



2 November 2021

Rob Bernau
Director
Network Pricing Directorate
Electricity Authority

Tamara Linnhoff
Senior Advisor

Dear Rob and Tamara,

Electric Kiwi supports distribution pricing reform

Electric Kiwi continues to support distribution pricing reform. We have appreciated the way Authority staff have engaged with us on the draft revised Practice Note and distribution pricing reform consultation.

In our recent submission in response to the “Updating the regulatory settings for distribution networks” consultation paper, we commented “Electric Kiwi considers that ensuring network pricing is cost-reflective is the most important element of the potential regulatory interventions detailed in the consultation. This is one of the elements that fits most squarely in the domain of the Electricity Authority”.¹

We are impatient to see change; particularly given the pace at which the Electricity Authority is requiring Transpower to develop a new TPM which is orders of magnitude more complex than the expectations it has laid out for electricity distribution pricing reform.²

At the 18 October workshop, distributors raised the issue that some of the larger retailers were resistant to reform, including on the grounds they didn’t have systems in place to deal with electricity distribution pricing reform or new pricing signals. We do not believe distribution pricing reform should be held ransom to the lowest common denominator and interests of incumbent, legacy, electricity retailers. We urge distributors to move forward with the reforms. Pricing reform doesn’t require all electricity retailers to respond to be a success.

The issue of retailer pass-through is an undesirable distraction

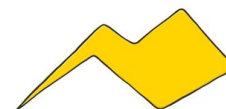
At the workshop there were also some suggestions the Authority should consider regulating retail prices to mandate pass-through of distribution pricing signals. We are not aware of any basis on which the Authority could impose price control at the retail level,³ but it is an option wholly incompatible with operation of a competitive electricity market. It was particularly surprising it was raised given the well traversed problems with existing pricing regulation, i.e. the Low User Fixed Charge, which both retailers and distribution companies have lobbied to remove.

Leaving aside these fundamental issues, any coherent argument in support of retail price control also requires advocacy of regulation of distribution pricing methodologies.

¹ Given some of the comments in the DER consultation paper, it appears the Authority doesn’t consider electricity networks have sufficiently strong incentives to improve efficiency, and to find lowest cost options (which could include tariff reform to avoid or delay investment in network capacity), which is something it may wish the liaise with the Commerce Commission over.

² Relevant to Question 5.

³ We queried this at the workshop.



We note the inherent incompatibility of applying voluntary regulation to monopoly distribution pricing, but regulated price control to competitive retail pricing. What this would effectively mean is that distributors would be able to prescribe how retailers in their network area set prices i.e. the distributor would become the de facto regulator.

The focus of network pricing reform should be on benefits to consumers from incentivising efficient consumption behaviour

We reiterate we are very supportive of cost-reflective distribution pricing, which will enable greater retail innovation to drive appropriate consumer behaviour:⁴

- Network pricing should reflect that the primary driver for network cost and investment is network capacity. Network pricing should signal the cost of potential future investment needs. Cost-reflectivity should be the key criterion.
- The work the Climate Change Commission has done – particularly its consideration of potential electrification of the economy – highlights that if peak load growth is not managed it could result in significantly higher/inefficient network capacity investment/network pricing. We agree with the Climate Change Commission, for example:⁵

Efficiency improvements can also reduce electricity use at peak times – in the mornings, evenings and in winter. Reducing demand at peak times helps the entire energy system as there is less need to upgrade electricity lines, which can reduce costs for all households. Scaling these benefits would require technologies for demand response, and innovative business and pricing models. Electricity pricing incentives, such as low-cost night rates, combined with smart charging technology could be effective.

- Electricity distributors should not shy away from complex, cost-reflective pricing. The price signal needs to be in a form that retailers can manage and respond to, though, in order to be effective.

Price risk can be managed by electricity retailers on consumers' behalf. For example, we continue to support the adoption of Coincident Peak or Maximum Demand (CMD) Pricing but this does not mean we think it should necessarily be reflected in end-consumer pricing (particularly at the residential level).⁶

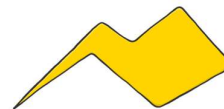
The pending removal of permanent peak, RCPD, charges from the TPM is a backward step for distribution network pricing reform as it will inefficiently suppress distributor peak or capacity pricing signals (reflecting the LRMC of distribution only, and not the entire electricity network LRMC).

- If retailers see cost-reflective pricing some will innovate to get the maximum engagement from their customers in minimising distribution costs. Some retailers may choose not to engage customers but, ultimately, this will undermine their competitiveness if other retailers end up with lower (distribution) cost bases.

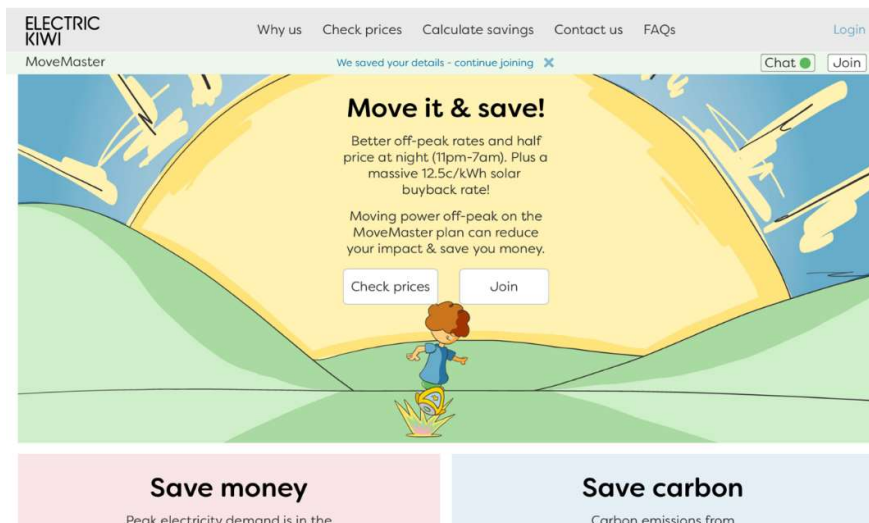
⁴ We have provided our last submission on this topic is part of the current submission given the heavy overlap of issues and questions the Authority has raised: Electric Kiwi, Delivering better distribution pricing for consumers, 19 February 2019.

⁵ Climate Change Commission, Inaia tonu nei: a low emissions future for Aotearoa, 31 May 2021.

⁶ Our previous submission detailed that we consider "Coincident Maximum Demand (CMD) pricing is the most cost-reflective pricing methodology option" and "should be prioritised".



We aren't simply 'billing agencies' that pass-through network pricing⁷. Faced with CMD type pricing, for example, we would likely manage the pricing uncertainty on behalf of our consumers and the benefits to us and our consumers from promotion of time-of-use (TOU) pricing would be increased.⁹



One size does not fit all, but this doesn't mean each distributor should develop novel bespoke pricing arrangements

We support the Authority's 'clarification' that the appropriate/most efficient form of network pricing depends on expected load/peak load growth e.g. a network facing static or declining growth with plenty of capacity should prioritise use of fixed charges, while a network with high growth would benefit from application of peak/congestion pricing.

While we agree 'one size doesn't fit' nor do we want to see each distributor setting novel and bespoke pricing. The draft Practice Note highlights distributors should fit into a small range of categories (relating to network growth and capacity) for which standardised 'off the shelf' solutions could be developed; particularly for the benefit of the smaller distributors.

There is no 'right' answer to network pricing

We also support the approach the Authority has adopted of not prescribing a particular 'right answer' in the Practice Note though this should be made clearer and explicit.

⁷ See our 19 February 2019 submission. We previously detailed that electricity retailers are not billing agents for distributors and have a role in managing price risk for consumers, and noted our support for the EA view that:

The Authority does not see there is a particular efficiency reason why prices should be passed-through. Instead, pass-through could stifle the economic efficiency of the electricity sector because it reduces consumers' choice on how to manage price risk, and eliminates a dimension on which electricity retailers can innovate and compete for customers. ...

The vast majority of consumers, especially residential consumers, are on 'fixed price-variable volume' tariffs. That suggests that most residential consumers want some degree of protection from volatility in the prices they pay for electricity. This may be because they are risk averse or do not want to actively manage their use.

Consumers themselves are in the best position to decide on the level of risk or active management they prefer. ...

⁹ <https://www.electrickiwi.co.nz/movemaster/>



The Authority should also explicitly recognise different pricing approaches have different advantages and disadvantages, and should more overtly recognise the trade-offs between static and dynamic efficiency.^{10,11} Given the Authority's predominant focus on economic efficiency it would be helpful if this discussion was couched in terms of SRMC v LRM. ¹²

The draft Practice Note does not presently make these trade-offs clear, resulting in seemingly contradictory statements such as that "At times it may be appropriate to send a price signal where no current congestion or network need is evident, but the distributor's network understanding and trend analysis suggests that it will be required in the coming years" (which implicitly recognises the efficacy of LRM pricing) versus "any time in this paper we refer with approval to a peak charge or TOU pricing (or any other price signal), we are referring to such a price signal that is required due to actual / imminent network congestion" (which advocates an alternative short-run approach).

While the approach the Authority is taking is intended to avoid telling distributors how to set prices, and to recognise there are a number of legitimate approaches to network pricing (there is no 'right answer'), the draft Practice Note comes across as unduly jaundiced against time-of-use (TOU) pricing, and appears to have a preference for short-term peak or congestion prices that reflect "actual /imminent network congestion". The latter is evident based on the legitimate distributor concerns raised at the workshop. Based on comments at the workshop, it appears many distributors consider a longer-term approach to peak or congestion pricing is more beneficial and practicable, and pricing based on "actual /imminent network congestion" is too theoretical and would be too late to be useful or effective.¹³

We support this view of distributors, especially given the implementation of short-term peak or congestion pricing signals has much greater complexities and can easily get muted due to these complexities. If a short-term constraint cannot be effectively communicated to a retailer in a way that enables demand response then there is little value in the pricing signal and the distributor will be better placed to manage the supply constraint itself.

'[H]ow complex is too complex' is the wrong question

Instead of asking 'how complex is too complex', it would be better to consider what forms of complexity are unnecessary, inefficient or otherwise undesirable. Complexity in pricing structure to be cost reflective is fine. Complexity in implementing these price signals to retailers is not.

Our previous submission detailed that "Electricity retailers are not billing agents for distributors and have a role in managing price risk for consumers" and "It is important to recognise the distinction between network prices, and the retail tariffs end-consumers ultimately face".

The Authority and distributors should also be careful to consider complexity in the relation to electricity retailers and what they should be able to understand and manage, rather than end-consumers,¹⁴ including

¹⁰ Some of what the Authority describes as "Bad price signalling" may, for example, reflect trade-offs between static efficiency (the implicit focus of the Authority commentary) and dynamic efficiency.

¹¹ Relevant to Question 4.

¹² The Authority could, for example, draw on the content of its LRM Working Paper and related material.

¹³ Setting a pricing signal that reflects "actual / imminent network congestion" may theoretically score best from a short-term static efficiency perspective, but setting more predictable and enduring pricing signals will enable greater responsiveness (including in investments that can managed or reduce peak-usage).

¹⁴ With the exception of The Lines Company given they directly charge end-consumers. We noted previously that "One of the mistakes The Lines Company made was pricing to end-consumers directly, thereby preventing electricity retailers from managing the price risk its distribution pricing created on consumers' behalf."



small businesses and residential consumers. The Authority and distributors should not rule out pricing options because they may be 'too complex' for end-consumers. We are aware, for example, of distributors adopting capacity-based charges (which we applaud) but not extending this pricing to residential consumers.

We reiterate, the Authority should be cautious to avoid overstating the importance or benefit of simplicity:

The key criteria for distribution pricing should be that they are cost-reflective, and pricing approaches should be made as complex as they need to be.

Translating these prices into simple and effective retail prices is a source of retail innovation. As retailers see cost-reflective distribution pricing they will innovate and compete to get demand response from their customers in ways that minimise distribution and wholesale energy costs.

Legacy IT systems at some retailers shouldn't be allowed to hold the industry back based on an argument that these legacy systems are expensive to modernise. The industry and consumers should not settle for less efficient price signals and higher total costs so that some retailers can avoid investing in forward-looking technology.

Electricity distributors should aim to reduce the number of tariffs

An area where there is low-hanging fruit opportunity to reduce unnecessary complexity/transaction costs is the number of distribution tariffs. The benefits of tariff reduction could be particularly high in New Zealand given the large number of electricity distributors.

Electricity distributors should be mindful that there is likely to be little or no efficiency benefit in highly granular tariff setting, or in having low numbers of customers in some for mass market tariffs. There is particularly little value in granular tariffs where the principle function is simply to recover sunk or fixed costs in a non-distortionary manner. In fact our view is that multiple tariffs indicates an inherent lack of cost reflectivity.

The Authority's distribution pricing reform and 'scorecard' monitoring should include tracking of the number of tariffs (including for mass market/residential) each electricity distributor has, ranked against the number of customers they have and the spread of customer numbers on each individual tariff.

Next steps

The Authority appears to have given a lot of weighting in its rankings for roadmaps and plans for cost-reflective pricing. Whilst this may be appropriate at the early stages of the expected reform process, the Authority should rapidly shift its weighting from the merit of planned reform programmes, to actual reform and changes to distribution pricing. A distributor can have the best plan in the country but it isn't worth much if they lag behind their peers in pricing reform.

The Authority and distributors should also consider how pricing reform is co-ordinated and communicated given there are 29 electricity distributors. For example, if we compare TOU (with a clear set of pricing signals that are telegraphed well in advance) with Orion's peak demand charging, the weakness is about how they let retailers know when they want customers to reduce load. Technology is advancing to better enable communication of capacity constraints but if different methods are used by each of the 29 distributors significant inefficiencies will appear and pass-through of pricing signals is likely to be compromised.

The Authority should also consider making Asset Management Plan forecast growth/capacity expansion expenditure a more explicit part of its 'score-card' when assessing each distributor's pricing

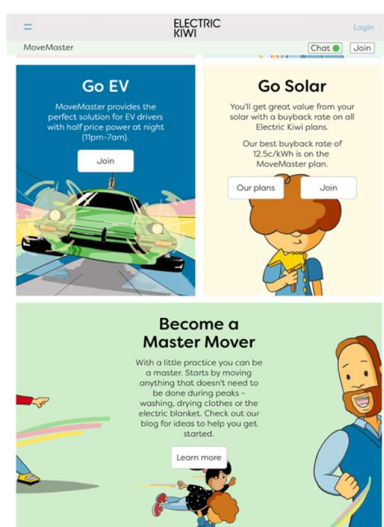


methodology/pricing reform strategy. This could include grouping each of the electricity networks into the Figure 4 and 5 growth categories.

Closing remarks

Electric Kiwi entered the New Zealand electricity retail sector in 2015 to challenge the status quo, pushing aside conventional retail offers and thinking. While problems in the wholesale electricity market have stifled our growth plans, Electric Kiwi's focus is on retail innovation and driving consumer behaviour to promote cost reflective savings to those engaged.

We have recently introduced an off-peak Move Master plan aimed at consumers with electric vehicles, solar and/or are able to consume electricity during off-peak.



Electric Kiwi also offers an electricity load shifting product, one hour of free off-peak power every day, and this has resulted in copy-cat pricing behaviour e.g. Contact Energy adopting 3 hours of off-peak electricity. This is analogous to the experience in the cellular telecommunications market where innovation from 2degrees, e.g. offering lower prices/treating Australia and New Zealand as part of the same market for pricing purposes, data roll-over etc, has been copied by the incumbents.

The emergence of a thriving competitive retail market would allow similar dynamics to become the norm. Retailers that don't innovate and take advantage of the potential cost savings from responding to network pricing signals should, in a workably and properly competitive market, ultimately become less cost competitive and lose customers.

Yours sincerely,

Luke Blincoe
Chief Executive, Electric Kiwi Ltd
luke.blincoe@electrickiwi.co.nz
+64 27 601 3142