5 February 2019

Distribution pricing reform should be consumer-led

For network pricing reform to be durable it needs consumer buy-in. It is important to note that just because a pricing option might satisfy economic theory doesn't mean it will be palatable to consumers.

The Electricity Authority has provided no evidence for its ranking of different pricing methodologies, and appears to treat the merit or validity of its views as self-evident.

The Electricity Authority should ensure it has robust evidence, including drawing on international experience with network pricing, to support its preferred pricing options. The Authority needs to be able to demonstrate the options it prefers would be to the long-term benefit of consumers.

Options like distribution "locational marginal pricing" (DLMP), which would effectively extend nodal pricing to a sub-distribution level, are unlikely to be supported by stakeholders wanting simplification and standardisation of prices.

The Electricity Authority should have consulted with stakeholders on whether DLMP was worth investigating before commissioning work on how it could be implemented. The consultation paper makes no reference to the consultant report on DLMP, despite relying on the consultant report conclusions. The Authority posted the report on its website 19 months after it was completed without notifying stakeholders, or didn't post it with the consultation paper it relates to. This highlights a lack of transparency in the Electricity Authority's process.

Summary of Entrust's views

- The Electricity Authority's proposed star rating system risks distracting from real pricing reforms. We see little value in the Authority giving high star ratings to pricing options such as dynamic peak-usage charges which consumers are likely to find confusing and unacceptable.

- Redistribution of Loss Rental Rebates provides an opportunity to improve consumer welfare: Entrust beneficiaries have benefited from a $350 dividend payment, plus an extra $30 from Vector to all Aucklanders last year. Entrust considers that lines companies should either pay Loss Rental Rebates directly to consumers as Vector is now doing, or use the rebates to reduce line charges. These are the most effective ways of ensuring rebates go to consumers and aren't captured by the large incumbent retailers.

- Entrust actively supports the consumer-led approach Vector is taking to review its distribution pricing, including use of consumer surveys and trials.[1] For any pricing methodology to be durable and effective it needs consumer buy-in and acceptance.

- The experience with the Low Fixed Charge Regulations and The Lines Company's previous pricing arrangements should serve as a salutory lesson about what can happen when consumers object to changes in pricing arrangements.

- Instead of emphasising the importance, and central role, of consumers, the Electricity Authority's proposals side-line consumers. Entrust supports the existing Distribution Pricing Principles' (DPPs') focus on consumers, including that pricing should be transparant, price stability and certainty should be promoted, and suppliers should have regard to the impact on consumers.

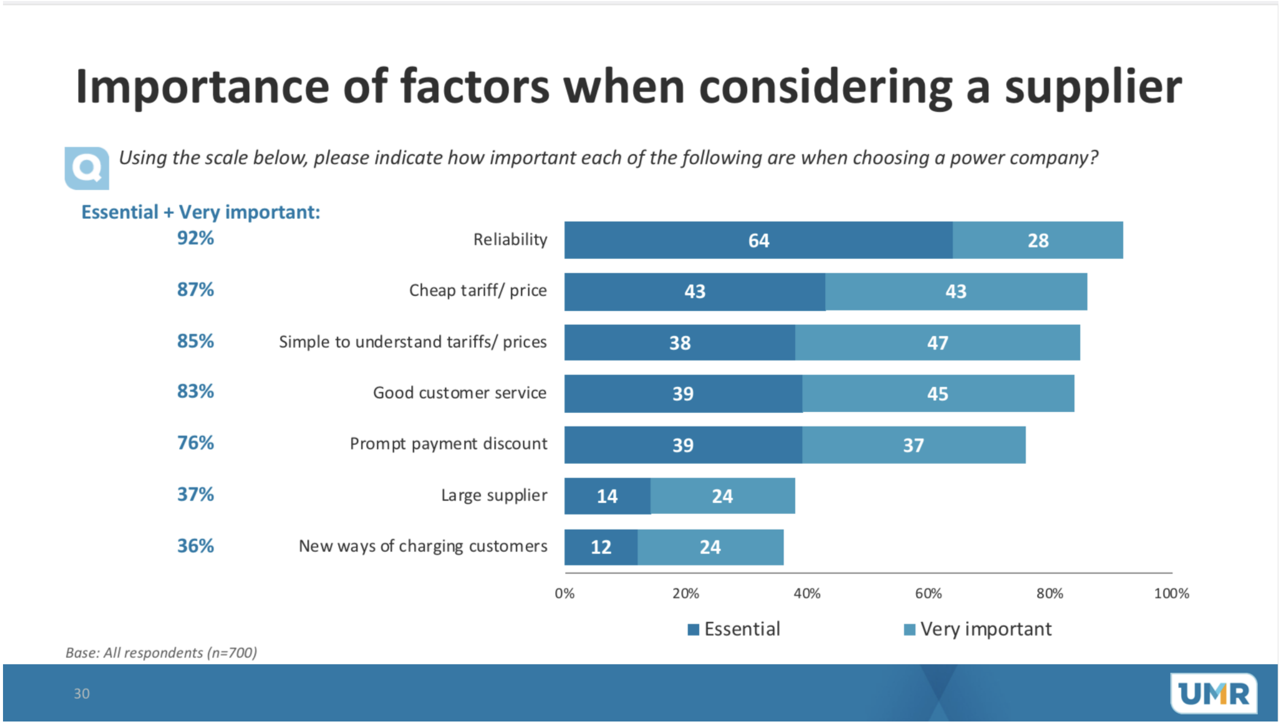
[1] Vector's distribition pricing roadmap is available at: https://www.vector.co.nz/personal/electricity/about-our-network/pricing

Households want simple, uncomplicated billing

Entrust commissioned UMR to survey Auckland consumers about electricity retailing issues.[2]

The purpose of the survey was to ensure consumer voices are heard through the Electricity Price Review process. The results are also relevant to Electricity Authority workstreams, including on "saves and winbacks" and pricing reform.

Respondents to the UMR survey were asked to rate how essential or important several factors were when it came to choosing an electricity supplier. 38% of respondents said simple to understand tariffs/prices were essential, while 47% rated this as very important. Only reliability of supply and cheap prices ranked higher in importance. A clear message was that "They need to be clear and open with pricing".



We think it is reasonable to conclude the survey results translate to consumers wanting distribution services that are reliable (Commerce Commission responsibility), affordable (Commerce Commission responsibility), and with prices that are simple to understand (Electricity Authority distribution pricing jurisdiction).

Any changes to the pricing principles should increase the focus on consumer interests

Entrust does not support replacement of existing the Pricing Principle (d) requirement that "Development of prices should be transparent, promote price stability and certainty for stakeholders, and changes to prices should have regard to the impact on stakeholders" (which should, more specifically, refer to end-consumers).

The proposed replacement (proposed Pricing Principle (c)) requirement that "The application of these principles should be transparent and predictable" is considerably watered down and weakens the focus on consumers. We do not consider (c) to be a "Clarified and contracted version of principle (d)".

We consider that, instead of replacing pricing principle (d), it would be useful to:

[2] UMR, Consumer research on electricity usage and supply issues, October 2018.

- Clarify that the principle is referring spefically to end-consumers;
- Add that prices should be "consistent with outcomes produced in competitive markets" (drawing on the Part 4 Commerce Act purpose); and
- Add that prices should be "Simple – transparent and easy to understand" (ENA Pricing Principles).

The regulatory driver for pricing reform is Part 4 operation not a star system

Lines companies will need to accommodate new technology and the consumer-led energy future new technology unlocks.

This will require lines companies to adapt. Vector is helping to enable this future with initiatives such as data analytics, battery storage, peer-to-peer trading, integration of consumer-owned distributed generation, managed smart Electric Vehicle (EV) charging, smart load control and new pricing. Entrust supports these initiatives.

The key regulatory driver supporting pricing reform is operation of price control under Part 4 of the Commerce Act, and promotion of incentives for lines companies to innovate and improve efficiency.

The Commerce Commission's decision to move lines companies to a revenue cap from 2020 onwards is welcome and will allow major price change without regulatory compliance risk.

Entrust has a growing concern about the disjunct between the aspects of economic regulation of lines companies the Commerce Commission and the Electricity Authority are responsible for. While the Commerce Commission is responsible for ensuring lines companies have incentives to improve efficiency and innovate, the Authority doesn't seem to think the Commission is doing enough and wants to intervene itself.

Entrust does not consider the Electricity Authority should be 'shoe-horning' its own views about how lines companies should operate, be it in relation to 3rd-party procurement[3] or distribution pricing. Entrust agrees with the Commerce Commission that regulators "have to be careful before deciding to tell firms how to run their business because they very likely know that better than us".[4]

The proposed star ratings would produce false results

We do not have confidence in the Electricity Authority's ability to guide or facilitate distribution pricing reform, based on the Authority's track record on transmission pricing.

The Electricity Authority's proposed revisions to the DPPs and introduction of a star rating system could distract from lines companies' efforts to review their pricing arrangements.

Entrust does not consider it likely consumers would understand or consider the Electricity Authority's preference (top rated option) for dynamic kVA-based charges to be fair or provide the pricing certainty and predictability they want.

If the proposed star rating system was in place, The Lines Company's move away from capacity charges to a simpler, and more understandable, form of time-of-use pricing, which does not vary across seasons, would result in a drop-in star rating. The Lines

---

[3] For example, we previously noted "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": Entrust, Submission to the Electricity Authority on 2018/19 appropriations and work priorities, 18 December 2017.

[4] Commerce Commission, Commerce Commission regulation of energy networks - key concepts, Prepared for IPAG, June 2018, paragraph 13.

Company's shift away from pricing consumers did not like, would result in a drop from 4 stars to less than 2 under the Authority's proposed system.

The fact a pricing methodology the Electricity Authority would rate highly isn't acceptable to consumers should serve as a clear warning there are problems with the proposed star ratings.

The Electricity Authority's distribution pricing review process is not helping reform

While the Electricity Authority has complained that distribution pricing reform is happening too slowly, the Authority needs to take responsibility for the uncertainty and adverse impact its own actions are having:

- The Electricity Authority's transmission pricing review has been an ongoing (since 2011) and unnecessary source of distraction and uncertainty. Any lines company considering distribution pricing reform needs to consider the uncertain and potential impact and implications of transmission pricing change.

- The Electricity Authority's failure to acknowledge the implications of the Low Fixed Charge Regulations for distribution pricing reform has been an ongoing, and unhelpful, source of frustration for Electricity Networks Association (ENA) and lines companies.

- The Electricity Authority developed a decision-making and economic (DM&E) framework for assessing distribution pricing options in 2012, and in 2015 said it would evaluate lines companies pricing against the framework. The DM&E framework has never been mentioned since, as far as we are aware.[5] This is despite the substantive focus the Authority has given the identifical DM&E framework throughout the transmission pricing review.

- The Electricity Authority's 2015 consultation on emerging technology and distribution pricing appeared to reconfirm the existing DPPs (no changes were proposed), with clarification that the Authority considered capacity, peak-usage and time-of-use pricing appropriate forms of pricing to comply with the pricing principles. The Authority is now shifting the goal-posts, suggesting some of the pricing reforms it endorsed three-years ago are inadequate.

The Electricity Authority wants lines companies to act with urgency, but there is now considerable uncertainty about what the DPPs will end-up looking like, if and when the DPPs will be changed, how the Authority's proposals sit with the Expert Advisory Panel's views on distribution pricing (which the Authority ignores in its consultation paper) and the outcome of the transmission pricing review.

It isn't obvious why it has taken so long for the Electricity Authority to produce the latest consultation paper

The Electricity Authority's review of distribution pricing is symptomatic of the slow progress it has been making on its work programme and priorities, particularly in relation to network regulation issues.

The Electricity Authority consulted on criteria for assessing distribution pricing in September 2011, then on the DM&E framework for distribution pricing in January 2012 which it confirmed it would apply (unamended) in May 2012.

The Electricity Authority subsequently consulted on the impact of evolving technology in November 2015, nearly four years later.

---

[5] If the Electricity Authority has abandoned the DM&E framework, as appears to be the case, it should clarify matters by saying so.

It then took the Electricity Authority over three years to produce the DPP consultation paper.

We have repeatedly said there shouldn't be gaps of three or more years between consultations. Three years should be more than long enough to complete an entire review process, in most circumstances.

We are struggling to understand why there has been such a long gap, and why there were so many delays with the DPP consultation paper. The existing and proposed DPPs only contain five brief principles. The consultation paper itself is relatively short and contains no new evidence or quantified analysis of the benefits of the changes (and pricing methodologies) the Electricity Authority is now advocating.

Concluding remarks

The focus of Entrust's comments are unabashedly beneficiary and consumer focussed. Entrust wants electricity to be supplied in an efficient and affordable way to all consumers, including the over 331,000 households and businesses in Auckland, Manukau and parts of Papakura and eastern Franklin that are beneficiaries of Entrust. We are proud to be playing our part to help consumers.

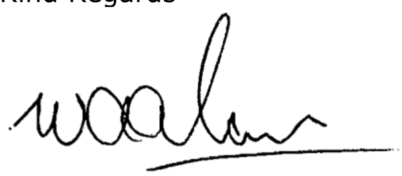
The Electricity Authority's latest proposals reflect no genuine assessment of what consumers might want or think about different pricing methodologies, rather they are based on little more than untested opinion and subjective judgement.

The focus should be on ensuring there are good review processes in place and recognition of the importance of gaining consumer buy-in and acceptance.

It should be recognised there is significant complexity in implementing new pricing models, and what the Electricity Authority considers to be the theoretically best option is not necessarily what consumers want or lines companies should adopt. The Authority's preferences are not a substitute for consumer views.

For further information, contact:
Helen Keir, Chief Operating Officer, Entrust
Phone: 09 929 4567

Kind Regards



William Cairns
Chairman