treated the same as local networks?**

[19] The Authority notes that the Retail Advisory Group is currently looking at distributor/consumer contracts in the context of considering the role that voluntary minimum terms and conditions might play. This paper inevitably covers some of the same contracts but starts from the perspective of considering issues with MUoSAs.

7. Analysis of benefits and costs

7.1 Introduction

7.1.1 This section assesses the incremental benefits and costs of the Authority's preferred approach (option 4) (the counterfactual) against the status quo (option 0).

7.1.2 This is a preliminary assessment of the benefits and costs associated with moving to default terms for UoSAs, pending feedback from interested parties on this consultation document.

7.2 Problem definition

7.2.1 The outcome sought by the Authority when it published the MUoSAs in September 2012 was for distributors and retailers to use standardised terms and conditions in their UoSAs that promoted the efficiency and competition limbs of the Authority's statutory objective.

7.2.2 If this approach were adopted, the transaction costs of developing, negotiating and executing a UoSA would be significantly reduced for retailers and distributors. Furthermore, adopting this approach would give rise to competition benefits by reducing one of the barriers to entry into retail electricity markets and/or expanding trading into new local network areas (an issue raised frequently by entrant retailers over the past 15 years).

7.2.3 However, contrary to the Authority's expectations, Vector has subsequently developed a UoSA that contains amendments (both material and minor in nature) to almost every clause of the MUoSA. These amendments act as a barrier to smaller retailers entering into, and/or expanding on, Vector's network. This is significant given that Vector supplies more than one quarter of New Zealand's ICPs.

7.2.4 On the flipside, Network Tasman has sought to adopt the MUoSA but the overwhelming majority of retailers operating on its network have not been prepared to alter their existing agreements with Network Tasman, thereby retaining non-standard, less efficient and less pro-competitive legacy UoSAs.

7.2.5 As noted earlier in this paper, the Authority considers this situation to be in conflict with the competition and efficiency limbs of its statutory objective.

7.3 Assessment of benefits and costs

Static efficiency effects

7.3.1 Static economic efficiency is achieved when:

(a) goods and services desired by consumers are produced at minimum cost to the economy (productive efficiency)

(b) the marginal value consumers place on a good or service equals the cost of producing that good or service, so that the total of individuals' welfare in the economy is maximised (allocative efficiency).

Productive efficiency net benefits

Reduced transaction costs

7.3.2 Under option 4, transaction costs are lower than under the status quo. Transaction costs include the costs of drafting, reviewing, negotiating, amending, approving and maintaining a UoSA. These costs include time spent by business analysts, technical experts, managers, lawyers and Board members.

7.3.3 Under option 4, distributors and retailers have the option of virtually eliminating ongoing transaction costs in regard to the majority of the terms of UoSAs.[20] Over time, this may facilitate some dynamic efficiency benefits, as distributors and retailers would likely be more willing to make amendments to their UoSAs for reasons of service innovation and product development, knowing that the cost of doing so would be materially less than at present.

7.3.4 If option 4 was to reduce the cost of negotiating a UoSA by $30,000 - $60,000 per agreement,[21] and three retailers were seeking to enter 10 distribution networks, a default agreement approach would reduce transaction costs by $900,000 to $1,800,000. Based on electricity retail market activity over the past three years, this number of retailers seeking to enter this number of distribution networks is not unreasonable.

7.3.5 Hence, productive economic efficiency net benefits under the counterfactual are likely to be higher than under the status quo.

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[20] Transaction costs would not be eliminated since the default agreement would need to evolve over time to accommodate investment and innovation in service and product offerings by retailers and distributors. The Authority would seek to minimise these remaining transaction costs by timely updates to the default agreement.

[21] Based on feedback from industry participants, the Authority considers this cost range to be conservative.

Q14.	**Based on your experience negotiating UoSAs, what is the average time and cost for a retailer and a distributor to negotiate and thereafter administer a UoSA on a local distribution network that the retailer is entering for the first time?**

Allocative efficiency net benefits

7.3.6 Based on feedback from interested parties during the various consultations undertaken by the Authority on the MUoSA, as well as the Authority's understanding of existing UoSAs, electricity consumers would likely receive a greater level of satisfaction from the distribution services they receive under the MUoSA than under existing UoSAs. In economic terms, the consumer surplus under a MUoSA-based default agreement would be greater than under the suite of existing UoSAs.

7.3.7 The creation of Part 12A of the Code has addressed those aspects of UoSAs that result in larger consumer surplus benefits (for example, liability/indemnity, prudential security requirements).

7.3.8 However, further gains could be made in areas such as:

(a) establishing very clear definitions of services received by consumers, defining measures against which to gauge distributors' service performance, and specifying target service levels

(b) providing further clarification in respect of various activities where distributors interact with consumers (for example, entering a consumer's premises, responding to a request for disconnection).

7.3.9 Overall these and other improvements under the proposed default terms would not be expected to result in material additional ongoing costs to distributors, which would, in the absence of an ability to increase their distribution prices under the default/customised price-quality regulatory regime, reduce their producer surplus.[22]

7.3.10 Hence, the net benefit from improved allocative efficiency under the counterfactual is estimated to be approximately equal to the additional consumer surplus arising from implementing the counterfactual.

7.3.11 In summary, allocative economic efficiency net benefits under option 4 are expected to be higher than under the status quo.

[22] Producer surplus is the economic term for the benefit a producer receives for selling a good or service. It is the difference between the price a producer of a good or service is paid and the minimum price that producer would accept for the good or service.

Establishment costs

7.3.12 Implementing the Authority's preferred option would result in the Authority and industry participants incurring costs associated with moving from the status quo. The Authority's costs would relate primarily to the cost of evolving the MUoSA into a set of default terms and making the necessary amendments to the Code (including consultation with interested parties). Participants' costs would relate primarily to responding to further consultation documents released by the Authority, and making any necessary changes to their internal policies and procedures to accommodate the new approach. It is not anticipated that distributors and retailers would face significant costs in regard to existing UoSAs because the Authority would likely deem that the relevant default terms apply to existing UoSAs.

7.3.13 The Authority's estimate of its incremental regulatory costs (vis-a-vis the status quo) to implement option 4 is approximately $250,000. The Authority's estimate of participants' incremental costs to implement option 4 is approximately $500,000 (contingent on the Authority adopting the 'deeming' approach to implementing the default terms referred to in the previous paragraph). The $500,000 is based on an average cost of $7,500 to $10,000 per distributor and retailer to update policies and procedures, and an allowance for some incremental costs for several distributors and retailers to respond to further consultation documents released by the Authority.

Q15.	**Based on your experience adopting the UoSA clauses contained in Part 12A of the Code, what do you estimate the cost to be of adopting the default terms approach?**

7.4 Dynamic efficiency effects

7.4.1 Dynamic economic efficiency is achieved by firms having appropriate incentives to innovate and invest in new products and services over time, thereby increasing their productivity and lowering the relative cost of goods and services over time.

Dynamic efficiency net benefits

7.4.2 In some markets uniform standards have the potential to reduce service and product innovation, as well as to delay improvements to customer service standards (including the cost-effectiveness and efficiency of customer services).

7.4.3 However, where there is a monopoly provider of a service or product that has a high degree of homogeneity across the consumers of that service or product, uniform standards can be an efficient means by which to reflect the preferences of those consumers. This in turn provides an opportunity for third parties to provide value-add services or products based on the underlying product or service.

7.4.4 The provision of distribution services is a reasonably good example of this situation. Distributors provide a relatively homogenous service that enables consumers connected to a local network to purchase energy from retailers offering relatively heterogeneous products or services.

7.4.5 In this situation the greatest dynamic efficiency gains arise from strong competition between the energy retailers using the local network, as they seek to innovate and offer new and/or more cost-effective products or services to consumers over time. In this way dynamic efficiency is enhanced by uniform standards.

7.4.6 However, an important caveat is that the standards must be capable of evolving over time where this assists product or service innovation, on the part of distributors as well as retailers, and therefore enhances dynamic efficiency. As the Authority's information set evolves over time, so too will the default terms. However, acknowledging that many individual economic agents will collectively have superior information to a central regulator, the Authority's proposed approach is to provide for distributors and retailers to agree variations to these default terms.

7.4.7 Therefore, the Authority considers it is unlikely there will be significant adverse impacts on dynamic efficiency from adopting option 4. The Authority does however consider that there are potentially quite significant dynamic efficiency benefits from adopting this option, through the lowering of barriers to entry for entrant retailers on local networks.

7.4.8 Enhanced retail competition, including the *threat* of entrant retailers on local networks, increases competitive pressure on electricity prices and encourages efficient investment in capital goods and innovation. It provides consumers with greater confidence that the price of electricity more closely reflects the marginal cost of producing, transporting and retailing electricity to them, and that price movements are driven by underlying supply and demand movements.

7.4.9 This is consistent with the Authority's interpretation of the competition limb of its statutory objective, which is that the Authority will *[exercise] its functions in ways that facilitate or encourage increased competition in the markets for electricity and electricity-related services, taking into account* *long-term opportunities and incentives for efficient entry, exit, investment and innovation in those markets*.

7.4.10 The 2009 Ministerial Review of Electricity Market Performance found that average retail profit margins in New Zealand appeared to be relatively higher than in the eastern states of Australia and in the United Kingdom.[23] Margins in New Zealand tended to be highest on distribution networks with the smallest number of customers and in regions with fewer retailers actively seeking customers.

7.4.11 Providing some support for these findings still being applicable today is recent analysis undertaken by the Authority, which looked at:

(a) the 20 (of 39) regions in New Zealand with the lowest number of residential electricity consumers

(b) the 20 regions with the largest price savings available to residential electricity consumers in 2012.[24]

7.4.12 This analysis showed there is a correlation between regions with a low number of residential electricity consumers and regions with larger residential price savings. Common to both of these categories were the following 12 regions: Ashburton, Bay of Islands, Buller, Central Otago, Invercargill, Marlborough, Nelson, Otago, Queenstown, South Canterbury, Southern Hawke's Bay and Southland.

7.4.13 The Authority's monitoring of New Zealand's electricity retail market has also analysed the relationship between market concentration (measured by the Herfindahl-Hirschman Index (HHI))[25] and residential electricity prices. This analysis also largely confirms that the situation described in the 2009 Ministerial Review remains.

7.4.14 Those regions of New Zealand with the lowest market concentration (for example, Auckland, parts of Northland and parts of Waikato), tend to

[23] The Ministerial Review noted that its analysis, based on the International Energy Agency's (IEA) Energy prices and taxes for the fourth quarter of 2008, was subject to a number of caveats. Care was needed in interpreting the data because product specifications, statistical methodology and information differed considerably among countries. Taxes that had to be paid by the electricity user and were not refundable were included. Value-added taxes (such as New Zealand GST) were included for residential users, but were excluded from the industrial price because they were refundable to industry.

[24] Using data from Powerswitch.

[25] The HHI is a measure of market concentration, and the relationship with competition occurs because less concentrated markets are likely to be more competitive. The HHI has a maximum value of 10,000 for a monopoly, so the lower the number, the more indicative of a competitive market structure. Two things reduce the HHI: more participants and market shares becoming more even. These indicate a more competitive market; hence, the Authority uses HHI as a measure of market structure. By way of comparison, for merger and acquisition analysis, the US Department of Justice considers an HHI of 2,500 or above to be highly concentrated and an HHI of 1,500–2,500 to be moderately concentrated.

provide residential electricity consumers with the lowest potential savings from seeking out the best electricity price available to them. In contrast, those regions with the highest market concentration (for example, the Bay of Plenty, King Country and the West Coast of the South Island) tend to provide residential electricity consumers with the largest potential savings from seeking out the best electricity price available to them.

7.4.15 There are situations where this general finding is not applicable (for example, the Waitaki region has a very high HHI, but a relatively low level of potential savings for residential electricity consumers not on the lowest retail tariff). However, such situations are the exception rather than the rule.

7.4.16 The Authority notes that generally the overall level of competition in the retail market is one of reducing regional market concentration with some new independent retailer entry and growth having an effect on the main retailers. This is a sign that the retail market is becoming more competitive.[26]

7.4.17 However, by reducing the transaction costs associated with retailers entering local distribution networks, adopting a default terms approach should facilitate this trend towards a more competitive market structure. The default terms approach is expected to increase the number of retailer/traders competing in regions with relatively fewer consumers and retailers. More competition on smaller networks will be encouraged if the per-customer cost of negotiating UoSAs on such networks moves closer to that for larger local networks.

7.4.18 This in turn will lead to increased competitive pressure on electricity prices in these smaller networks vis-a-vis the status quo, and will encourage increased levels of efficient investment and innovation, by retailers in particular, vis-a-vis the status quo.

7.4.19 In summary, the dynamic efficiency benefits from adopting a default terms arrangement are considered to be materially larger than any potential dampening of dynamic efficiency from adopting such an arrangement.

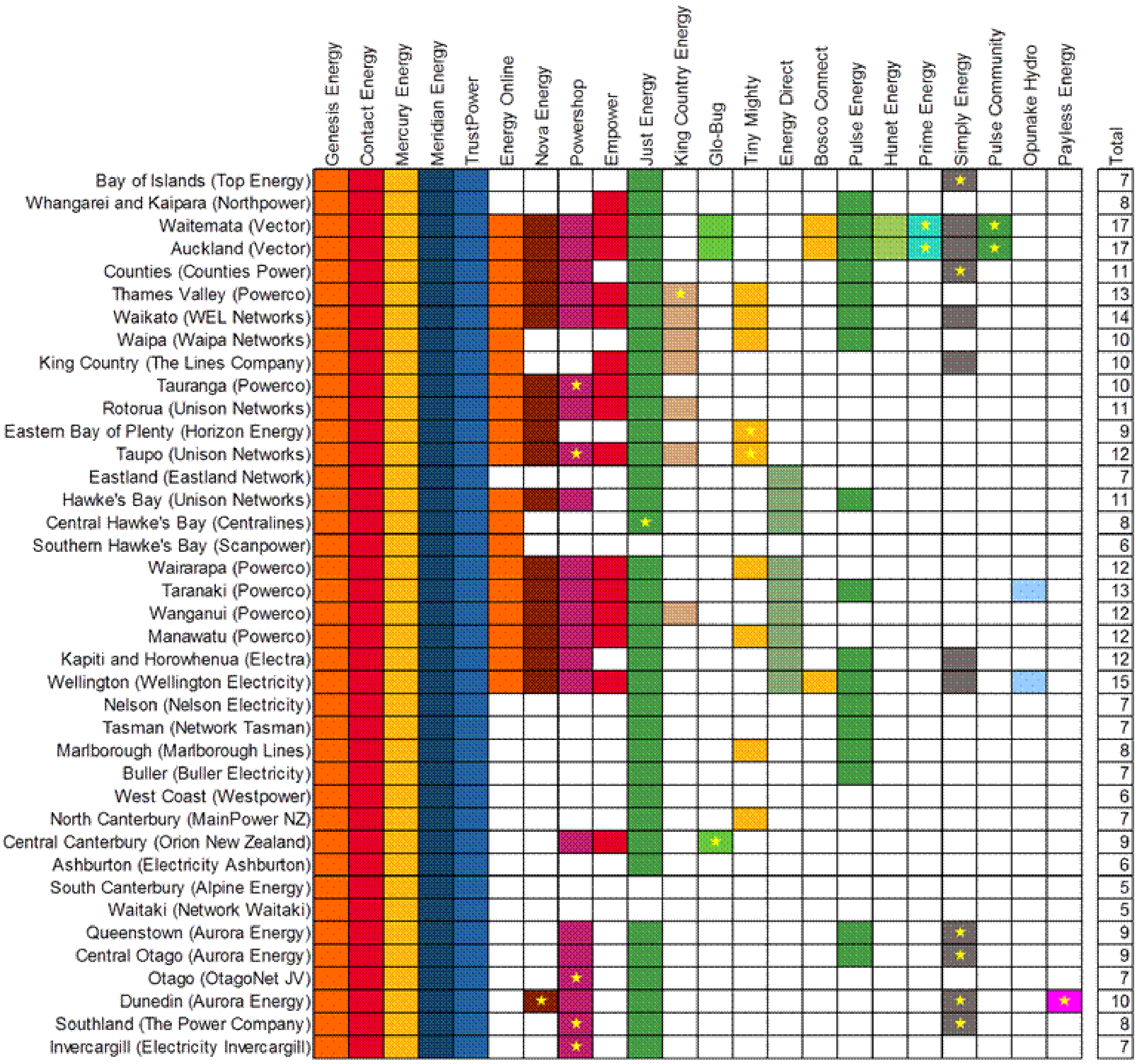
7.5 Overall net benefit

7.5.1 The preliminary assessment of benefits and costs set out above indicates that option 4 is preferable to the status quo.

[26] Refer to the Authority's publications *Electricity Market Performance: A Review of 2012* and *Electricity Market Performance: 2013 Year In Review*.

Q16. Based on your experience with electricity retail competition, and with reference to Figure 2, over the next two to five years on average what number of retailers (being retailers likely to enter into UoSAs) would you expect to see entering regions with less than 10 retail brands, under the following two scenarios:
a) *without* a default terms arrangement in place, and
b) *with* a default terms arrangement in place?

Figure 2: Retail brands serving all ICPs in regions at 31 December 2012



* Change from 1 January 2012.

Appendix A Format for submissions

Question No.	General comments in regards to the:	Response
1	Do you have feedback that would update the issues outlined in this section?	
2	If you are a distributor, are you actively developing and negotiating UoSAs with retailers? If you are a retailer, are you actively engaged with any distributors in relation to UoSAs? Please provide information relating to your approach, experiences, successes and concerns.	
3	Are you aware of any new issues that have arisen since the Authority undertook monitoring and communication with participants relating to UoSAs in early 2013?	
4	Are you aware of any new developments that would provide additional information or update the situation presented in section 4? If so, please provide relevant details.	
5	Do you agree that the Authority is unlikely to achieve its objectives for UoSAs within a reasonable timeframe by persevering with largely voluntary measures? Please state the reasons for your view.	
6	What other options can you suggest that would be worth considering alongside the options identified in section 5.2 and explained in more detail in section 5.3? Please explain the key advantages of your suggested option(s).	

7	What feedback do you have on the design detail discussed in this section? What options amongst the design detail do you think would best meet the Authority's objective?	
8	Are you aware of any issues relating to the variation of network connection standards between distributors that the Authority should consider? Are there opportunities to provide greater standardisation of network connection standards? Why would network connection standards not be suitable for greater standardisation across distribution network areas?	
9	Do you agree that the extended options described in section 6.4 reasonably represent the range of options available to the Authority in seeking to meet its objectives for more standardised, efficient and pro-competitive UoSAs? If you disagree, please describe what other options should be considered and what advantages these options would provide?	
10	Do you agree with the Authority's initial assessment that option 4 (require reset of all existing interposed agreements and introduce a default agreement for distribution service into the Code) is the best approach to meet its objectives?	
11	What other Code design details should be considered if option 4 were subsequently adopted for development?	

12	What information do you have that a problem exists in the way that distributors that adopt the conveyance approach establish contracts with retailers and consumers? Should standardisation of conveyance UoSAs be pursued as well?	
13	What information do you have that a problem exists in the way that embedded network owners establish contracts with retailers? Should standardisation of embedded network UoSAs be treated the same as local networks?	
14	Based on your experience negotiating UoSAs, what is the average time and cost for a retailer and a distributor to negotiate and thereafter administer a UoSA on a local distribution network that the retailer is entering for the first time?	
15	Based on your experience adopting the UoSA clauses contained in Part 12A of the Code, what do you estimate the cost to be of adopting the default terms approach?	
16	Based on your experience with electricity retail competition, and with reference to Figure 2, over the next two to five years on average what number of retailers (being retailers likely to enter into UoSAs) would you expect to see entering regions with less than 10 retail brands, under the following two scenarios: a) *without* a default terms arrangement in place, and b) *with* a default terms arrangement in place?	

17 (included in Appendix B)	The column headed “Suitable for inclusion in core terms?” in Appendix B provides the Authority’s initial view of the parts of the interposed MUoSA that would be suitable for direct transfer into a default or mandatory agreement, if such an approach were adopted. Do you agree with the assessments provided here for each clause and schedule? Please reference your responses to specific clauses and schedules and provide reasons if you disagree.	

Appendix B Assessment of core terms

B.1 Table 4 provides detail of the assessment of whether interposed MUoSA terms are suitable as core terms.

Table 4: Assessment of core terms

Interposed MUoSA clause	Content	Suitable for inclusion in core terms?
Introduction		
A, B & C	Introductory citations and purpose of the agreement.	Yes but would need to be redrafted to establish the default agreement within the Code.
Agreement		
1. Term of Agreement	Commencement and termination dates.	Yes but commencement and termination need to be referenced to the Code.
2. Services	2.1 Distributor's services and obligations	Yes, for 2.1(a) – (I). 2.1(j) relating to Additional Services would not be appropriate for core terms.
	2.2 Retailer's services and obligations	Yes, for 2.2(a) – (b) and (e) – (h). 2.2(c) – delete, since in a basic default agreement, the retailer does not provide any services to the distributor. 2.2(d) – remove the square bracketed part relating to providing service interruption service but retain the remainder of the clause. 2.2(i) – per 2.1(j), remove this provision relating to Additional Services.
3. Conveyance only	Provides for some Consumers to be provided with Distribution Services under a Distributor's Agreement.	Yes. It is common for distributors to directly contract with large end-consumers. This section provides the flexibility to allow this to occur within an otherwise interposed model. 3.2(b) – select the relevant option.
4. Equal access and even-handed treatment	Requires equal access to Distribution Services for all retailers and for the Distributor to treat all retailers even-handedly.	Current view is that this would not be included in a default or mandatory agreement, rather the relevant provisions would be carried directly into the Code. This section provides the fundamental underpinnings for

Interposed MUoSA clause	**Content**	**Suitable for inclusion in core terms?**
		retail competition on an equal access basis under the voluntary MUoSA approach.
5. Service Interruptions	5.1 – 5.4 General section	5.1 – yes, parts of schedule 5 are suitable as core terms 5.2, 5.4 yes 5.3 – to improve clarity, redraft this clause to require inclusion of this policy at agreement formation as a schedule, rather than after the commencement date.
	5.5 – 5.7 Unplanned Service Interruptions	5.5 –The choice of party to receive Unplanned Service Interruption calls is an operational term, to be decided prior to agreement formation. 5.6 – yes, parts of schedule 5 are suitable as core terms 5.7 – yes
	5.8 – 5.10 Planned Service Interruptions	5.8 – yes 5.9 – yes, parts of schedule 5 are suitable as core terms 5.10 – costs of communication. The choice of party to undertake Planned Service Interruption notifications is an operational term, to be decided prior to agreement formation.
	5.11 – 5.12 Restoration of Distribution Services	Yes
6. Load management	Sets requirements relating to load management, which can be carried out by either party	Yes. Review to see if some of schedule 8 is suitable to be transferred into clause 6.
7. Losses and loss factors	Sets requirements relating to loss factors	Yes
8. Service performance reporting	Sets requirements relating to service performance reporting	Yes but amend clauses to reflect that there are no retailer services in the default agreement.
9. Distribution services prices and process for changing prices	Processes for setting and changing prices	Yes 9.5 Note that the requirement to use standard tariff codes is under review and consequentially, this clause may

Interposed MUoSA clause	Content	Suitable for inclusion in core terms?
		require amendment commensurate with the outcome.
10. Allocating price categories and tariff options to ICPs	Processes for allocating and changing ICP tariffs from eligible options and for dealing with credit following corrections	Yes
11. Billing information and payment	Calculating invoices	11.1 – this clause requires the retailer to provide the distributor with the consumption information needed to calculate a monthly invoice for distribution services. The clause as drafted provides options for two pricing methodologies (ICP-based and GXP-based) and, if ICP-based, three billing information methodologies (as-billed, incremental normalised, replacement normalised and incremental replacement normalised). A method is required for the distributor to elect which billing information methodology(s) applies. This election could be specified in a new schedule 10 and is an operational term. 11.2 – 11.10 yes, except 11.5(a)(i), remove the reference to invoices for Additional Services
12. Prudential requirements	Requirements relating to credit security	Yes 12.7 – 12.8 Retain these clauses, despite the practice note which explains that these two clauses are optional. This will provide maximum flexibility in respect of Additional Security.
13. Access to the consumer's premises	Rights of access to consumer's premises	Yes
14. General operational requirements	Interference and damage by consumers. Connection of distributed generation. Additional metering equipment.	Yes
15. Network connection	Consumers to comply with network	Yes

Interposed MUoSA clause	**Content**	**Suitable for inclusion in core terms?**
standards	connection standards	
16. Momentary fluctuations	Spikes and surges are not interruptions	Yes
17. Consumer service lines	Consumer responsible for service lines	Yes
18. Tree trimming	Consumers to comply with tree regulations	Yes
19. Connections, disconnections and decommissioning ICPs	Links to detailed processes contained in schedule 6.	Yes
20. Breaches and events of default	Terms relating to breaches of the agreement and events of default	Yes
21. Termination of agreement	Rights of parties to terminate the agreement	As for agreement formation, at least some (possibly all) of the provisions in this clause should be transferred directly into the Code. 21.6 – delete reference to Alternative Contract, which is no longer relevant.
22. Confidentiality	Obligations relating to confidential information. No limit of liability on breach.	Yes
23. Force majeure	Definition of a force majeure event and party's obligations	Yes
24. Amendments to agreement	Process for amending agreement	No. Default or mandatory terms may not be amended by agreement. Default terms may be replaced with an alternative agreement if the parties agree. The Code should incorporate a process to change the default agreement, otherwise every amendment will require a Code amendment. Remove the provisions relating to Variable Provisions and de minimis changes. 24.1(e) and 24.5 yes (retain) – provides for changes to GXPs.

Interposed MUoSA clause	Content	Suitable for inclusion in core terms?
25. Dispute resolution procedure	Processes for resolving disputes	Yes but include both arbitration and court proceedings as options for resolving the dispute. Consider making these provisions more robust – c.f. the transmission benchmark agreement, which is more detailed than the MUoSA provisions in this area.
26. Liability	Limitation of liability, indemnities and warranties.	Yes 26.8 Distributor indemnity – clause 12A.6 of the Code currently applies. Clause 12A.6 (and other relevant parts of Part 12A) would require review if a default or mandatory agreement approach was adopted.
27. Consumer contracts	Requirement for retailer to include certain provisions in consumer contracts for benefit of the distributor	Yes
28. Notices	Process for sending notices	Yes
29. Electricity Information Exchange Protocols	Requirement to use EIEPs	Yes 29.1 – possibly some minor rewording needed, as the agreement would now be a default or mandatory agreement.
30. Miscellaneous	Miscellaneous legal clarifications	Yes Consider specific drafting in accordance with the Code that would be necessary to establish the Code framework for the agreement.
31. Interpretation	Definitions	Yes Consider specific drafting in accordance with the Code that would be necessary to establish the Code framework for the agreement. Also, some definitions would become redundant in a default or mandatory agreement (for example, commencement date).

Interposed MUoSA clause	Content	Suitable for inclusion in core terms?
Schedules		
Schedule 1: Service Standards	Details service standards, measures and levels. Provides reporting obligations and any service level guarantees.	Schedule is needed but the content in the tables would be operational terms at the distributor's discretion. The current draft is generally a good model covering many common service measure categories.
Schedule 2: Additional services	Provides terms relating to additional services and draft provisions relating to retailers passing through distributor rebates	No. Additional Services are discretionary services that should be subject to a separate agreement that is not mandated in the Code. Nevertheless, the MUoSA schedule as drafted remains a useful model for rebate agreements.
Schedule 3: EIEPs	Clarifies which EIEPs are to be used by parties	No. The need to agree which explicit EIEPs are in use would still need to be provided for but these are operational terms. Consider replacing the part of this schedule that is simply a copy of the Authority's existing schedule of currently published EIEPs with a reference to the relevant part of the Authority's website.
Schedule 4: Consumer contracts	Cross references the specific UoSA clauses that are to be included in consumer contracts	Possibly. The purpose of this schedule is as a useful (but not essential) cross-reference of relevant clauses.
Schedule 5: Service interruption communications policies	Process detail for communication about planned and unplanned outages	Yes. With some minor operational details, this schedule is generally suitable as part of a default agreement. The schedule would require review to decide the extent to which the distributor can modify the options provided.
Schedule 6: Connection policies	Detail relating to new, upgraded and decommissioned network connections. Also provides rights and obligations relating to disconnections and reconnections.	The initial view is that this entire schedule is suitable as core terms, even though there is a lot of process detail included.
Schedule 7:	Provides the distributor's pricing	No. Provide instead a relevant external

Interposed MUoSA clause	Content	Suitable for inclusion in core terms?
Pricing principles	principles (or links to that information)	link.
Schedule 8: Load management	Provides detail relating to load management process and services	Yes
Schedule 9: Pricing information	Provides pricing schedules and methodology (or links to that information)	No. Provide instead a relevant external link.

Q17. The column headed "Suitable for inclusion in core terms?" in Appendix B provides the Authority's initial view of the parts of the interposed MUoSA that would be suitable for direct transfer into a default or mandatory agreement, if such an approach were adopted. Do you agree with the assessments provided here for each clause and schedule? Please reference your responses to specific clauses and schedules and provide reasons if you disagree.