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By email: submissions@ea.govt.nz

ERANZ submission on More Efficient Distribution Pricing consultation paper

The Electricity Retailers Association of New Zealand (ERANZ) welcomes the opportunity to provide feedback on the Electricity Authority's (the EA's) 11 December 2018 consultation paper on its proposal to amend its Distribution Pricing Principles and monitor and rate the efficiency of distributors' prices and their progress on price reform.

Electricity distribution is critical to the electricity industry meeting the expectations of its customers. The consequences of distributors' investment decisions are ultimately borne by end consumers, with sub-optimal investments and / or decisions not to invest manifesting as higher prices, reduced quality, or both. Distribution pricing is a key input that will materially affect investment decisions by incentivising (or not) efficient electricity use by customers.

As the customer-facing part of the industry, retailers' reputation and brand, as well as costs, are tied to the quality and cost of distributors' service provision.

This consultation coincides with a time of increased scrutiny of the electricity industry. The Government's Electricity Price Review (EPR) is underway and has focussed attention on the drivers of electricity costs for consumers. In addition, there is a strong focus on the role the electricity sector can play to help New Zealand move to a low carbon economy. Getting distribution pricing right is crucial to achieving these goals.

We have structured our submission to align with the questions raised in the consultation paper, although we have not addressed all questions.

Q1 – Do distributors need to reform their prices?

Yes. ERANZ agrees that distribution network pricing need to change. We have been advocating tariff reform for several years.

Most pricing methodologies currently used by EDBs are heavily weighted towards consumption. Consumption charges making up around 80 percent of EDB revenue.

Consumption-based pricing fails to reflect the costs the EDBs face. EDBs costs are largely fixed in nature rather than varying with the level of consumption. Further, a simple per kWh charge does not signal the times, location, and extent of network congestion.

While consumption charges may be easy for consumers to understand they do not incentivise the efficient use or supply of electricity. This will lead to inefficient investment by both distributors and consumers, and therefore cause net economic costs to society.

ERANZ agrees with the EA that the expected increased uptake of new technologies such as electric vehicles and solar panels will increasingly exacerbate this issue. For example, current consumption-based distribution pricing serves to encourage over-investment in solar panels.

Solar panel installations enable a household to significantly reduce its distribution consumption charge, despite still requiring a connection to the grid and using electricity at peak times. A kWh charge means these households therefore pay a disproportionately small portion of network costs, which will push a greater proportion of network costs onto consumers who do not use these technologies.

This can create the perverse outcome of those on low incomes (and less likely to be able to afford to invest in solar panels or other capital-intensive distributed generation technologies such as batteries), effectively cross subsidising the wealthy who can afford to invest, and by doing so, avoid network charges.

Q2 – How urgent are reforms?

Delay will mean consumers pay more over the long-term.

It is now three years since the EA released its paper '*Implications of evolving technologies for pricing of distribution services*' which identified the costs to New Zealand of current pricing structures as \$3 to \$5 billion NPV and potentially driving a 10% increase in bills (30% in distribution charges) by 2025¹.

Deferring action on pricing reform risks all customers being worse off due to total future network costs being higher than necessary. While a move to cost reflective pricing structures will create short-term winners and losers, current pricing structures also do this, favouring high peak usage customers, and customers that can minimise their overall consumption (such as those with solar PV).

¹ <https://www.ea.govt.nz/development/work-programme/pricing-cost-allocation/distribution-pricing-review/consultations/#c15642>

ERANZ believes therefore that reform needs to proceed with more vigour. We are supportive the EA's proposals to increase scrutiny on the speed of change being undertaken by distributors.

However, we would also caution that pricing reform carries significant risk if it is poorly executed. ERANZ wants to note the importance of allowing enough time for effective implementation once reforms are decided upon by distributors. Many of the proposed changes represent a fundamental change to distribution pricing and retailers will need a reasonable amount of time to make the changes required implement them.

It is also important also that consumers receive a sufficient heads up about reform, to inform decisions they make now. This will need to come from retailers as only they are in a position to give consumers information on what the changes may mean in the context of their total electricity bill.

ENA is currently setting up a pan-industry working group (including retailers) which will build on the work carried out by the joint EDB-Retailer technical implementation working group (TIWG) to develop and agree an industry wide roadmap for cost reflective distribution tariff reform. The expectation is that the agreed industry roadmap produced by the working group will define the appropriate timeframes needed for implementation of system changes, consultation and rule changes.

Given the importance of tariff reform and the concerns around progress, ERANZ suggests that the EA has an observer attend these working group meetings to get a better understanding of the progress the industry is making on implementation issues, the levels of participant engagement and ambition, and the likely timeframes required for effective reform implementation.

Q3 + 4 – Distribution pricing principles

ERANZ is broadly supportive of the updated principles proposed by the EA. As the consumer-facing part of the electricity industry, retailers are keenly aware of the need to ensure potential regulatory changes are assessed or their impact on consumers.

It is encouraging to see the inclusion of a principle that 'consumers should be able to know or predict prices they will face when making decisions to connect to or use the network'. However, we are concerned that the star ratings suggest this principle has less importance than others. The complexity of some of the potential pricing structures should not be under-estimated. Pricing structures which provide sufficient alignment with costs, such that the promised benefits and efficiencies of pricing reform are captured, should be the key focus. It is also important that consumers are able to understand new pricing structures.

ERANZ understands the ENA's new pan-industry road-map working group will assess the likely time and costs required to technically implement each of the various pricing structures proposed. This information should quantify transaction costs of the various options and enable and cost-benefit assessments to be made.

Q5 – Proposed star-ratings

ERANZ welcomes the EAs proposal to include a rating system to assess the quality of distribution pricing.

As per our feedback to question three, we consider there is a need to ensure new pricing structures are simultaneously efficient and understood by consumers. It is important that the EA brings this perspective into its ratings assessments of specific charges.

Q6 – Time required by distributors

As discussed in question two, the outcomes of the pan-industry distribution tariff reform working group will provide an accurate assessment of likely implementation time-frames. ENA's proposed scope of the working group has the final report from the working group at the end of April 2019. As above, we would suggest the EA request that has an observer on the working group to provide it with an overview of progress.

Q7 – Is the LFC regulation a barrier?

While it is clear from submissions to recent electricity price review that there is widespread support (including ERANZ and its members) for the removal of the LFC, we do not believe EDBs need to wait for its removal before proceeding with distribution tariff reform.

It could take several years to reach agreement on how to implement a removal of the LFC. Given the costs and risks associated with delaying reform as discussed in question two, ERANZ recommend reform should proceed regardless.

Other feedback

ERANZ strongly agrees with the EA that it should be optional for retailers to pass on distribution pricing changes to customers. Retailers provide a range of products depending on the demands of consumers. Some consumers are willing to pay to be shielded from price fluctuations – and retailers provide products that allow them to do that.

Thank you for your consideration of this letter. Tariff reform is a complex matter and ERANZ is happy to meet with the EA at any time to discuss any aspects in detail. ERANZ can also arrange and facilitate joint meetings between the EA and our members as required. We look forward to continuing to work with the Electricity Authority for the benefit of the sector and the long-term interests of consumers.

Yours sincerely



Cameron Burrows
Chief Executive