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Graeme Peters
Chief Executive
Electricity Networks Association (ENA)
WELLINGTON

Dear Graeme

Distribution Pricing: an ENA discussion paper

We welcome the ENA's consultation on distribution pricing and related matters. We have a particular interest in distribution pricing because we recover over 70% of our transmission revenues through electricity distributors, also because the combination of transmission and distribution costs represent around 40% of a typical residential consumer's bill.¹

We think that it is a good idea for the ENA to take a fresh look at distribution pricing as the sector grapples with new challenges and opportunities. We appreciate that the discussion paper does not contain proposals or chart a way forward but we do consider it a useful first step.

We found consultation with industry, and interested parties, an invaluable part of our own pricing review conducted in 2014/15. It helped us get a better understanding of industry views, and helped shape the proposed amendments to the transmission pricing methodology that we submitted to the Electricity Authority. As with the ENA consultation, we also found it helpful to undertake an initial, high level, consultation before developing our analysis more fully.

We support active consideration of the impact of technology changes

The emergence of photovoltaics (PV), electric vehicles (EV) and battery technology, as discussed in the discussion paper, has the potential to substantially change the landscape of the electricity industry, just as technology developments have impacted other network industries such as telecommunications.

At this stage it is unclear whether this will result in a resurgence for the sector as EVs displace transport fuels or, as some suggest, a 'death spiral' as PV plus storage displaces grid delivered electricity. However, ensuring pricing methodologies (that were developed in a very different market and regulatory environment) are cognisant of these competing and complementary technologies will be essential for the health of the sector.

¹ Electricity Authority, Electricity in New Zealand, 4 July 2013, figure 12.

We have no doubt that lessons can be learned from other jurisdictions and note the recent Grattan Institute report² as an example. Although New Zealand has not adopted “lavish government subsidies” for PV schemes, the Grattan report provides a timely reminder of the scale of harm that can be caused by well-intentioned, but poorly thought through, policy responses and of the importance of ensuring network prices evolve.

About 1.4 million Australian homes have installed solar panels on their roofs since 2001”, “the largest take-up of photovoltaic (PV) solar systems of any country”, “lavish government subsidies plus the structure of electricity network tariffs means that the cost of solar PV take-up has outweighed the benefits by almost \$10 billion. By the time the subsidies finally run out, households and businesses that have not installed solar PV will have spent more than \$14 billion subsidising households that have.

This is a stark lesson for policy makers, industry participants and regulators.

Distribution pricing reform

Retailers and distributors themselves are better placed than us to comment on the efficacy of current distribution pricing models. However, we can comment in general terms on the objectives of distribution pricing reform and on the impact that distribution pricing can have on competition, the price signals consumers receive and the overall efficiency of the sector. For example:

- **Problem definition:** it may be useful to quantify the extent to which current distribution prices are not cost-reflective, and result in cross-subsidisation. Such analysis would help determine the extent to which there is a problem with current distribution pricing arrangements and help focus distribution pricing reform.
- **Pass-on of price signals:** clear and simple tariffs are straight forward for retailers to manage and better enable and encourage the transfer of price signals to consumers. The process of competition should, over time, ensure that price signals are passed on to consumers to the extent possible. This can enable more active engagement by consumers, for example shifting demand from peaks, and the potential for the sector to transition to a lower cost model.
- **Impact on competition:** clear and simple tariffs are also more likely to be competitively neutral between retailers. The reason for this is that they are likely to be less costly and require less averaging across retailer’s customer base (both of which can disproportionately impact smaller scale retailers). Disruptive entrants with different and new business models can deliver great benefits to consumers. Care should be taken to ensure distribution pricing does not tilt the playing field against those entrants.
- **Efficient pricing:** well-designed tariff structures should promote informed, efficient technology and electricity consumption choice by consumers. Conversely, poorly designed or outdated distributor and retail tariffs can result in inefficient consumer decisions and, as experienced in Australia and other jurisdictions, may impose large costs on society.

Retail tariffs

The discussion paper raises a concern that retailers may repackage distribution tariffs which can blunt or mute the pricing signals the tariffs are intended to send.³

Importantly, retailers have the primary responsibility for managing and promoting pricing and service options to consumers. This means that retailers are able to re-bundle distribution and transmission prices when determining the actual electricity tariffs which consumers pay. Thus in practice cost reflective distribution pricing signals may not be passed on to consumers, inhibiting their ability to make efficient consumption and investment decisions.

² Grattan Institute, Sundown, sunrise – How Australia can finally get solar power right, May 2015.

³ ENA, Distribution Pricing: a discussion paper, 11 May 2015, paragraph 34.

The paper then asks “Should distribution charges be separated from retail charges to preserve distributor price signals, or as an alternative should retailers be required to pass on distribution price signals to consumers?”⁴ We struggle to see the merits of either of these options and consider they would impose additional costs and complexity on the sector with few corresponding benefits.

We would be hesitant about any suggestion that price controls or retail price regulation should be imposed on competitive parts of the electricity sector. If distribution tariffs are clear and simple then the process of competition in the retail market should ensure these, along with energy price and other signals are reflected in retail tariffs. It may be useful to get an understanding from electricity retailers about the commercial drivers behind the end-user tariffs they set, and why they repackage distribution tariffs. For example, we note that electricity retailers have raised concerns about the large number of distribution tariffs they have to manage across the 29 electricity networks.

Finally, we are unaware of unbundled billing in other vertically separated network sectors. Of itself, that does not mean it would not be appropriate here but caution should be exercised. As well as testing the plausibility that it could elicit positive behavioural change not otherwise available (and the consequential efficiency gains clearly outweigh the cost of duplicate billing systems, additional complexity and increased transaction costs to consumers) a number of practical issues would need to be addressed. For example:

- The potential impact on retail competition if electricity network billing systems (and related costs such as bad debts) were allowed to be treated as a distribution cost, in the DPP and CPP price resets, and distributors entered the electricity retail market.
- The implications for dual gas and electricity network providers such as Vector and Powerco if direct billing were only to be applied for electricity distribution services. Would it mean Vector and Powerco charge consumers directly for electricity distribution services, but charge retailers for gas distribution services?
- Would both electricity retailers and distributors have the right to disconnect consumers for non-payment of electricity bills (and how would metering and other ancillary services be dealt with)?

Please let me know if you have any questions or would like to discuss any of the points made in this submission.

Yours sincerely

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

Jeremy Cain
Regulatory Affairs & Pricing Manager

⁴ ENA, Distribution Pricing: a discussion paper, 11 May 2015, question 1a).