19 February 2019

Jean-Pierre de Raad
Acting Network Pricing Manager
Electricity Authority
PO Box 10041
Wellington 6143

By e-mail: submissions@ea.govt.nz

Dear Jean-Pierre,

Delivering better distribution pricing for consumers

There is a need for urgent action on distribution pricing reform.[1]

Electric Kiwi is very supportive of cost-reflective distribution pricing, which will enable greater retail innovation to drive appropriate consumer behaviour.

Debate over distribution pricing has been ongoing from the Electricity Commission era. While the incumbent retailer views have remained constant over this time, focusing on a desire for standardisation and simplification,[2] Electric Kiwi wants to be more than a mere 'billing agent' for distributors. We are open to managing more dynamic and complex forms of pricing and can make our own judgements about what this translates to for end-consumer tariffs.

Summary of Electric Kiwi's views

- We share the Electricity Authority's desire to see distributors hurry up and get on with pricing reforms.
- The focus of network pricing reform should be on benefits to consumers from incentivising efficient consumption behaviour. Cost-reflectivity should be the key criterion.
- The pricing principles should continue to recognise the primary driver for network cost and investment is network capacity. Network pricing should signal the cost of potential future investment needs.
- Electricity distributors should not shy away from complex, cost-reflective pricing. Price risk can be managed by electricity retailers on consumers' behalf.

[1] This view is reflected in the joint independent retailer (Electric Kiwi, Flick Electric, Pulse Energy and Vocus) submissions to the Electricity Authority on its 2019/20 work priorities, and to the Electricity Price Review.
[2] As reflected in incumbent retailer submissions to the Electricity Commission from a decade ago, and in response to ENA consultation in 2016: ENA, New Pricing Options for Electricity Distributors: A discussion paper for industry feedback, November 2016.

- The importance of simplicity should not be overstated. Let retailers package pricing for consumers.

- Distributors shouldn't attempt to prescribe terms under which pricing is available. Any such prescription will inevitably hamper innovation and risks distributors trying to back winners.

- Coincident Maximum Demand (CMD) pricing is the most cost-reflective pricing option. CMD should be given the highest star-rating. We consider CMD pricing to be superior to Time of Use (TOU) pricing.

- Network pricing should not discourage consumers using the network heavily at times when overall network load is low. Anytime Maximum Demand (AMD) is not a cost-reflective mechanism for the mass market and should be given a low star-rating.

- In seeking stakeholder engagement the Authority needs to be even handed and not assume any organisations are proxies for any industry segment. The views of ERANZ and its incumbent membership are NOT a proxy for retailer views, despite ERANZ purporting to represent 99.5% of retailers by market share. It is clear incumbent retailers hold conservative views about distribution pricing, aimed at preserving simplicity and protecting legacy IT systems.

ERANZ cannot be used as a proxy for retailers and does NOT represent independent retailers

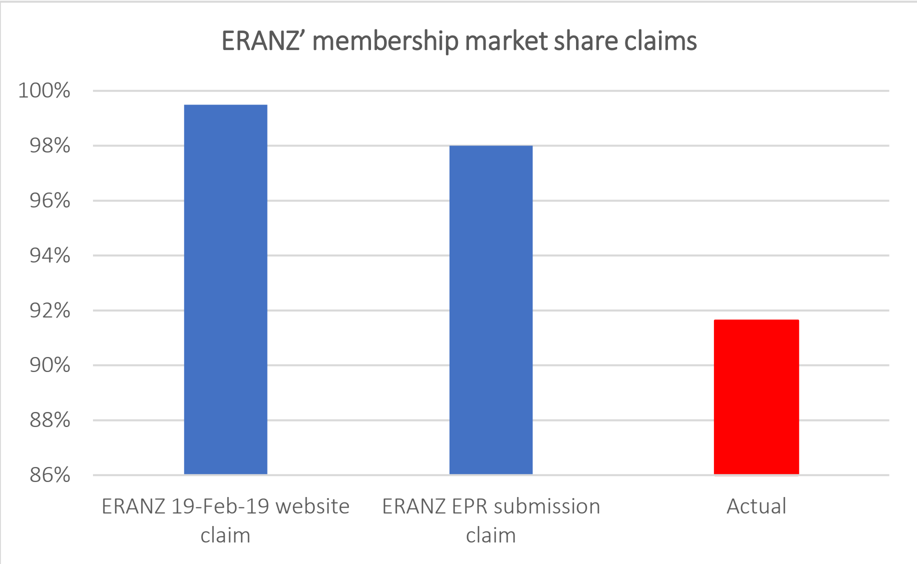
For the avoidance of doubt, engagement with ERANZ, and ERANZ' membership, is not a proxy or substitute for engagement with retailers. We understand some of the ENA and Electricity Authority engagement has been specifically with ERANZ to the exclusion of other retailers.

It is independent retailers who are driving pricing innovation, including our own 'free hour' of electricity. Incumbent retailers are likely to take a more conservative view focused on simplicity and standardisation, and protection of their legacy IT systems.

ERANZ represents the incumbent retailers' view only, as is reflected in their membership. The Electric Kiwi, Flick Electric, Pulse Energy and Vocus joint submission on the 2019/20 work programme commented on ERANZ' misrepresentation of its membership. ERANZ continues to make the false claim "Members represent 99.5% of the customer base in New Zealand across a range of companies and their brands" on its website. ERANZ' membership actually represents 91.63% market share as at 31 January 2019,[3] and is declining.[4] Electric Kiwi's market share alone makes ERANZ' 99.5% claim impossible.

[3] https://www.emi.ea.govt.nz/Retail/Download/DataReport/CSV/R_MSS_C?_si=v|4

[4] The inaccuracy of ERANZ' claims were first pointed out in comment on the Energy News article "New ERANZ chief executive named", 25 September 2018. While Energy News corrected the market share figure, ERANZ has continued to persevere with its claims.



Electricity retailers are not billing agents for distributors and have a role in managing price risk for consumers

It is important to recognise the distinction between network prices, and the retail tariffs end-consumers ultimately face.

Electric Kiwi agrees entirely with the Electricity Authority about the role electricity retailers can play in managing end-consumer price risk:

> 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. …

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.

Distributors should not attempt to prescribe how retailers design propositions or whether certain propositions qualify a retailers access to pricing, rather, create the incentives and let competition drive consumer engagement and innovation.

A couple of distributors, e.g. WEL Networks and Counties Power, who have recently introduced TOU charges have said that they will only allow TOU pricing if a certain set of criteria are met. This includes needing to offer a higher price for at least x hours that overlap with their peak period. It is not the distributors' role to dictate to retailers how to structure their pricing. It should be up to retailers to decide how they package distribution pricing, otherwise it stifles innovation and competition.

It follows that the Electricity Authority is correct to reject "mandated retail pass-through". Such proposals are misguided, and aren't in distributors' own interests, let alone retailers' or end-consumers' interests.

One of the core functions of a retailer is to manage risk and complexity for their customers, mandating pass-through of distribution pricing is no different to mandating pass-through of wholesale energy costs, which we have seen can have unintended consequences for consumers.

Access to timely and accurate data with respect to the distribution charges will be a key determinant in the ability of retailers to deliver innovative products, and manage this price risk. Retailers should be provided with access to network peak forecasts in order to incentivise residential customers to shift or reduce load at these times.

Cost-reflectivity should be the key criterion

Electric Kiwi strongly believes cost-reflectivity should be the key criterion or pricing principle. Any pricing approaches that are limited in their contribution to this key criterion should be discounted.

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, they won't remain competitive if other retailers end up with lower (distribution) cost bases.

Retailers will be forced to pass on the savings to customers due to competitive pressures. Retailers may not pass on the charges verbatim but will experiment and test the market to see what consumers will respond to. This is a problem well suited to the innovation and competition in retail market.

Electricity distributors should not necessarily try to solve the problem of what consumers will respond to as part of this process. Cost-reflective pricing should be the focus and will mean retailers will be sent the right signal to encourage new products that engage consumers in the right ways. If retailers don't encourage customer engagement they will be surpassed by those who do.

Don't overstate the importance 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.

Coincident Maximum Demand (CMD) pricing is the most cost-reflective pricing methodology option (this should be reflected in high star ratings)

Pricing options like CMD should be prioritised. CMD approaches align signals at the customer level with network peaks. If electricity distributors send retailers cost-reflective CMD price signals it doesn't necessarily follow that retailers will show similar prices to consumers (for example, like The Lines Company has done with poor public relations consequences). Indeed, this is an appropriate risk for retailers to manage internally. A core competency of a retailer is wholesale risk management, and this can extend to distribution pricing.

Electric Kiwi would take the approach of modelling and forecasting the charges, just as it does for wholesale energy prices, and translate the price signals we see into a forward-looking product we think consumers will understand and respond to. Electric Kiwi would have no problem dealing with a CMD charge and believe it may be the most cost-reflective.

The ENA has pointed out that the primary driver for network cost and investment is network congestion.[5] In Electric Kiwi's view this means pricing approaches which provide the strongest customer signals at times of network congestion must form the primary component of distribution pricing for most customers. We believe these are CMD and to a lesser degree ToU and this should be reflected in these options being given the highest star ratings (and in the Pricing Principles).

Using a forward-looking TOU approach Electric Kiwi is already seeing customers shifting an average of 4% of their winter evening peak load into off-peak periods.

Don't discourage consumers using the network heavily at times when overall network load is low - Anytime Maximum Demand is not a cost-reflective mechanism for the mass market

Anytime Maximum Demand (AMD) <u>discourages</u> consumers using the network heavily when coincident network demand is low, and the marginal cost of consumption is near zero. This is inefficient and not cost-reflective. The consultation paper is silent on what star rating AMD would get, but we consider it warrants a very low rating.

A reality of load shifting given today's technology and consumer lifestyles, which Electric Kiwi is observing amongst its customer base, is that consumers typically take action once a day to shift load. For example, someone may delay using the dishwasher, dryer and washing machine during the evening peak if sent the right signal. But they will then turn all of those appliances on at once in an off-peak period. This response is good for the network but consumers behaving like this could be penalised under AMD.

Demand response is likely to rely mainly on these manual interventions by consumers for at least the next 5-10 years until smart appliances penetrate the market to a higher degree. It is not realistic to expect consumers to drastically change their lifestyle, rather simple changes that are cost reflective of any effort to consider electricity usage.

[5] ENA, New Pricing Options for Electricity Distributors: A discussion paper for industry feedback, November 2016.

Simplistic Peak Customer Capacity pricing approaches, such as AMD should be options only for secondary pricing approaches where customer capacity is a strong driver on network costs i.e. low density, high distance lines.

Pricing for imports and exports

There is broad consensus that over-time storage will play a significant role in our electricity sector and some of this will be behind the meter. It may be possible for households with batteries to be net exporters during peak network times, and this should be encouraged. An efficient pricing methodology should reward exports at peak network times and not just penalise consumption. This would help ensure investments behind the meter are efficient.

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. Electric Kiwi's focus is on retail innovation and driving consumer behaviour to promote cost reflective savings to those engaged. Since inception Electric Kiwi has seen strong growth with a customer base which is now over 35,000 customers nationwide.

Electric Kiwi offers an electricity load shifting product, one hour of free off-peak power every day. As consumers start to understand the product, correlated with monetary savings free off-peak power provides, load shifting into off-peak periods has consistently remained at 4% since 2015. This shows that long-term customers continue to see the value of the free hour of off-peak power and do not lose interest or motivation over time to shift load.

Electric Kiwi welcome changes to distribution pricing methodologies and supports forward-looking distributors nationwide in crafting more cost-reflective pricing, thus enabling greater retail innovation to drive appropriate consumer behaviour.

In terms of the Electricity Authority's proposals:

- We support cost-reflective network pricing (which can mean different things in different contexts), and consider that the Pricing Principles should retain the existing focus on signalling future investment costs;

- Any pricing signal should be "Actionable" (using ENA terminology), so that price risk can be managed. As the Electricity Authority has noted "distribution prices only lead to efficient outcomes if network users can act on them". This doesn't necessarily have to be by the end-consumer. Managing price risk and translating distribution prices into simple and effective retail prices is a source of retail innovation.

- We consider that CMD should be given the highest star rating, and AMD pricing should be given a very low star rating.

- We would like to be confident that distributors are adopting sound stakeholder and consumer engagement processes and is even-handed. A dialogue between ERANZ and ENA is neither of the above.

Yours sincerely,

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