

18 December 2009

Electricity Commission
PO Box 10041
WELLINGTON 6143

Dear Sir/Madam

Submission on the Proposed Distribution Pricing Principles and Information Disclosure Guidelines

Following submissions on the earlier consultation papers¹, the Electricity Commission (“the EC”) has released a further Consultation Paper “Distribution Pricing Principles and Information Disclosure Guidelines, December 2009” (“the Consultation Paper”).

This letter forms our submission on the Consultation Paper which has been prepared by PricewaterhouseCoopers on behalf of the following 22 Electricity Distribution Businesses (“EDBs”):

- Alpine Energy Limited;
- Aurora Energy Limited;
- Buller Electricity Limited;
- Counties Power Limited;
- Eastland Network Limited;
- Electra Limited;
- Electricity Ashburton Limited;
- Electricity Invercargill Limited;
- Horizon Energy Distribution Limited;
- MainPower New Zealand Limited;
- Marlborough Lines Limited;
- Nelson Electricity Limited;
- Network Tasman Limited;
- Network Waitaki Limited;
- Northpower Limited;
- OtagoNet Joint Venture;
- ScanPower Limited;
- The Lines Company Limited;

¹ Electricity Commission, Distribution Pricing Methodology, Consultation Paper on a Model Approach, 5 June 2009 and Draft Distribution Pricing Principles and Methodological Requirements Discussion Paper, 30 September 2009

- The Power Company Limited;
- Top Energy Limited;
- Waipa Networks Limited; and
- Westpower Limited.

Individual EDBs which support this submission may have also made submissions on areas of particular interest or importance to them.

Background

1. After considering submissions made on the 5 June 2009 and 30 October 2009 consultation papers, including the PwC submissions made on behalf of 22 EDBs, the EC is now recommending that:
 - A principle based approach is adopted for the model electricity distribution pricing methodology;
 - The EC will publish guidelines to assist distributors to prepare disclosures of their pricing methodology;
 - The EC will initiate periodic independent expert reviews to assess compliance with the pricing principles using the information disclosure guidelines; and
 - If an EDB's disclosure is deemed to be materially non compliant, the EC will seek to persuade the EDB to comply, and will consider direct regulation if there is no improvement.
2. The EDBs which are represented by this submission support these high level decisions. However we have additional comments on how each of these proposals is to be implemented and we address each in turn in the following paragraphs.
3. We also continue to be concerned at the overlap between the responsibilities of the EC and the Commerce Commission (the CC) in respect of distribution pricing methodologies. We raised this issue in our previous submission² and submitted that given the considerable overlap between the legislative obligations of the two Commissions, the requirements on EDBs for pricing methodologies must be consistent and implemented without duplicating compliance processes. In particular one of the Commission's must take responsibility for monitoring of distribution pricing. It is inefficient for the responsibility to be shared.
4. We recognise that both Commissions currently have legislative obligations in this respect however we submit that the Memorandum of Understanding between the Commissions in respect of electricity lines services provides a means for the responsibilities to be effectively assigned to one not both Commissions. We urge the EC to proactively work with the CC to resolve this inefficiency in the regulatory requirements for EDBs.

² PwC, Submission on Draft Pricing Principles and Methodological Requirements, 30 October 2009, Section II

5. We also note that since the release of the Consultation Paper, Cabinet has released the Electricity Industry Bill and the CC has indicated that the timetable for input methodology determinations have been extended until the end of 2010. Both of these announcements have implications for distribution pricing. It is therefore not appropriate in our view, for the EC to implement new requirements on distributors in respect of their distribution pricing before the consultation processes associated with the Electricity Industry Bill and the CC Input Methodologies have progressed. We include further comments on the proposed timing of the EC's proposals in the remainder of this document.
6. In this respect however we note that we endorse in principle the EC's recommendations outlined in paragraph 1 above, and will be supporting these recommendations in our consultations with the CC, Select Committee and the MED in 2010.
7. The remainder of our submission is structured as follows:
 - Pricing Principles
 - Information Disclosure Guidelines
 - Pricing Methodology Review
 - Other Issues.

I Pricing Principles

8. After considering submissions on the pricing principles, the Consultation Paper now sets out a modified set of principles. The proposed modifications are shown with mark ups in the following table which also includes our comments and suggested amendments to the proposed principles (in double mark up).

Proposed Principle	Comment
<p>(a) <i>Prices are to signal the economic costs of service provision by:</i></p> <p><i>(i) being subsidy free (equal to or greater than incremental costs, and less than or equal to stand alone costs) except where subsidies arise from compliance with legislation and/or other regulations;</i></p> <p><i>(ii) having regard, to the extent practicable, to the level of available service capacity; and</i></p> <p><i>(iii) signalling, to the extent practicable, the impact of additional usage on future investment costs.</i></p>	<p>We support the proposed amendment which clarifies that compliance obligations may distort economic pricing signals.</p> <p>We note that government policies in respect of the obligation to supply uneconomic customers, changes to rural and urban prices, distributed generation regulations and low user charges prevent distributors from developing and implementing prices which are fully consistent with the economic cost of service principle. This is a fundamental limitation on the effectiveness of the pricing principles.</p>
<p>(b) <i>Where prices based on "efficient"</i></p>	<p>We support the proposed deletion. The</p>

<p><i>incremental costs would under-recover allowed revenues, the shortfall should be made up by setting prices in a manner that has regard to consumers demand responsiveness (i.e.: Ramsey pricing) and/or the quality of service they receive, to the extent practicable.</i></p>	<p>additional information is not required as it is inconsistent with a principle approach and there are limitations to applying Ramsey Pricing in practice which make this example inappropriate. The removal of reference to quality of supply is also supported as it is adequately covered in principle (c).</p>
<p>(c) <i>Provided that prices satisfy (a) above, prices should be responsive to the requirements, and circumstances of users stakeholders in order to:</i></p> <p><i>(i) discourage uneconomic bypass, and</i></p> <p><i>(ii) allow for <u>negotiation to better reflect the economic value of specific services</u> and enable stakeholders to make price/quality trade offs or non-standard arrangements for services;</i></p> <p><i>and</i></p> <p><i>(iii) where network economics warrant, encourage investment in transmission distribution alternatives (eg distributed generation or demand response) and technology innovation.</i></p>	<p>We support the use of the term “stakeholders” rather than “users” throughout the principles, which is a more inclusive term. We do not support however the continued reference to “price/quality trade-offs” or “non-standard arrangements”. Neither of these terms is defined (or the implied alternative “standard arrangements”) and they may mean different things to different EDBs or stakeholders. We believe the existing wording ‘economic value of specific services’ is sufficient. It is also more valid, as it links the service requirement to its value, which is the appropriate principle to underpin pricing. The concept of negotiation is also useful, as it reflects the reality of setting service standards for those consumers which are able to consider possible alternatives. We do not support the inclusion of the proposed principle (iii). These concepts are already covered by other forms of regulation. The CC is developing explicit regulatory mechanisms to address energy efficiency, to ensure EDBs are not disincentivised from investing in energy efficiency initiatives. Distributed generation is adequately covered by the Distributed Generation Regulations and inclusion of this requirement in a pricing methodology principle is confusing, excessive and creates potential inconsistencies in the regulations applying to EDBs. Distribution alternatives and technology innovation are not objectives which are readily achieved through pricing methodologies, but they are objectives which</p>

	<p>can be disincentivised by overly prescriptive regulation.</p> <p>Innovation, including possible distribution alternatives, is best dealt with through the price-quality path and is being explicitly considered by the CC as it develops its efficiency carry over mechanisms and CPI-X regime. In addition the uneconomic bypass requirement in (i) already addresses this requirement.</p>
<p>d) Development of prices should be transparent, promote price stability and certainty for users, stakeholders, and lead to prices that are able to be understood by users changes to prices should have regard to the impact on stakeholders.</p>	<p>There is no need for the transparency requirement which is superfluous as this is what the disclosures themselves will achieve. We support the remaining amendments as transitioning new pricing structures is an important component of any pricing methodology.</p>
<p>e) Pricing structures should not place undue transaction costs on retailers and consumers, Development of prices should have regard to the impact of transaction costs on retailers and should be competitively neutral economically equivalent across retailers.</p>	<p>We support the proposed changes which remove previous ambiguity and focus on the concept of “economically equivalent” rather than “competitively neutral”.</p>
<p>f) Prices and pricing structures should promote efficient usage of electricity and encourage investment in distributed generation (including renewable generation), distribution alternatives and technology innovation.</p>	<p>We support the removal of this principle as these objectives are better met using other forms of regulation and place undue limitations on distributors’ ability to recover their costs, including the recovery of investment in sunk assets.</p>

II Information Disclosure Guidelines

9. We support the proposal to abandon the proposed methodological requirements which are inconsistent with a principle approach to distribution pricing methodologies. As we previously submitted any guidance on pricing methodologies must be consistent with the Electricity Distribution (Information Disclosure) Requirements (IDRs) as prescribed under Part 4 of the Commerce Act 1986.

10. The Consultation Paper proposes the following in respect of information disclosure guidelines for distribution pricing methodologies:
 - For the pricing period commencing 1 April 2010, EDBs disclose pricing methodologies consistent with the **new** pricing principles (to be published in February 2010) using the **existing** information disclosures requirements set out in Requirement 23 of the IDRs
 - For the pricing period commencing 1 April 2011, EDBs disclosed pricing methodologies consistent with the **new** pricing principles (to be published February 2010) using **new** information disclosure guidelines to be published by the EC in February 2010. EDBs will also be required to publish pricing methodologies consistent with the **existing** Requirement 23 of the IDR.

11. The proposed compliance process is unworkable because it will not be possible for EDBs to disclose pricing methodologies consistent with the new pricing principles by 1 April 2010. If this project is to add any real value to the electricity market, distributors must have time to consider the new principles, review their existing pricing methodologies, make changes to their existing pricing methodologies to better reflect the new principles if necessary, consult with consumers and other stakeholders, develop a transition plan, and draft and publish a new pricing methodology. This is not something that can be, nor should be, achieved by the beginning of the next pricing period on 1 April 2010.

12. The principles will not be published at the time EDBs are required to notify their prices for the coming year to Retailers. EDBs are already well advanced in developing their prices for the pricing year commencing on 1 April 2010. It is not possible to retrospectively impose new principles into this process and accordingly the first pricing methodology disclosures consistent with the new principles must be, at the earliest, for the pricing period commencing 1 April 2011. This timetable also allows for the consultations on the Commerce Act Part 4 Input Methodologies and the Electricity Industry Bill to have progressed.

13. Pricing methodology disclosures for the 1 April 2010 pricing period should continue to be disclosed according to the provisions of Requirement 23 of the IDRs. The preparation of these disclosures is already well advanced as EDBs are close to finalising their prices for the forthcoming period.

14. We note the Model Use of System Agreement published by the EC³ includes specific notification periods for EDBs wishing to change a pricing methodology, as follows:

9.2 Process to change pricing methodology: When the Distributor contemplates a change to its pricing methodology which may result in the introduction of a new Price Category or the closure of an existing Price Category the following process shall be followed:

³ Electricity Commission, Model Use of System Agreement - Interposed, Consultation Draft, April 2008

- (a) *Advise the proposal: the Distributor will notify the Retailer of its proposed changes and rationale and invite the Retailer to provide written comments within [20] Working Days of such notification;*
- (b) *Notify submissions and responses: Prior to disclosure of the pricing methodology under clause 9.2(d), the Distributor will provide the Retailer with a summary of any submissions received and its response to them;*
- (c) *Consider certain matters: The Distributor will develop its final pricing methodology and prices, and in doing so it shall:*
 - (i) *have regard to the pricing principles in schedule 8; and*
 - (ii) *consider in good faith all matters relevant and available to it in developing its views, including the submissions and information made available during the process set out in this clause;*
- (d) *Disclose pricing methodology: upon developing the final methodology, the Distributor will Publish its final pricing methodology and prices and reasons for its decisions.*

9.3 *Notice of price adjustment: The Distributor will give the Retailer written notice (and notice by email, where email is not an agreed method of notice under clause 28.2(d) of this agreement) of any price adjustment as specified below:*

- (a) *Existing pricing methodology: in the case of new prices calculated using an existing pricing methodology, [40] Working Days written notice;*
- (b) *New pricing methodology: in the case of new prices calculated using a new pricing methodology, [60] Working Days written notice.⁴*

15. The suggested notification periods set out above provide for 20 working days (ie: approximately a month) consultation with the Retailer where changes in tariff structures are proposed and then a further 40 – 60 working days (ie: approximately two –three months) advance notice of the new tariffs, depending on the nature of the change.
16. Accordingly, consistent with the requirements of the EC's own Model Use of System Agreement, EDBs will be unable to disclose pricing methodologies consistent with the new principles which are to be published in February 2010 for the pricing period commencing on 1 April 2010.
17. In addition, the proposed process for disclosure and the associated guidance to be provided for distributors is problematic. We do not support both the EC and the CC preparing information disclosure guidance for this purpose. Given the first disclosures consistent with the new pricing principles will be able to be made, at the earliest by 1 April 2011 there is sufficient time for the EC and the CC to work together and align their disclosure requirements for pricing methodologies. In our view this should form part of the Input Methodology consultations currently being undertaken by the CC.

⁴ [] indicate terms which may be negotiated between EDB and retailer when agreeing the UoSA.

18. In particular we are concerned about the proposed process set out in paragraph 4.1.6 in the Consultation Paper:

Provided that the information sought by the Commission is the same as the information submitted by distributors to the Commerce Commission with respect to the information disclosure, in an effort to avoid duplication, the Commission would get a copy of the information from the distributor's website. If further information is required the Commission would seek the information directly from distributors.

19. The proposed information disclosure guidelines however are different to those included in Requirement 23 of the IDRs. Thus, the information proposed to be sought by the EC will be different to that submitted to the CC. We note that Clause 149 of the Electricity Industry Bill 2009 intends for the CC to take into account provisions or decisions made by the Electricity Authority in respect of pricing methodologies or associated guidelines. This suggests the proposed process set out above, could be readily simplified by closer alignment of the CC's pricing methodology requirements with those of the Electricity Authority.

20. We note the proposed new Guidelines contained in the Consultation Paper are notably different to the requirements set out in the IDR. The following table illustrates the similarities and differences.

Commerce Commission, Requirement 23, IDRs	Electricity Commission, Proposed Information Disclosure Guidelines
[No equivalent requirement]	(a) Prices should be based on a well-defined clearly explained and published methodology, with any revisions notified and clearly marked.
(a) Describe the methodology used to calculate the prices charged or to be charged;	(b) The pricing methodology disclosed should include sufficient information on the following for an independent expert to assess compliance with the pricing principles, including: (i) how the methodology links to the pricing principles and any non-compliance;
(b) Include the key components of the revenue required to cover costs and profits of the disclosing entity's line business activities,, including cost of capital and transmission charges, which must include the numerical value of each of the components;	(iii) quantification of the key components of costs and revenues (also below)
(c) State the consumer groups used to	(ii) the rationale for consumer groupings

<p>calculate the prices charged or to be charged, including:</p> <ul style="list-style-type: none"> (i) The rationale for the consumer grouping; (ii) The method by which the disclosing entity determines which group the consumers are in (iii) For each of these consumer groups, the statistics relating to that group which were used in the methodology 	<p>and the method for determining the allocation of consumers to the consumer groupings</p>
<p>(d) Describe the method by which the disclosing entity allocated the components of revenue required to cover the costs of its lines business activities amongst consumer groups, which must include the numerical values of the different components allocated to each consumer group and the rationale for allocating it in this manner</p>	<ul style="list-style-type: none"> (iv) an explanation of the cost allocation methodology and the rationale for the allocation to each consumer grouping (iii) quantification of the key components of costs and revenues (as above)
<p>(e) Describe the method by which the disclosing entity determined the proportion of its charges which are fixed and the proportion which are variable, and the rationale for determining the proportions in this manner.</p>	<p>[No equivalent requirement]</p>
<p>[No equivalent requirement]</p>	<p>(v) pricing arrangements that will be used to share the value of any deferral of investment in distribution and transmission assets with the investors in alternatives such as distributed generation or load management, where this is practicable.</p>
<p>[No equivalent requirement]</p>	<p>(c) The pricing methodology should</p> <ul style="list-style-type: none"> (i) employ industry standard tariff formats and nomenclature, where possible; and
<p>[No equivalent requirement]</p>	<ul style="list-style-type: none"> (ii) where a change to the existing pricing methodology is proposed, describe the details of the impact on consumer classes and the transition arrangements proposed to mitigate the effect of redistribution of costs and “rate shock”.

21. This suggests that it is unlikely that distributors will avoid two sets of pricing methodologies disclosures, unless one or other set of guidelines or requirements is changed significantly before the proposed new guidelines come into effect. As noted above, we strongly oppose duplication in the pricing methodology compliance

requirements on EDBs and therefore do not support the proposals, unless the inconsistencies between the two sets of guidelines are resolved and eliminated.

22. In respect of the proposed guidelines themselves we have included our comments and suggested amendments (in mark up) on the proposals in the following tables:

Electricity Commission, Proposed Information Disclosure Guidelines	Comments on Proposed Guidelines
(a) Prices should be based on a well-defined clearly explained and published methodology, with any revisions notified and clearly marked.	This is superfluous and we do not support its inclusion. This is the disclosure requirement, ie: to publish a methodology and any revisions to it. It should not form part of the guidelines.
(b) The pricing methodology disclosed should demonstrate: include sufficient information on the following for an independent expert to assess compliance with the pricing principles, including:	This also is not an appropriate inclusion in a set of guidelines. This is a process issue not guidance of relevance to the methodology itself.
i) how the methodology links to the pricing principles and any non-compliance;	The term non compliance is ambiguous and unnecessary. There will be a legislative requirement for the pricing methodologies to comply with the principles. Any assessment of non compliance will occur following independent review, not by the EDBs themselves.
ii) the rationale for consumer groupings and the method for determining the allocation of consumers to the consumer groupings	We support this component of the Guidelines
iii) quantification of the key components of costs and revenues	It is the allocation of costs to consumer groups which is required to support a pricing methodology, not revenues. Revenues are the outputs of the prices (and associated quantities).
iv) an explanation of the cost allocation methodology and the rationale for the allocation to each consumer grouping	We support this component of the Guidelines
v) an explanation of the derivation of the tariffs to be charged to each consumer group and the rationale for the tariff design	The proposed guidelines miss the step in the pricing methodology which converts cost allocation into tariffs, for each customer group.
v) pricing arrangements that will be used to share the value of any deferral of investment in distribution and	We do not support this requirement, as we do not support the proposed principle (c) (iii) for the reasons outlined previously. In addition,

<p>transmission assets with the investors in alternatives such as distributed generation or load management, where this is practicable.</p>	<p>the sharing of any investment deferral benefits arising from distributed generation typically forms part of a commercial contract negotiated between the distributor and the generator. It is not appropriate for the details of such contracts to be publicly disclosed. This is adequately covered by the Distributed Generation Regulations (refer Schedule 4 Pricing Principles)</p>
<p>(c) The pricing methodology should: (i) employ industry standard tariff formats and nomenclature, where possible; and</p>	<p>There is no definition of what these are and no discussion of these in the Consultation Paper. This cannot therefore be complied with and should be removed, unless further clarification and direction is provided.</p>
<p>(ii) where a change to the existing previous pricing methodology is proposed implemented describe the details of impact on consumer classes and the transition arrangements proposed implemented to mitigate the effect of redistribution of costs and “rate shock” introduce the new methodology.</p>	<p>Reference to proposed changes should be removed. The purpose of the disclosure is to document the methodology to be applied. The words “details of” are also superfluous. We also do not support the phrase ‘mitigate the effect of redistribution of costs and rate shock’ as we do not believe this is consistent with the proposed principle which is that ‘changes to prices should have regard to the impact on stakeholders’. We do not believe this principle requires mitigation of price shock per se. Prices may increase or decrease and there may be reasonable justification for large changes in some instances for example a change in service requirements.</p>

III Pricing Methodology Review

23. The EC proposes that periodic reviews of pricing methodology disclosures are undertaken to assess compliance. We support a review process to assess compliance, identify best practice and assist EDBs to improve their disclosures. We agree that it will be unnecessary to undertake reviews every year, and agree with the suggestion that following an initial review of all disclosures, reviews may be limited to those EDBs which implement significant changes to tariff structures and pricing methodologies.
24. We do not support however the suggestion that the first review would be a benchmarking exercise. It is not an appropriate objective for the review report to publish a ranking or league table of pricing methodologies. Pricing methodologies will by necessity be descriptive and contain a significant amount of explanatory information. They will also

necessarily reflect the particular circumstances facing each distributor including existing tariff structures, transition arrangements and network characteristics and challenges. We therefore do not support a relative assessment which will require subjective judgements. We do support identification of best practice and areas for improvement. This is where the value will be added to the industry. Not through a subjective league table.

25. We also do not support the proposed timing of the initial review. For the reasons outlined above the pricing principles can only be incorporated into pricing for the 1 April 2011 year for the first time. Therefore the first review can only occur in 2011 at the earliest, not 2010 as suggested in the Consultation Paper.
26. We support the intention for the EC to attempt to persuade EDBs to improve compliance where areas of non compliance or poor compliance are identified during a review.

IV Other Issues

27. The Consultation Paper also acknowledges a number of related issues raised by previous submissions. We support the EC's initiative in facilitating a working group and look forward to the recommendations concerning:
 - wash-ups
 - tariff complexity
 - unaccounted for electricity⁵
 - common terminology.
28. We are perplexed however by the comments in paragraph 16 of the Executive Summary of the Consultation Paper regarding the number of distribution businesses and in particular the statement that suggestions that distributors should be amalgamated are matters of government policy. We are aware of no such policy and request that the EC clarifies its comments in this regard.

⁵ As stated in our previous submission, it is important that the EC recognises, and endorses that EDBs are entitled to recover from retailers the full costs of the transportation of unaccounted for energy.

If you have any queries in relation to this submission, please contact either of the signatories below.

Yours faithfully



Lynne Taylor
Director
Advisory



Craig Rice
Partner
Advisory