



19 December 2016

Submissions
Electricity Authority
Level 7, ASB Bank Tower
2 Hunter Street
P O Box 10041
WELLINGTON

Trustpower Limited
Head Office
108 Durham Street
Tauranga
Postal Address:
Private Bag 12023
Tauranga Mail Centre
Tauranga 3143
F 0800 32 93 02
Offices in
Auckland
Wellington
Christchurch
Oamaru
Freephone
0800 87 87 87
trustpower.co.nz

By email: submissions@ea.govt.nz

TRUSTPOWER SUBMISSION: 2017/18 LEVY-FUNDED APPROPRIATIONS AND STRATEGIC PRIORITIES CONSULTATION PAPER

1 Introduction

- 1.1.1 Trustpower appreciates the opportunity to submit on the Authority's 25 October 2017/18 *Levy-funded appropriations and strategic priorities Consultation paper (Consultation Paper)*.
- 1.1.2 It is now six years since the Electricity Authority (**Authority**) was established. Since that time it has completed its organisational build, addressed the matters set out in section 42 of the Electricity Industry Act 2010 (**Act**) and implemented a significant number of initiatives to enhance wholesale and retail market competition.
- 1.1.3 The Authority has said that it has now shifted its focus to the efficient operation of the industry. Trustpower considers that this is absolutely appropriate. However, we would have expected that this shift would result in careful prioritisation of projects to those likely to deliver demonstrable value to consumers in the near to medium term, including by a reduction of industry costs to serve.
- 1.1.4 The Consultation Paper does not establish that this has occurred. Further, we consider that more can likely be done to reduce the Authority's operational costs.

2 Overall appropriation

- 2.1.1 For this reason, Trustpower does not support the Authority's proposed overall appropriation of \$73.937 million for 2017/18.
- 2.1.2 We consider
 - having completed the work programme implied by section 42 of the Act, it is appropriate that, rather than hold its base level of expenditure constant, the Authority reduces its expenditure. This could be readily achieved if the Authority leveraged more off industry expertise in its work programmes and more rigorously prioritised its policy reform;

- the Authority has not made a strong case for not passing on to consumers the step down in system operator fees, which has occurred as a result of the system operator having now fully recovered the costs of several historical asset investments;
- the Authority’s decision to continue its consumer participation facilitation measures beyond the three-year project approved by Cabinet is not well justified in the Consultation Paper (see section 3 below); and
- the Authority should fund any expenditure on litigation costs over the \$500,000 contingency out of its \$18 million operating budget, rather than have recourse to additional levy funds, as this will ensure that it has incentives to follow processes which are likely to suppress rather than inflate these costs.

3 Further expenditure on consumer participation measures

3.1.1 On 14 April 2014, Cabinet approved the Budget amounts set out below to provide for a programme to promote the potential benefits of switching, and facilitate the ease of the switching process for consumers, in accordance with the Electricity Authority’s statutory functions.

	\$m - increase/(decrease)				
	2013/14	2014/15	2015/16	2016/17	2017/18 & Outyears
Non-Departmental Output Expense:					
Electricity Industry Governance and Market Operations	-	2.000	3.000	2.500	-
Total Operating	-	2.000	3.000	2.500	-

Source: <http://www.treasury.govt.nz/downloads/pdfs/b14-info/b14-2900420.pdf>

3.1.2 That programme has now been completed and implemented.

3.1.3 The Authority has noted in a number of forums that competition and innovation in the industry has increased significantly since the structural reforms in 2010. It has also said that in the light of this improved competition it considers that there may be fewer pro-competitive initiatives worth pursuing in the future and that as a result it will shift its emphasis to projects that promote operational efficiency.¹

3.1.4 We were therefore surprised to see that the Authority is seeking to continue the project for an additional year to that approved by central government.

3.1.5 The Authority’s rationale is particular weak. It says that:

- there is money available (in the form of a reduced expenditure from an entirely unrelated area); and
- further expenditure is consistent with the Authority’s statutory objective of promoting competition.

3.1.6 Accordingly, we do not support this proposal.

¹ Electricity Authority *Summary of Submissions 2015/16 Appropriations and Work Programme Information Paper* page 24

- 3.1.7 However, for the avoidance of doubt, we support the continuation of funding for the Powerswitch website by the Authority, as we think this is a well-known and respected tool. The competitive process will be enhanced by consumers continuing to have access to comparative information on this trusted website.
- 3.1.8 More generally we think the proposal raises concerns about the extent to which the Authority has made a genuine attempt to set priorities and contain its operating expenses in this appropriation process.

4 Expenditure on employees

- 4.1.1 We note that, according to the Authority's annual reports of 2010/11 and 2015/16, from 2010 to 2016, the number of permanent staff of the Authority has increased from 48 to 60, an increase of 25%.
- 4.1.2 Over this same period, the number of employees on a salary greater than \$100,000 has increased from 31 to 43, an increase of 39%.
- 4.1.3 This increase in both employee numbers and salary levels raises obvious risks around the incentives that might apply to the development of the Authority's ongoing work programme.
- 4.1.4 This factor, in combination with the ongoing lack of transparency about individual projects discussed in the next section, is why we consider it is imperative that the Authority engage an external organisation every five or so years, to assess, and provide confidence to, consumers and levy payers about the overall levels of the Authority's costs.
- 4.1.5 As the Authority is now in its sixth year, this should be done in 2017.

5 Adequacy of information in the Consultation Paper

- 5.1.1 As we have indicated in previous submissions, the efficient level of expenditure clearly depends on the mix of projects, appropriateness of priority setting, and resource levels. However, there is insufficient information in the Consultation Paper for stakeholders to be confident that the Authority has made effective decisions on these matters.
- 5.1.2 Despite frequent calls for more transparency from submitters in previous levy consultations, there is still no information in the current Consultation Paper about individual project costs, including past expenditure and forecast future costs for multi-year projects, or about the expected benefits.
- 5.1.3 Instead, submitters in the current consultation round are asked to presume a possible work programme from the Authority's general areas of work. These areas of work are organised around high-level strategic priorities and include examples of initiatives which might, depending on Authority's subsequent priority setting, be included in the work programme.
- 5.1.4 There is no information about the criteria the Authority will subsequently apply to firm up its work programme in June or July 2017 after the opportunity to comment on the levy has passed. Nor is there any information about what changes to the work programme from previous years are likely, noting the current work programme has 45 separate projects in it.
- 5.1.5 This raises real questions about whether the Authority has consulted with levy payer on "*the costs that are intended to recovered by the levy*" as required by section 129 of the Act.

6 Comments on certain areas of work

- 6.1.1 The Authority has asked for input on the priority timing and scope of the work it should undertake to deliver its strategic priorities.

6.1.2 As noted earlier, we think that operational efficiencies should be at or near the top of its priority list. Within the possible projects under this area, the removal of technical barriers to entry would be our first priority.

6.2 Proposed replacement of GENCO

6.2.1 An example of a technical barrier to entry and ongoing participation are the rules which underpin the use of the GENCO software. Appendix B of the Consultation Paper includes a business case from the system operator for investment in a new electronic dispatch facility (EDF) to replace the current GENCO system.

6.2.2 The Authority seeks feedback on that business case from levy payers and other stakeholders on this proposal, which is expected to cost \$4.995 million and have an impact on appropriations for six years from 2018/19 (i.e. next year's levy).

6.2.3 Trustpower supports this project as we consider that the GENCO system is inhibiting innovation and efficiencies in the market. It is demonstrably not suitable for the changing market environment. For example, we experienced a significant number of issues with this system in our recent shift to new premises, interfacing with modern equipment and/or third parties' equipment. This involved having to get hold of people who wrote pieces of code twenty or so years ago, developing "work arounds" for old communication protocols and recourse to telephone dispatch.

6.2.4 As a result, our view is that the implementation of a new system will enhance the efficient operation of the industry and be in the long term interests of consumers. It should be progressed without delay.

6.3 Improved administered prices and cost allocation methods

6.3.1 Trustpower supports well justified policy reform. This has not occurred with the Authority's proposals for reform of the TPM Guidelines or reform of Schedule 6.4 of the Code.

6.3.2 The Authority has received a large number of submissions and independent expert reports from stakeholders explaining in depth why these reforms will not meet the Authority's operational efficiency objectives and/or its Code change requirements. It follows these initiatives will not be in the long-term interests of consumers.

6.3.3 Going forward, we would suggest that where a matter is particularly complex, involves substantial change and is likely to be contentious, the Authority should use independent experts and advisory groups to stress test its own thinking and inform and critique its work much earlier in the policy development process.

6.3.4 In suggesting this, we acknowledge that advisory groups will not resolve all issues, and will often not reach consensus, but we are confident that their use will lead to lower costs and a more efficient use of resources (both within the Authority and across the industry). Similarly, a greater use of experts will enhance stakeholder confidence, strengthen the evidential basis for the policy approach and reduce the risk of regulatory failure.

6.4 Code reviews

6.4.1 Over-regulation is a significant burden on market participants and is also likely to increase industry costs to serve and/or stifle innovation and competition.

6.4.2 As it is now twenty years since the wholesale market began we think that it is appropriate to reconsider whether some of the matters currently included in the Code and as a consequence, subject to a formal regulatory processes, could be entrusted to the service providers to undertake within frameworks established by the Authority.

6.4.3 For example it does not seem to us to be consistent with the efficient operation of the industry to have two rounds of consultation on the System Operator's procurement plan during which only one submission is received (from Meridian Energy to the system operator).

6.4.4 Accordingly, we suggest that instead of the Authority's 'technical and non-controversial' code review next year the Authority set up an ad hoc advisory group with an independent Chair, representatives from the industry, consumers, MBIE, and the Authority to make recommendations on areas where the Code can be reduced in scope or complexity.

6.5 Post implementation reviews

6.5.1 The Consultation Paper advises that the Authority expects to carry out one or two post implementation reviews (against impacts sought) of completed projects. No details are provided about which projects will be subject to review in 2017 or what the basis for project selection is.

6.5.2 In the last six years the Authority has undertaken numerous reviews of industry participants and consumers' behaviour but only one review of the effectiveness of its own policy work, namely last year's review of its Demand Side Bidding and Forecasting initiative².

6.5.3 This is disappointing given the size of the Authority's past and present overall work programme.

6.5.4 The feedback loop – assessing what each intervention was meant to cost and achieve and what it did, in fact, cost and achieve – is a critical part of the market development process that needs to be hard-wired into the Authority's work programme activity before new programmes are added and new projects started.

6.5.5 We recommend more post-implementation reviews in 2017.

7 Achievement of Authority's vision

7.1.1 The Authority's vision is to be a world-class electricity regulator delivering long term benefit to the consumers and contributing to the New Zealand economy. In order to achieve this vision we consider that:

- partnership with industry is important in the exercise of all its functions including through a more committed use of advisory groups in its market development activity;
- the Authority should use market studies and scenario analysis to provide insight into when change might be required;
- evidence-based problem definitions will build more support for change rather than descriptions of hypothetical problems; and
- the Authority should allow the market to adapt and change rather regulate in anticipation of change as ongoing interventions are unlikely to be successful and will obscure the impact of earlier change.

7.1.2 We encourage the Authority to take this feedback into account as it develops its work programme further.

² Other reviews, such as the review of the implementation of Part 10, did not assess the effectiveness of the actual policy implemented. Instead, the Part 10 review covered the effectiveness of the Authority's project management and delivery, including its coordination of industry participant actions.

7.1.3 For any questions relating to the material in this submission, please contact me on 07 572 9888.

Regards,

A handwritten signature in black ink, appearing to read "Peter Calderwood". The signature is written in a cursive, flowing style.

PETER CALDERWOOD
GENERAL MANAGER STRATEGY AND GROWTH

Trustpower_Appropriations_and_strategic_priorities_Dec2016 v1.0.docx