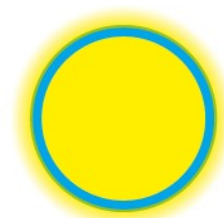


22 December 2009

Kate Hudson
Electricity Commission
Level 7, ASB Bank Tower
2 Hunter Street
Wellington

[By email]

POWERCO



Dear Kate

Distribution Pricing Principles and Information Disclosure Guidelines

1. Powerco welcomes the opportunity to comment on the Electricity Commission's (the "Commission") consultation paper, *Distribution Pricing Principles and Information Disclosure Guidelines* (the "Paper").
2. Powerco generally welcomes the Commission's proposals and believes they will lead to sustainable improvements in pricing methodologies across electricity distribution businesses (EDBs). This process has provided a good example of constructive engagement and debate of the issues between the industry and the Commission.
3. Powerco notes that the Electricity Industry Bill includes a three year provision for the Minister of Energy and Resources to make rules on electricity line tariff structures 12 months after the Electricity Market Authority (EMA) is established (proposed to be October 2010). Powerco's comments in this submission aim to provide a process that will help ensure these regulations are not required.
4. As requested by the Commission, this submission provides feedback on the:
 - a) pricing principles;
 - b) proposed process for distributors to report against the pricing principles; and
 - c) information disclosure guidelines.
5. Thank you for considering the points raised in this submission.

Yours sincerely

A handwritten signature in blue ink that reads "Goodeve".

Paul Goodeve
Regulatory and Business Manager

Response to questions

Q1: Do you agree with the wording of these proposed principles? Please give reasons where you did not agree.

6. Powerco supports the wording of the proposed principles, with two exceptions.

Distribution and transmission alternatives

7. Powerco still has concerns over the wording to “encourage transmission and distribution alternatives”. The Commission has elaborated on the meaning by including in brackets “e.g. distributed generation or demand response”. This is helpful in explaining what the Commission is seeking, although some more guidance is needed.

8. For example, Powerco has a distributed generation policy which follows the pricing principles in the Electricity Governance (Connection of Distributed Generation) Regulations 2007. Will describing this ensure that Powerco meets this aspect of the principle?

9. In addition, Powerco already provides some price signals to encourage demand response, eg Powerco’s wholesale demand charge on our Western Network has a positive effect on demand-side management. Neil Walbran Consulting, on behalf of the Commission found that,

The strongest tariff signals are provided by Orion and Powerco, which include a peak charge as well as a differential energy charge. The signals attempt to provide an indication of the long run incremental cost of new transmission and distribution investment.¹

10. At the moment, Powerco has not developed tariffs for residential advanced meters. The main retailers on Powerco’s network are Genesis, Trustpower and Contact and none of these retailers have started significant roll outs of advanced meters on our electricity footprint. For example, Genesis has a target rollout of 500,000 advanced meters by 2013. It is inefficient for Powerco to develop tariffs that very few customers will use, so implementation of these tariffs will come as the number of advanced meters increases on Powerco’s network.

11. Our main concern is that under Commerce Commission regulation, EDBs may not achieve an adequate return on investment if they persuade customers to reduce electricity volumes. Consequently Powerco is limited in what it can do beyond the above examples.

12. We recommend “to the extent practicable” is added to the principle to recognise this, resulting in the principle that, “C)...(iii) where network economics warrant **and to the extent practicable**, encourage investment in ~~transmission~~ distribution alternatives (e.g. distributed generation or demand response) and technological innovation.”

Economic equivalence across retailers

13. We are uncertain how principle (e) will be interpreted (“Development of prices should have regard to the impact of transaction costs on retailers and should be economically equivalent across retailers”.)

14. It would be very difficult for Powerco to calculate the impact of its pricing on retailers. Instead Powerco would refer to its consultation with retailers and how it has taken their

¹ EC report: Appendix One: Load Management Value and Pricing Report - Appendix Seven: Analysis of Tariff Signals for Managed Load, Neil Walbran Consulting, July 2006

feedback into account on pricing proposals. Further, Powerco would expect to demonstrate that line charges are economically equivalent by having one pricing schedule that applied to all retailers.

15. If the Commission deems this to refer to something else it should specify this. For example, it could mean that any price change (applying to all retailers) must not disadvantage one retailer over another. This would be near impossible to comply with as retailers' customer bases and operating practices differ so much.
16. Powerco recommends that the principle is changed to:

Development of prices should have regard to the impact of transaction costs on retailers and ~~should be economically equivalent~~ **economic equivalence** across retailers.

Q2. Do you support the concept of information disclosure guidelines rather than the more prescriptive methodological requirements?

17. Powerco supports information disclosure guidelines and opposes more prescriptive methodological requirements. The reasons for this are outlined in pages 15 and 16 of Powerco's submission to the Commission on 30 October 2009.

Q3: Do you agree with the wording of these proposed information disclosure guidelines? Please give reasons where you do not agree?

18. The Commission has proposed that EDBs:
- use the current Commerce Commission's information disclosure requirements in disclosing pricing methodologies on 1 April 2010; and
 - use the Commission's proposed information disclosure guidelines from 1 April 2011.
19. The Commission also notes that it wishes to minimise duplication and there is likely to be an iterative process with the Commerce Commission in finalising information disclosure requirements with respect to pricing.

Demonstrating compliance with the principles

20. Powerco generally supports the information disclosure guidelines proposed on page 15 of the Commission's paper, although we have some concerns on wording.
21. The wording of the final instructions of how EDBs should report against the principles is important. We are uncertain of the level of evidence the independent reviewer will require to judge if the relevant principle has been taken into account. Powerco would mainly demonstrate compliance by: explaining how the principles have been considered in pricing; describing the trade-offs; and giving examples as supporting evidence. It would be unrealistic to expect Powerco to provide a formula or model that tracks costs and trade-offs through to prices as there are too many variables to take into account.
22. As an example of level of evidence required, there are a range of techniques Powerco could use to calculate incremental cost and stand alone cost. As the subsidy free zone

is significant, Powerco should not have to invest in extensive modelling and analysis to improve the accuracy of this estimation.

23. An approach could be to deem the marginal cost to equate to the cost to connect a customer from their meter to an electricity line. This was the approach taken by Vector in the Gas Authorisation.
24. To accurately estimate standalone cost Powerco would need to calculate an ODV for each class of customer, which would be a substantial undertaking. Powerco is still considering the most cost effective way to estimate stand-alone costs for classes of customer and recommends the Commission allows for wide estimations.
25. In the Gas Authorisation process the addition of the words “to have regard to” were helpful in providing guidance and recognised the issues with providing information and trade-offs between principles. Showing compliance with the principles required giving genuine attention to consideration to the principles in the pricing process and making decisions, in a transparent manner, which were appropriate and practical.
26. We recommend (b) is changed as follows:

The pricing methodology disclosed should include sufficient information on the following for the independent expert to assess **the extent to which regard has been shown to** ~~compliance~~ the pricing principles [...]
27. We are also concerned about the requirement to provide “an explanation of the cost allocation methodology”. Powerco prefers the text in the Commerce Commission Information Disclosure Requirements, where Powerco has to “23(d) Describe the method by which the disclosing entity allocated the components of the revenue required to cover the costs of its line business activities amongst consumer groups [...]”.

Q4: Do you agree with the proposed process and timetable for reporting? Please give reasons where you do not agree.

Proposal

28. The Commission has proposed that:
 - for the 1 April 2010 financial year, EDBs report against the pricing principles using the current Commerce Act’s information disclosure requirements; and
 - for the 1 April 2011 financial year, EDBs report against pricing principles and the proposed information disclosure guidelines.
29. Powerco is concerned about the feasibility of the timeline. Table One on the following page highlights a number of issues. It compares Powerco’s timeline for annual price changes, the Commission’s proposal, the Commerce Commission’s electricity information disclosure and default price path (DPP) work. The issues Powerco has identified are discussed below.
 - a) *Less than 2 months to produce 2010 pricing methodology*
30. The Commission plans to publish the final pricing principles in February 2010. Powerco’s prices (and methodology are) are finalised at the end of December 2009 (ie we have just finalised the prices for 1 April 2010) and released to retailers at the end of January 2010. The 2010 methodology and prices have been

developed without consideration of the Commission's principles and will contain no changes as a reaction to the pricing principles.

31. This timeline provides less than two months for Powerco to consider the principles and prepare our disclosure. This is insufficient time.

b) Less than 2 months to consider changes suggested by the independent reviewer

32. Powerco aims to begin consultation with retailers six to seven months (ie October 2010 for implementation from April 2011) before price changes take effect. If the independent review's findings are published at the end of July, Powerco has less than 2 months to consider the review's recommendations and develop price changes in response.

33. The Commission has proposed that EDBs respond to the findings of the independent review by 31 August 2010. This increases the workload of EDBs at this time, and further reduces the capacity to take into account the recommendations.

c) The new Commerce Commission information disclosure requirements are unlikely to be published before the input methodologies are finalised in December 2010

34. The Commerce Commission has not published the date for finalising the new electricity information disclosure requirements, so Powerco is uncertain when the new pricing methodology requirements will apply from.

35. We also note that the Electricity Industry Bill will remove the requirement for the Commerce Commission to develop a pricing methodology input methodology if the Electricity Authority develops its own regulations.² The Bill does not change the Commerce Commission's information disclosure scope, so Powerco assumes pricing methodologies will continue to be disclosed to the Commerce Commission.

36. It is clear that the information disclosure requirements will need to be shaped by the input methodology determinations. As these are unlikely to be finalised before 31 December 2010, the pricing methodologies will probably still need to use the current Commerce Commission requirements. This may mean that the second independent review (and final review if no significant changes are suggested by distributors) may not include the Commission's proposed information disclosure guidelines.

Powerco's recommendation

37. To address these issues, Powerco recommends that the first independent review takes place in April 2011. Reviewing the 2010 methodology is a waste of resource as EDBs will have had around a month to explain how the methodology meets the principles and the methodology will contain no changes by EDBs in response to the principles.

38. Powerco has been a supporter of a voluntary principles based approach and agrees with the Commission when it states that, "this is an opportunity for distributors to show that a light-handed approach will result in improvements".

² The bill amends section 52T(1)(b) by inserting after "methodologies" " , except where pricing methodologies are set out in relation to particular goods or services that are subject to regulation by an industry-specific regulator (such as the Electricity Authority).

Unfair judgements will be formed about the effort distributors have made to comply with the principles.

39. The Gas Authorisation process published pricing principles on 30 October 2008, then provided 7 months to develop the methodology and prices (by 1 May 2009). Powerco then made price changes 5 months later on 1 October 2009. Our experience was that this timeline was tight, and a first disclosure of April 2011 is more feasible.
40. We also note that the Electricity Industry Bill includes a provision for the Minister of Energy and Resources to make rules on electricity line tariff structure around October 2011 (12 months after the Electricity Market Authority (EMA) is established, which is proposed to be October 2010). This fits well with a first disclosure to pricing methodologies following the EC guidelines on 1 April 2011.
41. Powerco supports the Commission’s proposal that only two reviews are initially required, and that further reviews should be conducted only where there are significant changes to the methodology. We predict that the earliest opportunity to complete a review using the Commission’s proposed guidelines will be April – July 2012. If the first review takes place in April-July 2011, it follows that the second review should take place in April-July 2013.

Table One: Comparison of timelines

Date	Pricing Process	EC Proposal	Commerce Commission timeline	Powerco proposal
Dec-09	2010 prices finalised			
Jan-10	Begin considering major price changes	Pricing principles published		
Feb-10		Less than 2 months to produce pricing methodology		
Mar-10				
Apr-10	Price change	Publish Methodology using CC requirements	Commerce Commission new information disclosure guidelines unlikely to be published before input methodology determinations	Publish methodology - no review
May-10				
Jun-10	Begin considering minor price changes			
Jul-10		1st Review published by 31 July		
Aug-10		Less than 2 months to make changes before consultation with retailers		
Sep-10	Consultation with retailers on 2011 prices			11 months to consider principles, make changes and consult with retailers
Oct-10				
Nov-10				
Dec-10	2011 prices finalised		Input Methodologies finalised	
Jan-11	Begin considering major price changes			
Feb-11				
Mar-11				
Apr-11	Price change	Publish Methodology - using EC guidelines		Publish methodology
May-11				
Jun-11	Begin considering minor price changes			
Jul-11		2nd Review published by 31 July		1st Review published by 31 July

Date	Pricing Process	EC Proposal	Commerce Commission timeline	Powerco proposal
Aug-11 Sep-11	Consultation with retailers on 2012 prices	Less than 2 months to make changes before consultation with retailers and respond to the EC by 31 Aug		
Oct-11				
Nov-11 Dec-11	2012 prices finalised	Minister may consider making rules	New CC info guidelines released?	20 months to consider recommendations, make major changes if required...
Jan-12	Begin considering major price changes			
Feb-12 Mar-12				
Apr-12	Price change	Publish Methodology - no review unless significant change	DPP: Likely to be Po adjustment	Publish pricing methodology
May-12 Jun-12	Begin considering minor price changes			...consult with retailers and consider new electricity information disclosure guidelines.
Jul-12 Aug-12 Sep-12	Consultation with retailers on 2013 prices			
Oct-12 Nov-12 Dec-12	2013 prices finalised			
Jan-13	Begin considering major price changes			
Feb-13 Mar-13				
Apr-13	Price change			Publish pricing methodology
May-13 Jun-13	Begin considering minor price changes			
Jul-13				2nd Review published by 31 July - only further review if major changes required
Aug-13			Electricity Information Disclosure	
Sep-13	Consultation with retailers on 2014 prices			