

## Auckland Energy Consumer Trust submission to the Electricity Authority:

### More standardisation of use-of-system agreements

#### Introductory remarks

The Auckland Energy Consumer Trust (AECT) welcomes the opportunity to provide a submission on the paper “More standardisation of use-of-system agreements” (the consultation paper) issued by the Electricity Authority (EA) dated 8 April 2014.

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The EA wishes to address the question of what method it should use to improve the welfare of consumers via model use-of-system agreements (MUoSA).

#### Discussion

The consultation paper makes a fundamental error by assuming away key features of the situation when carrying out its analysis. It is no good assuming that the MUoSA is unambiguously better for all consumers in all circumstances than a tailor made one.

The point is that any standardisation is likely to be both a cost and a benefit, and thus it requires detailed investigation to determine whether (and to what extent) it is better (in consumer welfare terms) than alternatives. And that this position is even more strongly justified when the option being considered includes the possibility of making a direction that would be either a default or imposed as mandatory rather than voluntary.

One effect of the standardisation of the contracts (as MUoSA) should be lower transaction costs of reaching an agreement between a retailer and a distributor. This is so because most of the “regular” contracting issues – including legal checking of new sections and demands - are able to be quickly disposed of allowing substantive deliberations to be confined to the few areas where some tailor-making is required.

But on the other hand, the “fit” of the result to the specifics of the situation – including the concerns of the retailer<sup>1</sup> - is likely to be poorer than a more “one-off” version could be; and the model features restrain the potential for the participants to later tune the contract as they learn in more detail what is best and what might better suit changing circumstances.

Moreover the extent to which the transaction costs are lower depends on degree to which the MUoSA fully reflects the current concerns of both sides in the final text. This in turn depends on the process by which the MUoSA was reached. And we know that at least one of the participants were

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<sup>1</sup> Which are obviously cogent, see discussion on p12 of the consultation paper.

insistent that their submissions were predicated on the premise that the model was “just a model and some deviation from the model in contracts that are agreed between parties is to be expected.”<sup>2</sup>

Moreover, given the coverage and complexity of the situation and the still limited experience both types of companies have had with such agreements, there is likely to be significant learning going on about the possible need for including more items and dealing with them in different and better ways. So any UoSA needs to have a sensible revision method included to ensure it remains best suited to its role. This is unlikely to be satisfactorily realised by a commitment that “the default agreement would need to evolve over time .... The Authority would seek to minimise these remaining transaction costs by timely updates to the default agreement.”

In the general language of policy assessment this type of indeterminacy demands a well-worked through social cost-benefit analysis to resolve the matter. In particular, the social “value” of each choice of wording and the associated trade-offs made when selecting the version that becomes the model, needs to be carefully evaluated; and then the net result compared with the overall contributing factors, such as standardisation’s potential for saving transaction cost on the one hand, and the accompanying potential loss from fixing the shape and content of the agreement, on the other.

The Sapere report has undertaken a qualitative review<sup>3</sup>, which it describes as a cost benefit analysis in places. This is an analytical review which seeks to identify the notional costs and benefits of moving from the current VUoSA to the MUoSA. While no numbers are actually included, in places the authors have made an assessment which tries to judge the likely net out of two opposing effects (cost and benefit).

Obviously as is the case in any such analysis there is room for criticism about the assessments and indeed, about the broad discussion of the costs and benefits. Given that this work seems to address the key issues reasonably and comes to an unambiguous result,

But it is surely still incumbent on a regulator considering proposing mandatory requirements to show that they are clearly socially justified by carrying out a sound cost benefit analysis of their own.<sup>4</sup> Appealing to the model contract drafting production process that has taken time, even one that included a significant degree of consultation, does not meet this requirement.

## Conclusion

The logic of this regulatory situation, where a proposed solution to a perceived problem is widely acknowledged to have both positive and negative effects, demands that the regulator fully justify the strong action that is being proposed. As a framework for carrying out such an assessment is in use across the policy community (and indeed prescribed for both first and second tier regulatory interventions) it is clear what needs to be done here.

There should be a careful detailed examination via a full cost benefit analysis of the case for the various intervention options discussed in the consultation document. This cannot just assume that the MUoSA is a consumer benefit against all alternatives.

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<sup>2</sup> See Vector Ltd (2012) *Submission to Electricity Authority Model Use-of-System Agreements* p5.

<sup>3</sup> See Sapere report p 37-47.

<sup>4</sup> This is why the Cabinet Manual says (in the section on Regulatory Impact Analysis - RIA): “The government’s RIA framework encourages an evidence-based approach to policy development which helps ensure that all practical options for addressing the problem have been considered and the benefits of the preferred option not only exceed the costs, but will also deliver the highest level of net benefit.”

The aim is to show where there is a net social benefit and which option has the best value. This type of work should not be left to the regulated industry.