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Dear Kate

Distribution Pricing Principles and Information Disclosure Guidelines

1. Thank you for the opportunity to provide feedback on the above paper, dated December 2009. No part of our submission is confidential and we are happy for it to be publicly released.

Government electricity reform announcements

2. In making this submission we are cognisant that the Government has announced its latest electricity reforms, subsequent to the release of the consultation paper, some of which have implications for distribution pricing; in particular:
 - a. The objective that should be pursued by the regulator is the promotion of competition, efficiency and reliability for the long-term benefit of end-users.
 - b. "The large number of lines businesses (29), combined with a multiplicity of line tariff structures and use-of-system business rules, makes it costly and difficult for retailers to enter new areas, particularly smaller ones."¹
 - c. "... while there are 29 line companies, some companies have multiple tariff areas, raising the total number of areas with different tariff structures to 39."^{2,3}
 - d. "... the UK regulator (Ofgem) recently decided to impose a unified (line) distribution pricing methodology on distribution companies to remove what it termed a significant barrier to retail entry ..."⁴

¹ Paragraph 20, bullet 4, of the Cabinet Economic Growth and Infrastructure Committee paper "Ministerial Review of the Electricity Market".

² Paragraph 60 of the Cabinet Economic Growth and Infrastructure Committee paper "Ministerial Review of the Electricity Market".

³ Not including embedded networks.

⁴ Paragraph 62, bullet 4, of the Cabinet Economic Growth and Infrastructure Committee paper "Ministerial Review of the Electricity Market".

- e. "It should be noted that there are only 14 distribution areas in Britain, with an average number of 1,800,000 ICPs per area, compared with the \approx 28 network charging areas in New Zealand with an average number of 50,000 ICPs per area."⁵
 - f. There should be a reduction in "the diversity of line business tariff structures and use of system rules."⁶
 - g. "... legislative provision is desirable to allow the Minister to make rules if the issue is not satisfactorily addressed in the meantime by the EC/EMA."⁷
3. The Government has also announced greater responsibility for the Electricity Commission by giving the Commerce Commission a subordinate role in electricity (distribution and transmission) tariff methodology setting.
 4. These statements reinforce our view that, for the Electricity Commission's proposals to be successful they will need to result in a reduction in the number of line tariffs and complexity (particularly in small network areas) and be shown to help promote retail competition.

Proposed Pricing Principles

5. The proposed pricing principles have been set at a high level but are fundamentally sound. We also believe it is desirable, as the Electricity Commission proposes, for there to be periodic views of EDB pricing against the principles, with the threat that regulation will be introduced if the principles are not being met.
6. Having said that, we have the following comments on the principles.
7. The pricing principles (a) to (c) basically state that pricing methodologies should be cost reflective and subsidy free. We think there is a real risk the principles (a) to (c) that they will be interpreted as indicating that greater tariff disaggregation and greater tariff complexity should be adopted to ensure tariffs are fully cost-reflective and subsidy free. This would be a retrograde step.
8. We also believe that for the Electricity Commission to determine principles (a) to (c) are being met would require an extensive amount of information from each of the EDBs which goes way beyond the apparent independent review process the Electricity Commission is proposing. A good example of this is the information requirements imposed by the Commerce Commission on Unison, Vector and Powerco, as part of its Part 4/4A Commerce Act responsibilities, during investigations into whether it should invoke price control and what form that price control should take.
9. Principle (d) suggests pricing should be transparent and promote price stability and certainty. Any pricing methodology can achieve this so long as the methodology is

⁵ Footnote 20 of the ETAG/MED "Summary note on recommendations taking account of submissions", October 2009.

⁶ Paragraph 20, bullet 4, of the Cabinet Economic Growth and Infrastructure Committee paper "Ministerial Review of the Electricity Market".

⁷ Paragraph 63 of the Cabinet Economic Growth and Infrastructure Committee paper "Ministerial Review of the Electricity Market".

disclosed and prices aren't changed on a regular (more than annual) basis. Principle (d) also suggests "changes to prices should have regard to the impact on stakeholders" but this is probably isn't specific enough to provide EDBs with much guidance.

10. Principle (e) gets more to the heart of Mighty River Power's concerns stating that "Development of prices should have regard to the impact of transaction costs on retailers". However, it would appear principle (e) is sub-ordinate to the other principles as EDBs are only required to "have regard to" it. If principles (a) to (c) are given greater weight this could actually drive greater tariff complexity. Principle (e) goes on to suggest that prices "should be economically equivalent across retailers". Any pricing methodology should achieve this as long as they are not discriminatory.
11. Mighty River Power believes it would be helpful if, at the very least, the Electricity Commission included as principles, or key measures it will rely on to determine if the principles had been appropriately adopted that, notwithstanding any of the other principles, the Electricity Commission expects:
 - a. EDBs to adopt a single (contiguous network) tariff area;
 - b. there to be a reduction in tariff categories/complexity; and
 - c. the smaller the EDB the simpler the pricing methodology will be and the less tariff categories that will be adopted.

Concluding remarks

12. We would like to emphasise from our previous submissions that Mighty River Power is generally supportive of a principles-based approach. We are supportive of providing EDBs with discretion over such matters as cost allocation (within bounds such as incremental and stand-alone costs). Where we believe greater prescription than the Electricity Commission is proposing is needed is on "low level elements". Matters such as customer definition, number of tariff categories and complexity of tariff structures can have a substantial impact on transaction costs and retail competition, particularly in small EDB network areas.
13. We consider that the Electricity Commission's proposals presently risk an over-emphasis on economic purity in electricity distribution pricing methodology setting, which could actually increase the number of tariff categories and complexity. At present, Mighty River Power (through Mercury Energy) has to deal with around 1,000 line tariffs.⁸ We believe though that the proposed pricing principles can be easily tweaked (to make explicitly clear that EDBs should be seeking to achieve the opposite) to avoid this risk.
14. We also want to ensure that the Electricity Commission's decisions can be expected to achieve the outcomes the Government is seeking in relation to EDB tariff regulation. It would not be in the best-interests of end-users if EDBs ended up having to undertake two sets of tariff reforms, one following the Electricity Commission's requirements and then

⁸ In its submission on the Ministerial Review, Meridian stated that it had to deal with around 2,000 line tariffs.

another resulting from Government invoked regulation under the Electricity Industry Bill once it is enacted.

15. If you have any queries regarding this submission please do not hesitate to contact me on 09 308 8259 or robert.allen@mightyriver.co.nz.

Yours sincerely

Robert Allen
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