DOMESTIC ENERGY USERS' NETWORK

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Submission: Distribution Pricing/Info Disclosure Principles Consultation

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The consultation paper is at http://www.electricitycommission.govt.nz/pdfs/opdev/transmis/pdfsconsultation/draft-pricing-principles-guidelines.pdf

Summary

1. The consultation paper proposes as a pricing principle that the most captive consumers should pay the highest distribution prices. DEUN rejects that principle.

2. The paper says that prices should lie between the cost of running existing capacity and the cost of providing services from new capacity. Because lines services are extremely capital-intensive and therefore a monopoly, the gap between incremental and stand-alone costs is extremely large. This pricing principle is so broadly specified it is not very useful.

3. The paper proposes several specific changes which reflect the Electricity Industry Bill, just introduced.

    a. It removes domestic consumers as stakeholders in the electricity industry.

    b. It removes the objectives "fair", "environmentally sustainable" from the objectives of the Electricity Act, and "cost-reflective pricing" from its desired outcomes.

4. DEUN rejects all these changes. We call for electricity regulation to be for the purposes of all stakeholders in the industry including domestic and other small consumers. We call for wide objectives, including fairness, sustainability, and cost-reflective pricing (with any exceptions being for social purposes not maximizing profits), to be retained in the Electricity Act,

Submission

1. DEUN made a submission on the September discussion paper on the same topic. We had attended the Electricity Commission's workshop, and expressed strong concern that the proposed pricing principles included "Ramsey-compliant pricing".

2. Ramsey pricing charges the highest prices to those consumers that are most captive. The Commerce Commission considers this to be a very efficient pricing strategy, but difficult to implement in practice.[1]

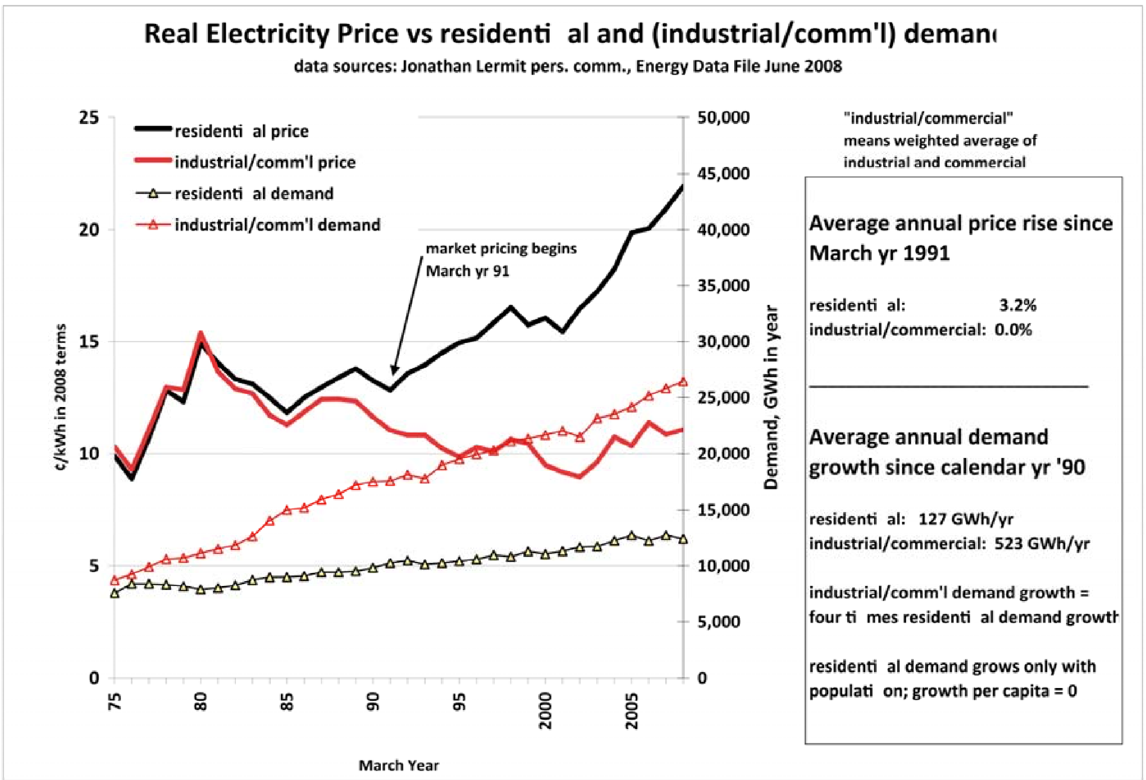
3. DEUN submitted that Ramsey pricing is unjust for electricity which is actually an essential service, though legally is no more "essential" than any other commodity – such as baked beans.

4. The subsequent consultation paper, dated December 2009, removed the description "Ramsey-compliant", saying "this would reduce the potential for stakeholders to believe that they must implement Ramsey pricing per se, which is difficult to do in practice."

5. The paper comments on the DEUN submission to the September paper. It states: **"**The revised version provides greater clarity and **does not diminish the intent of the principle" [**Our emphasis]

6. Ramsey pricing is only relevant under the Commerce Act for monopoly businesses. But the oligopoly of gentailers – Genesis, Meridian, Mighty River Power, Contact Energy and TrustPower, apply the same pricing principle, and this is condoned by the Minister of Energy.

7. The result is the growing gap between prices to domestic consumers and all other consumers (weighted average of "commercial" and "industrial), as shown in the graph from information in successive Energy Data Files. The effect of elasticity is clearly shown by the demand trends: non-



domestic demand is growing much faster than domestic demand.

8. Common sense says that domestic consumers are subsidizing electricity prices to non-domestic consumers, enabling non-domestic demand to grow faster.

9. The Commerce Act does not reflect common sense. It re-defines "cross-subsidy"[2] as meaning any price that is

    a. greater than the "stand-alone cost" (in this case, cost of electricity from new power stations, plus transmission and distribution lines); or

    b. less than the "incremental cost" (of electricity from existing power stations and lines).

10. Any pricing gap within those two bounds, according to the Commerce Act, is not a cross-subsidy, but merely "price discrimination".

11. Domestic consumers in overseas jurisdictions consider price discrimination in most cases to be unfair[3], with Ramsey pricing the extreme case. But the Commerce Act regards it as economically efficient.[4]

12. The gap between stand-alone cost (LRMC) and incremental cost (essentially, SRMC) is extremely large for distribution services – lines are a natural monopoly. The cross-subsidy principle is therefore not very helpful because it does little to specify appropriate pricing.

13. In future, the gap between LRMC and SRMC for generation will increase, because most new generation is from renewable sources. Capital costs for renewable generation are high and increasing, but running costs are relatively low because they do not include fuel prices or carbon emissions costs.

14. Price discrimination for publicly sanctioned purposes is not unfair. DEUN supports the example in the consultation paper of the subsidizing of remote rural lines services to enable affordable household electricity.

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[2] Ibid, [Input methodologies], section 9.17

[3] http://www.google.co.nz/url?sa=t&source=web&ct=res&cd=9&ved=0CCAQFjAI&url=http%3A%2F%2Fwww.comcom.govt.nz%2FBusinessCompetition%2FAnti-competitivePractices%2FApplications%2FContentFiles%2FDocuments%2FSustainable%2520Energy%2520Forum%25204.pdf&ei=OncuS7mmCY76sgPpt5jHBA&usg=AFQjCNHv4mvyi1AecQX7aRjjo6ULmVBGGQ&sig2=CSy0gI26s8QqCszoO5poNQ

[4] In fact, residential prices are greater than stand-alone price, because of excessive retail margins. This led the Ministerial Review team to recommend measures to "improve competition" for domestic consumers – the only tool available under the Commerce Act.

Such services may or may not be provided more economically by stand-alone generating systems than from very long power lines.

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15. The Electricity Industry Bill sets the stage for the electricity industry to evade criticism of unfair pricing.

    a. It removes "fair" from the objectives of the new Electricity Authority. (It also removes "environmentally sustainable", and "electricity efficiency" as objectives of the amended Electricity Industry Act.)

    b. It removes domestic consumers from the set of Industry Participants to whom the Electricity Industry is accountable.

    c. It provides for the Code (which replaces the present electricity market rules) to override any pricing principles set by the Commerce Act.

16. These changes will give Industry Participants a free hand to negotiate distribution pricing methodologies that suit their combined interests.

    a. All Industry Participants are calling for voluntary guidelines rather than mandatory pricing or information disclosure principles.

    b. Gentailers are seeking "simplified" distribution tariffs to make it easier for them to compete. This will mean opportunities lost for tariffs that capture specific cost and energy savings – an example given at the earlier workshop was chicken sheds in Franklin.

    c. Lines companies did not state a consistent position; it is clear that the position taken by each depends on its specific circumstances.

    d. The same could be said by positions taken by each Industry Participant, whether supplier or major electricity consumer.

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17. The consultation paper states that distribution pricing principles will, **where appropriate,** "reflect objectives set out in the Electricity Act 1992 Act" – the boldfaced phrase is necessary because the objectives of the new Act will be much narrower than those of the existing one.

18. DEUN considers that the Electricity Industry Bill, just introduced, intends to confirm in law the unfair pricing practices of the last decade.

19. Those practices have been condoned by successive Ministers of Energy, despite successive Government Policy Statements on electricity which incorporate objectives of "fair", environmentally sustainable, and "cost-

reflective pricing", and retains the principle of "cost-reflective pricing" except where price discrimination is socially sanctioned.[5]

Specific Consultation Responses

Question 1

20. Section 3.2.1, principle (a): DEUN rejects the definition of "subsidy-free";

21. Principle (b), DEUNdisagrees with the principle of charging the most captive consumers the highest prices.

22. DEUN disagrees with the replacement in Principles (c) and (d) of "users" by "stakeholders". This brings all Industry Participants inside the "regulatory tent", while specifically excluding consumers other than Industry Participants. The exclusion of domestic consumers is confirmed by one of the Commission's responses:

    "The generic term "stakeholder" has been introduced to cover all affected parties." [that is, domestic consumers are not 'affected'].

23. In Principle C (iii), the idea of encouraging investment in transmission or distribution alternatives, including distributed generation and demand response, is qualified by "where network economics warrant". This is a sop to the industry. Alternatives should be encouraged wherever the overall economics warrant, not where <u>network</u> economics warrant.

24. Principle (e) of the earlier discussion document referred to "retailers" and "consumers"; the consultation document deleted "consumers". DEUN rejects that deletion because we consider the Electricity Authority cannot ignore the needs of domestic consumers.

Question 2

25. DEUN rejects the document's proposed reliance on guidelines instead of prescribed methodologies for information disclosure. Poorly defined information disclosure led to extensive manipulation during the 1990s of lines company accounts, enabling massive transfers of wealth from consumers to lines companies.[6]

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[5] Price discrimination fails the principle of cost-reflective pricing; it is a deliberate preference for one class of consumer (non-domestic) over another (domestic).

[6] Bertram and Twaddle, paper on lines company profits: http://www.geoffbertram.com/fileadmin/publications/Price-Cost%20Margins%20and%20Profit%20Rates%20in%20New%20Zealand%20Electricity%20Distribution%20Networks%20Since%201994.pdf