



2 February 2016

John Rampton
Electricity Authority

By email: submissions@ea.govt.nz

Dear John

Distribution pricing review

We appreciate the opportunity to comment on the Authority's electricity distribution pricing methodologies (EDPM) consultation, *Implications of evolving technologies for the pricing of distribution services*, published 3rd November 2015.

The publication of the EDPM consultation paper is a positive step that brings focus to an issue of strategic importance for the sector. We consider an evolution in the design of distribution prices that can be reflected in retail price offerings is desirable for the long-term health of the electricity sector, as well as for the achievement of the Authority's statutory objective. This work should be a top priority with more direct stakeholder engagement, possibly via workshops or Advisory Group.

As the Authority identifies in the EDPM consultation, distribution tariffs have an important influence on retail pricing. In addition to basic tariff design (the focus of the EDPM consultation), the number and consistency of methodologies across the 29 distribution networks and the volume of individual tariffs are also influential factors.

In this submission we discuss the following points.

1. **The pricing problem.** We agree that if prices reflect the cost of providing the service then more efficient consumption and investment decisions will be enabled and encouraged.

Additional focus is needed on enduring concerns about the consistency and number of price methodologies which can increase cost, dampen competition and deter retail price innovation.¹

2. **Transition.** The challenge of developing and transitioning to more cost-reflective distribution (and in turn retail) price structures should not be underestimated.

We consider a pan-sector 'project' involving distributors, retailers, regulators and consumers, amongst others, would be desirable. The Authority also has an important enabling and supporting role in facilitating pricing reform.²

3. **Convergence.** We recognise the EDPM review has been in train since 2012/13 but this is the first substantive industry engagement. It arrives at a time of continuing policy debate on transmission and distributed generation pricing (and more recently on use of system agreements) and when the Commerce Commission is considering related issues about the impact of emerging technology in the context of its input methodologies review.

¹ Including to limit the ability of retailers to translate distribution price signals into retail prices.

² For example, to provide policy guidance and preferably to define 'safe harbours' in relation application of low fixed charge regulations to de-risk price reform by distributors and retailers; and, to provide a regulatory back stop to help overcome inertia and provide confidence that price reform will occur.

We encourage the Authority to detail the steps it is taking to ensure policy coherency across all these related and converging initiatives.

The distribution pricing ‘problem’

We consider there is a pressing need to simplify distribution pricing and to ensure those prices better reflect the cost of the services being provided. The need for reform is in part driven by the challenges and opportunities identified in the paper (we agree that emerging technologies will be “transformational”) but also by enduring concerns about the consistency and number of price methodologies which increase cost, dampen competition and deter retail price innovation.

We are concerned that some of the analysis and messaging of consultation materials leads to a view of technological winners and losers. We consider that there is likely to be an interrelationship between investment in EV and demand response, including batteries and investment in solar and that this materially affects the outcome of any efficiency analysis. For example, an end-user that invests in solar may be more likely to also invest in EVs and batteries, and vice versa. If an end-user invests in batteries because they are investing in solar then their reduction in peak usage can be attributed to solar.³

Ideally the analysis would be technologically-agnostic but given it focussed on solar PV it needed to recognise the potential interdependencies with the other self-supply technologies such as battery-storage and electric vehicles, as well as understand and quantify the various benefits of solar to consumers. Further analysis would also distinguish between distribution pricing and other components of retail tariffs that create a wedge between the marginal cost of electricity generation and variable charges.

Network pricing should send pricing signals that are ‘useful and usable’. Clear and simple tariffs that are straight forward for retailers to manage will likely better enable and encourage the transfer of price signals to consumers. Consistent with this, we agree the Authority that “It is not necessary for distributors to set prices that perfectly reflect the cost of the services provided”.

It should be recognised that tariff complexity and the number of different tariffs can impact on the costs to retailers of entering into, and competing in, any particular EDB network area. The smaller the network area (in terms of customer numbers) the smaller the number of potential customers these costs can be recovered from. This has been raised by retailers as a potential barrier to competition in the past, and a reason why there are different levels of competition (measured, for example, by the incumbent retailer market share or the number of retailers in any given network).

Further, if tariffs are too complicated, or too granular, retailers may respond by re-bundling (averaging) the tariffs into a smaller set. There needs to be an understanding of the level of complexity and transaction costs retailers are willing to (or can cost effectively) incur in setting retail tariffs – particularly, on networks with a small number of potential customers.

Transition to sustainable pricing structures

It does not matter whether a ‘too high’ volumetric charge is attributable to transmission, distribution, generation or retail. If it is reflected in retail tariffs it will have the same impact – including over-incentivising investment or activity – be it energy efficiency or substitutes e.g. gas supply or solar. We recognise “there is no single ‘right’ pricing structure for all distributors because each distributor faces different circumstances”, and a ‘one size fits all’ approach to ‘cost-reflective’ pricing will not necessarily be best”. However, the recovery of the fixed costs of distribution

³ Further, if electricity distribution pricing over-encourages investment in solar then it will also over-encourage investment, or consumption behaviour, that results in reduction in electricity consumption more generally e.g. take-up of gas and choice of higher energy efficiency rated appliances.

networks via volumetric charges appears to be a fundamental structural problem that is common to most if not all distributors that needs to be unwound to a greater or lesser extent.

We agree that distribution companies should have natural incentives to reform pricing structures and consider the Authority has an important role to play in enabling and supporting this reform. For example:

- Providing policy guidance and preferably to define 'safe harbours' in relation to the application of low fixed charge regulations to de-risk price reform by distributors and
- Providing a regulatory back-stop to help overcome inertia and provide confidence that price reform will occur.

We note that the Australian Energy Market Commission (AEMC) has already created rules (effective 1 December 2014) that require distribution businesses to develop network prices that are cost-reflective and send efficient pricing signals to consumers⁴

- [As the Authority identifies] clarification of the role of the Code's pricing principles and their meaning, including how to manage conflicts in the principles.

The Authority can also play a valuable coordinating role, possibly sponsoring an industry working group or establishing an Advisory Group (as section 21 of the Electricity Industry Act envisages for reforms of this nature).

With any potential tariff reforms it is important to demonstrate how consumers will receive clear and tangible benefits from reform (we thought the summary brochure to this consultation paper was a good example of how potentially complex matter can be communicated to a non-expert audience). We note use of a range of independent research and summary communication in the examination of pricing and technology issues for distribution networks in Australia. By way of illustration, work conducted by Energeia, for the Energy Networks Association in Australia, "found a potential benefit of \$17.7 billion in savings in investment in infrastructure over the next twenty years, resulting in an annual saving on average energy bills of \$250 by the end of the period".

We do not underestimate potential opposition to reform; for example where:

- where the need for and benefits of reform are ill-defined or not effectively understood by consumers
- where the information needed to respond to new tariffs is not available to consumers or able to be acted upon
- where consumers have invested large sums of money, in good faith, on the basis of current pricing arrangements. [As experienced with changes to feed-in-tariffs (FiTs) in Australia and the UK, payments which have been drastically scaled back as demand for the technology has increase. There has been a lot of predictable objection to the reduction in FiT rates from people that have invested in solar).

The difficulty of reform is increased by negative press and can be increased exponentially by major failings. We consider that this pushes strongly towards a carefully planned and coordinated transition effort that draws on the relevant stakeholder constituency, identified and addresses key challenges before they reach the headlines.

Network pricing coherence

While the Authority is presently treating the distribution pricing (EDPM), low fixed charge regulations, distributed generation pricing (ACOT) and the TPM review as discreet work streams, it seems axiomatic that the underpinning policy and pricing theory fit together in a coherent manner.

⁴ <http://www.aemc.gov.au/Rule-Changes/Distribution-Network-Pricing-Arrangements>

It is not always obvious that this is the case and we support clarification by the Authority of how it is ensuring policy coherence across these related and converging initiatives.

Finally, although we are not directly impacted by reform to distribution pricing, we have a strong long-term interest in ensuring consumers receive efficient price signals. This will promote efficient utilisation of transmission and distribution networks (and other supply chain elements) and improve the cost effectiveness and competitiveness of the services we collectively provide.

Yours sincerely

A handwritten signature in black ink, appearing to be 'JC' followed by a long horizontal stroke.

Jeremy Cain
Regulatory Affairs & Pricing Manager