

18 December 2017

Submission to the Electricity Authority on 2018/19 appropriations and work priorities

Entrust isn't persuaded the Electricity Authority has justified its proposed 2018/19 appropriation of \$74.27 million. Entrust considers it should be possible for the Electricity Authority to work within a lower overall fiscal envelope.

Entrust also isn't persuaded the Electricity Authority needs an increase in contingent funding for litigation. The Electricity Authority hasn't provided meaningful explanation of why the litigation fund should be more than doubled.

Entrust wants to ensure the Electricity Authority's work programme and expenditure represents consumers' best interests, including the over 327,000 households and businesses in Auckland, Manukau and parts of Papakura and eastern Franklin that are beneficiaries of Entrust. We don't want to see the Electricity Authority's focus diverted away from consumers to the vested interests of individual market participants. Consumers come first, second and third in the Electricity Authority's statutory objective.

It shouldn't be forgotten it is consumers who ultimately pay for the Electricity Authority's expenditure. Seventy-four million dollars is a lot of money. Every dollar the Electricity Authority spends is a dollar less in consumer pockets.

It would be helpful if more information was provided to explain why the proposed expenditure is warranted and how it would be prioritised across each of the projects in the work programme.

The Electricity Authority should be able to demonstrate it is spending the money wisely and responsibly, and delivering clear and tangible benefits to consumers. Entrust would like to see every project assessed and prioritised in terms of what it means for consumer power bills and service quality.

Summary of concerns about the Electricity Authority's proposed appropriations and work programme

Entrust has the following concerns based on the information available:

Work programme concerns	Budget concerns
<ul style="list-style-type: none"> • Entrust is concerned there are too many projects in the Electricity Authority's work programme. • Entrust is concerned about the lack of progress on many projects and priorities. • We doubt the Electricity Authority views the ten projects listed as first priority to all have equal priority. This leaves unclear what the Electricity Authority's actual priorities are. 	<ul style="list-style-type: none"> • There is a lack of transparency about how the Electricity Authority spends its budget on individual projects. • A tighter, more focused, work programme would save money. • Any project delays should be resulting in underspend and lower levies in subsequent years.

Entrust considers there is scope for the Electricity Authority to improve the efficiency and management of its work programme and questions whether having over 40 projects in the work programme is justified or sensible.

The Authority should prioritise areas where it can make the most difference, and pull back from projects where other regulators like Commerce Commission have a remit.

The work the Authority/ new Innovation and Participation Advisory Group (IPAG) is doing on Mass Participation/third-party service provision fits firmly under the Commission's responsibility for making sure regulated suppliers have incentives to innovate and improve efficiency.

This could result in 'doubly regulating' networks, which are already highly regulated under Part 4. The type of prescriptive arrangements that could come out of the Authority workstream could risk stifling network innovation and investment, particularly at a time of disruption in the energy sector.

The Authority should also de-prioritise, or remove from its work programme, long-standing projects that have not addressed the issues that triggered their establishment, or delivered tangible consumer benefits, e.g. TPM and DDA.

The Electricity Authority is making slow progress on its work programme and priorities

It is no surprise, given the large number of projects, that there has been little or no progress on many of them in recent years. The lack of progress is highlighted by the 14 projects the Electricity Authority identified as being delayed in the 2015/16 financial year.¹ This number may be an understatement as it seems to exclude projects that are in the work programme but the Electricity Authority hasn't started such as "Review of distribution sector".

The Electricity Authority told the Commerce Committee that "In all cases it is our intention to complete work deferred from 2015/16 during the 2016/17 financial year"² but subsequently failed to complete all the deferred work within this revised timeframe. Some of the deferred work remains outstanding.

A hidden cost of delay is that, if the projects are genuinely worthwhile, consumers could be missing out on the benefits that could be delivered from their completion.

Delays in the Electricity Authority's work programme should result in underspend and lower levies

Part of the reason the Electricity Authority has managed to keep a lid on its operating expenditure appears to be due to project delays.

Entrust would expect project delays to result in underspend, rather than just keeping within the overall budget, leaving funding available for the next financial year. This should mean lower levies and lower costs for consumers in the next financial year(s).

¹ Commerce Committee 2015/16 annual review questions 1 – 102 to the Electricity Authority, 15 November 2016, question 8.

² Commerce Committee 2015/16 annual review questions 1 – 102 to the Electricity Authority, 15 November 2016, question 10.

The Commerce Committee raised this with the Electricity Authority and the response was "No funding for projects, policies or programmes was carried forward from 2015/16".³

It appears that projects have been delayed too keep the Electricity Authority within its overall budget. The Commerce Committee's view is that this reflects a lack of planning.⁴ We agree. Entrust would like to see evidence of improved project planning and budgeting going forward. If the Electricity Authority delays projects to offset cost overruns it should at least be transparent about this in its weekly stakeholder updates and work programme.

Expenditure on CEO and staff has increased substantially

We are mindful of the Government's concern about salary growth at the top end of the public sector. The State Services Minister, Chris Hipkins, has said the Labour-led Government had asked for advice on its options to control the growth and was not ruling out a cap on pay if it needed to: "I'm not convinced that the current regulatory and legal regime around chief executive pay is sufficient to constrain what has been quite rampant growth at the top of the state sector. The current Government is very concerned about salary growth at the top end of the public sector".⁵

We make this observation in light of the increase in the Electricity Authority's CEO salary from just under \$280,000 to in excess of \$400,000 between 2011 and 2017. This is an increase of between 43% and 55%.

Personnel expenditure has risen by 29% since 2011⁶ with the number of staff earning more than \$100,000 increasing from 31 to 43. Entrust doesn't believe the increased staff resourcing has resulted in improved progress on the work programme or lower reliance on external consultants and legal advice.

There is opportunity to provide better information so stakeholders can fully scrutinise the Authority's appropriation proposals

The Electricity Authority provides no breakdown of how it plans to allocate operating expenditure (\$18.729m) amongst each of the 40 plus projects in the work programme.

The type of information the Electricity Authority has provided for the potential appropriation increases from 2021/22 for real time pricing (RTP), and to the Commerce Committee on budget versus actual expenditure for some projects,⁷ is what we would like to see for all projects as part of the proposed appropriations.

Entrust would also like to see each project's budget broken down to detail major expenditure items such as external consultants and legal advice.

This information should be readily available from the Electricity Authority's internal systems, so it shouldn't be onerous or difficult to produce. It would improve

³ Commerce Committee 2015/16 annual review questions 1 – 102 to the Electricity Authority, 15 November 2016, question 9.

⁴ 2015/16 Annual review of the Electricity Authority, Report of the Commerce Committee.

⁵ <https://www.stuff.co.nz/business/99812129/public-sector-boss-warns-escalating-ceo-pay-is-not-sustainable>

⁶ The high-level nature of the expenditure information in the appropriations consultation meant Entrust had to look at the Electricity Authority's Annual Reports to get a clearer understanding of what is going on with its budgeting.

⁷ Commerce Committee 2015/16 annual review questions 1 – 102 to the Electricity Authority, 15 November 2016, question 8.

transparency greatly and enable proportionate scrutiny of the Electricity Authority's budget.

Why is it necessary for a regulator to advertise if competition is working well?

Having a regulator advertise is highly unusual. In normally functioning markets, competitors can be relied on to advertise and encourage consumers to switch. The continued need for 'What's my number' highlights the ongoing problems with the retail market.

Retail Price Inquiry implications for wholesale and retail market workstreams

Entrust considers that:

- the Electricity Authority has been providing an overly optimistic view of market performance, while downplaying issues raised by stakeholders with the way the wholesale and retail markets are operating;
- even where the Electricity Authority acknowledges an issue, such as Meridian's use of net pivotal position to raise spot prices on 2 June 2016, it can be slow to resolve the matter;
- the Government Retail Price Inquiry provides a timely opportunity for an independent body, appointed by the Government, to deal with the competition issues we are concerned about and which haven't been resolved or properly examined by the Electricity Authority; and
- the Electricity Authority should not undertake any new work in the retail price space that might overlap, or be superseded by, the Retail Price Inquiry.

The Electricity Authority should take care when referencing market indicators, such as the Herfindahl-Hirschman index (HHI), as evidence the market is working well.⁸ We would expect improvements in these types of measures, over-time, regardless of how good a job the Electricity Authority is doing. Sustained retail price increases alone would be enough to increase customer switching.

Despite the Electricity Authority claiming it managed the dry winter in 2017 well,⁹ it isn't clear to us how this could be attributed to the stress testing and customer compensation regimes as no evidence was provided to substantiate this link.

It may simply be that the dry winter management was driven by the extremely high spot prices. The Electricity Authority recently used evidence that net pivotal periods were lower in 2011 – 2016 than 2010 (another dry winter) as evidence the market is working well so it is unclear why it did not look at this again in its review of the dry winter performance.¹⁰

⁸ Electricity Authority, 2016/17 Annual Report, page 3, pages 23 and 24, and Appendix A.

⁹ <https://www.ea.govt.nz/about-us/media-and-publications/market-commentary/outlook/keeping-the-lights-on/>

¹⁰ Electricity Authority, 2016/17 Annual Report, page 95 and Figure 10.

The Electricity Authority appears to have downplayed some of the issues with the way the wholesale and retail markets are operating. An example is the Electricity Authority’s recent response to concerns Vector flagged in the Mass Participation consultation:¹¹

Example of concerns raised about competition	Dismissive response by the Electricity Authority
“Vector considers that there is a significant concern with the operation of the wholesale energy market as a few parties can unilaterally exercise power through their ability to withdraw or provide capacity on uncommercial terms.”	“The Authority considers that the wholesale electricity market is workably competitive. This has most recently been demonstrated by the wholesale market response to the dry hydro conditions during winter 2017. ...”
“Vector considers that there is high market share concentration by incumbent retailers. This creates the ability for such businesses to retain cost savings, and not pass these through to customers whether they relate to network charges or lower energy prices. Pioneer raises similar concerns.”	“We note that market concentration in the retail market has significantly reduced over the last 10 years indicating that competition in the retail market is working effectively. ...”

Even where the Electricity Authority acknowledged there are market issues it hasn’t always treated them with the priority they warrant.

For example, the Electricity Authority determined Meridian had used its net pivotal position to raise spot prices, and breached the Code. The Electricity Authority consequently stated it would consider including a review of the high standard of trading conduct provisions in its work programme but hasn’t mentioned the matter in the appropriations consultation. There are clear detriments to customers and other market participants and it is now over 18 months after the incident.

The Government Retail Price Inquiry is a timely opportunity for an independent body, appointed by the Government, to get cut-through on some of the competition issues we are concerned about and which haven’t been resolved or properly examined.

Entrust does not believe the Electricity Authority should undertake any new work in the retail price space that might overlap, or be superseded by, the Retail Price Inquiry. This could mean the Electricity Authority’s budget needs are less than it currently proposes.

Closing remarks

The focus of our comments is unabashedly beneficiary and consumer focussed.

Entrust wants to ensure the Electricity Authority’s work programme is consumer-centric and focused on ensuring more competitive pricing and improved service quality.

Entrust is also mindful it is consumers’ money the Electricity Authority is spending and that every dollar of the Electricity Authority’s expenditure should provide clear and demonstrable benefits to consumers.

¹¹ Electricity Authority, Enabling mass participation: Response and next steps, 4 October 2017, Appendix A, page 12.

The question the Electricity Authority should ask itself is if consumers were to decide on the appropriation would they be happy to give the Electricity Authority the money? It is apparent too much money is being spent on review of the TPM. This clearly isn't value for money for consumers as they will ultimately foot the bill for the review and, under the Electricity Authority's proposals, end up paying more overall for transmission services as well.

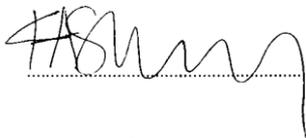
In summary:

- Entrust does not support a 2018/19 appropriation of \$74.27 million and believes it should be reduced;
- Entrust does not support an increase in contingent appropriation for the Authority's litigation fund; and
- the Electricity Authority should not undertake any new work in the retail price space that might overlap, or be superseded by, the Retail Price Inquiry.

For further information, contact:

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Kind Regards



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