



MAJOR ELECTRICITY USERS' GROUP

10 July 2009

Bronwyn Christie
Electricity Commission
By email to submissions@electricitycommission.govt.nz

Dear Bronwyn

Submission on Proposed Model Approach to Distribution Pricing Methodology

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Commission (the "Commission") paper, "*Distribution Pricing Methodology – Consultation paper on a model approach*," dated 9th June 2009¹ (the "consultation paper"). This submission focuses on the details of implementing the pricing methodology and the specific questions asked by the Commission. MEUG responses to the questions in the consultation paper are set out in the appendix.
2. MEUG is also a signatory to a separate submission by the Consumer Coalition on Energy (CC93). The CC93 submission comments on the following higher level issues:
 - The Commission needs to recognise that regulation needs to be, amongst other things, in the best long-term interest of end consumers;
 - There are other key principles that need to be considered in addition to the guiding principles in the consultation paper;
 - There is a strong case for a mandatory default approach rather than continuing with a voluntary approach; and
 - The next steps in improving regulation of distribution pricing and other contract terms and conditions will need to consider changes in regulatory institutions that may arise from the Ministerial Review of the Electricity Sector.
3. MEUG fully support the CC93 submission.

Yours sincerely

Ralph Matthes
Executive Director

¹ Refer <http://www.electricitycommission.govt.nz/consultation/distrib-pricing/view>

MEUG comments on Electricity Commission consultation paper, Proposed Model Approach to Distribution Pricing Methodology

Consultation paper question	MEUG submission
<p>1. Do you agree with the content of these proposed guiding principles? Are there alternative or additional guiding principles that should be considered?</p>	<p>Paragraph 2.1.4 of the consultation paper notes “the Commerce Commission has primary responsibility for ensuring both the composition and level of prices are efficient.” The consultation paper notes that the Electricity Commission has been tasked with the specific work to develop model distribution pricing. Nevertheless MEUG believes the primary role of the Commerce Act needs to be considered. Therefore we suggest the guiding principles should also align and support the Purpose statement in s.52A of Part 4 of the Commerce Act, ie:</p> <p>“The purpose of this Part is to promote the long-term benefit of consumers in markets referred to in section 52 by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services—</p> <ul style="list-style-type: none"> (a) have incentives to innovate and to invest, including in replacement, upgraded, and new assets; and (b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and (c) share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and (d) are limited in their ability to extract excessive profits.” <p>If the s.52A Purpose Statement of Part 4 of the Commerce Act is taken into account, then paragraph 5.51 (a) of the consultation paper would include additional criteria for a model distribution pricing methodology such as:</p> <ul style="list-style-type: none"> ▪ Reflect the quality and price trade-off demanded by consumers (refer Commerce Act s.52A (b)); and ▪ Be sufficiently transparent and detailed to ensure prices do not contain excessive profits (refer Commerce Act s.52A (d)).
<p>2. Do you agree that the Retail Delivery Model (RDM) should be the preferred approach?</p>	<p>MEUG agrees that the regulated pricing approach for electricity distributors should be based on the Retail Delivery Model rather than the Wholesale Delivery Model (WDM).</p> <p>Improvements in meter, control and communications technology throughout the electricity supply chain will allow better cost-reflective-pricing to be introduced for all classes of consumer. RDM is likely to be a better approach than WDM in facilitating smarter pricing and price-quality trade-offs at an individual end consumer level thereby assisting uptake of smart meter and smart grid technologies.</p>

3.	<p>Do you agree with the proposed approach to the allocation of costs (as set out in figure 4 and table 2)? Please provide specific comments on:</p> <ul style="list-style-type: none"> - load dependent costs - load independent costs, including: <ul style="list-style-type: none"> - Geographic zones - Asset groups - load group classifications - AMD and CPD to allocate the network asset group costs to load groups - transmission costs 	<p>MEUG assumes costs attributable to dedicated bi-lateral contracts are excluded from this allocation methodology. The pricing methodology should make this clear.</p> <p>The allocation methodology needs to have a mechanism to ensure distributors do not subsidise the costs of dedicated bi-lateral contracts that are un-economic.</p> <p>Load dependent could infer load means energy transported over a year. MEUG suggest the phrase “capacity dependent costs” would better match the primary goal of cost-reflective-pricing.</p> <p>Paragraph 3.4.3 of the consultation paper notes “distributors must ensure that, as set out in the GPS, any changes to rural line charges are kept in line with changes to urban line charges.” MEUG sees no reason why the rate of change in distribution prices should be the same between rural and urban zones if the rate of change in costs differs.</p> <p>The pricing methodology should be sufficiently transparent and detailed to allow an end consumer in each load group to validate their share of:</p> <ul style="list-style-type: none"> - Operating costs; - Maintenance costs; - Overhead costs; - Capital costs comprising: <ul style="list-style-type: none"> - Post-tax capital charge; - Tax charge (including interest tax shield); and - Depreciation and write-offs. <p>This would require disclosure ahead of each pricing year of each of the above forecast costs for each load group and the allocator(s) to be used to each individual consumer in each load group.</p> <p>This level of transparent has been published by Transpower in the past. For example² Transpower disclosed all of the above cost components for the HVAC Connection, HVAC Interconnection and HVDC assets ahead of the transmission pricing year ending 31 March 2008.</p> <p>In addition to the above, the pricing methodology should require distributors to disclose how transmission loss and constraint rebates received from Transpower are allocated.</p>
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² Refer http://www.transpower.co.nz/f1210.148662/148662_appendix-k-pricing-grid-connection-services-2007.pdf

4.	Do you agree with the proposed approach to allocating the net benefits of deferred network augmentation?	<p>MEUG supports the work by Transpower on Grid Security Contracts and the proposal in the consultation paper (paragraphs 9.7.1 to 9.7.2) that similar contracts should be considered by distribution companies.</p> <p>The consultation paper has no proposed approach to allocate Grid Security Contract type arrangements entered into by distributors and therefore MEUG cannot comment on allocation methodology. In principle though beneficiary consumer classes of such contracts should be allocated the costs. If the Distribution Grid Security contract only benefits a certain class of consumer, such as rural consumers, then the costs of the Distribution Grid Security contracts should be allocated to rural consumers.</p>
5.	Do you agree with the proposed approach to signaling critical peak periods and shoulder periods via distribution prices?	MEUG agrees with the price signaling proposal (paragraph 10.4.1) except for the reference at the end of paragraph 10.4.1 (b) to "prices based on the deferral value of the network investment" being signaled only to consumers with controllable demand. The reason for MEUG seeking removal of this text is discussed in response to question 7 below on the proposed discriminatory pricing of Long Run Average Incremental Cost (LRAIC) to Time-Of-Use (TOU) metered consumers only.
6.	Do you agree with the approach to structuring distribution prices?	MEUG agrees with the proposed price structure in paragraph 10.5.1(a).
7.	Do you agree with the model structure? Are there reasonably practicable alternatives?	<p>The proposed requirement in paragraph 11.3.2 (c) that only TOU consumers should be charged, "A variable critical peak period price component that reflects LRAIC, which is charged on demand in excess of the capacity to which the fixed capacity price component relates" will hinder dynamic efficiency compared to either:</p> <ul style="list-style-type: none"> ▪ Removing this charge altogether; or ▪ Charging all classes of consumer an excess contract capacity charge. <p>For example assume the capacity charge to recover existing sunk assets is \$100/kW. All classes of consumer should be charged this amount. If the next forecast increment of capital to meet demand growth is going to cost \$150/kW (ie the LRAIC) then that price signal should be given to all consumer classes that exceed existing peak contract levels deliverable by the existing assets. If TOU consumers are charged \$150/kW for exceeding current contract levels and non-TOU consumers are charged only \$100/kW, then TOU consumers will change future investment plans and behaviour to avoid those higher costs whereas non-TOU consumers will not. Only when both TOU and non-TOU consumers pay the same \$150/kW charge for demand in excess of contracted capacity will pricing signals maximise dynamic efficiency.</p> <p>It may be that as of today only some TOU consumers can actually change demand in response to peak charges. However unless all consumers receive the same cost-reflective-price, there will be no incentive on consumers that do not have an ability to respond to peak prices to invest to do so in the future.</p> <p>There is also an argument that signaling \$150/kW ahead of assets being built is speculative and to the extent the forecast LRAIC is below or over the actual needed future investment costs there will be inefficient over or under investment by end consumers respectively. What's known for certain is the current regulated asset base for assets actually used. This is the pricing approach by Transpower. There is no speculative charge for as yet to be built assets.</p>

8.	Do you agree that the proposed model approach meets the guiding principles appropriately?	As noted in responses above, MEUG suggest the guiding principles and pricing approach and structure require changes. Therefore MEUG does not agree that the proposal is appropriate.
9.	Do you agree this is an effective and practicable approach to monitoring uptake? Are there alternatives that are more effective and practicable to implement?	<p>The consultation paper proposes distributors self-report differences in their pricing methodology compared to the model approach published by the Commission. This would commence one year after the Commission published a final model pricing approach.</p> <p>Experience has shown that a voluntary approach to distributors following and reporting compliance with model pricing and model contracts has been abysmal. For example paragraph 1.3.3 of the consultation paper reports that only 4 of the 28 distributors responded to a Commission request for information on changes in pricing methodology since 2005 and progress in implementing the Pricing Approaches Working group (PAWG) recommendations.</p> <p>We see no change in the external environment that will result in a change the behaviour of distributors to volunteer information and self-report more than at present. Accordingly MEUG supports the proposal by CC93 that distributor pricing methodologies and related contract terms and conditions should be mandatory. CC93 suggest a default set of requirements with exceptions allowed for existing regulatory agreements with then Commerce Commission and should the distributor agree and consumers accept terms and conditions more favourable to achieving the goal of being in the best long-term interest of end consumers.</p> <p>A mechanism similar to the implementation of the mandatory transmission Benchmark Agreement³ as a default contract should be considered by the Commission.</p>

³ Refer Electricity Governance Rules, Part F, Schedule F2, <http://www.electricitycommission.govt.nz/pdfs/rulesandregs/rules/rulespdf/PartFSectionIIIScheduleF2-17January2008.pdf>