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More efficient distribution prices - what do they look like?

Genesis Energy Limited (**Genesis**) welcomes the opportunity to provide a submission to the Electricity Authority (the **Authority**) on the consultation paper, "More efficient distribution prices - what do they look like?" (**Consultation Paper**).

Genesis understands the Consultation Paper proposes amendments to the Distribution Pricing Principles (the **Principles**) and monitoring and rating of electricity distribution businesses (**EDBs**) in their progress towards more efficient pricing. We support this work and agree with the Authority that delivering more cost-reflective pricing is necessary for efficient investment. With a high level of technology disruption expected and a need for investment in electricity systems to meet future demand growth, distribution pricing reform is well overdue.

Ultimately the success of cost reflective pricing structures in delivering efficient investment will be measured on how well price signals connect with consumers and influence behaviour. Therefore, we would urge the Authority to elevate considerations around simplicity and practicality in the Principles and in the assessment of price structure options. Our view is that billing systems capabilities and consumer understanding of pricing drivers will be key success factors to delivering the signals for efficient investment and should not be treated as a secondary consideration.

We also note that customer impact has minimal mention within the Consultation Paper. Genesis' concern for the customer is not only centred on the short-term transition impact, i.e. price shock, but also the potential for vulnerable customers to bear higher costs under the new pricing structures. Greater transparency and in-depth impact assessments are necessary if we are to limit unintended consequences and maintain customer confidence in the electricity industry.

Urgency should not compromise a well-managed transition

Genesis is aligned with the Authority on the view that moving to more cost-reflective pricing is important to keep long-term prices low. As we stated in our Electricity Price Review submission, we are concerned that EDBs have been slow to adopt more efficient pricing and this is causing distortions that will most likely lead to suboptimal investments by consumers, EDBs and retailers.[1] It is therefore pleasing to see the Authority providing guidance on pricing structures that will enable efficient investment, as well as driving more urgency through monitoring and rating the progress of individual EDBs.

However, as the Authority is aware, there will be winners and losers as EDBs transition to the new tariff structures. If the transition pathway is not transparent or leads to unexpected bill shocks, the industry will face increased scrutiny and criticism from consumers. As a retailer, Genesis has a direct relationship with its customers and therefore we support the Authority's proposal to improve the current EDB consultation process with retailers, including providing guidelines on the format for pricing reform roadmaps.

It would be useful if the roadmaps included analysis on how various customer profiles are expected to be impacted by the changes as they roll through. This will enable us to identify whether additional safety nets are needed to support customers experiencing 'energy hardship'. Additionally, it would be useful to understand how an EDB implementing a new pricing structure is going to address situations where retailers do not have the data required for billing the new pricing tariff. For example, our Energy Online brand does not currently receive customers' half hourly data.

We also recommend the Authority maintains an eye on whether further support is needed for some EDBs through the transition, as they attempt to balance long-term efficiency goals with short term consumer impacts, such as price shock. As we have raised in other submissions, there are various projects impacting distribution pricing occurring concurrently and we are concerned not all EDBs may have the capability to sufficiently assess the impact of price changes on various customer segments.

Reduce complexity and increase practicality to strengthen pricing signals for customers

When considering distribution pricing, the question for Genesis, as a retailer, is how do we get the best platform for developing innovative products and tariffs that meet consumers' varied needs. We are encouraged that the Authority recognises EDBs are pricing to retailers, rather than the end consumer and that retailers can re-package these prices as they see fit. For example, a retailer may determine its customers would prefer an additional discount for shifting load out of peak periods, rather than being directly charged for peak time prices.

We would encourage the Authority to take a step further and include "low complexity" in the Principles to *enable* retailer innovation and drive efficiency. As we have called for in many of our previous submissions, distribution tariffs must be rationalised. Greater standardisation of distribution tariffs, which are simple and practicable, will provide the right platform for innovation, will reduce unnecessary operational costs and will increase the likelihood that retailers can appropriately reflect distributor price signals to their customers with minimal repackaging.

Additionally, we believe that a broader view of what constitutes effective pricing is needed when assessing the various structures considered in the Consultation Paper. Bearing in mind, the objective is not about having the best economic model but to achieve the strongest signals for efficient investment and, therefore, practicality is an essential element of pricing design. For this reason, our view is that time of use (**TOU**) pricing should rate higher than 2 stars, recognising that it is implementable in current systems with current data and is infinitely better than a flat variable rate at reflecting congestion.

[1] Genesis Energy submission on Electricity Price Review – First Report.

While the Authority has indicated an initial preference for demand based usage tariffs, Genesis wishes to highlight our significant concerns with the practicality and complexity of these tariff structures, as follows:

- New systems and processes to collect and invoice consumers based on demand data would be needed across the industry. This goes against the Principles regarding limiting unnecessary cost.
- The consumer understanding gap is significant. Improving energy literacy is a priority for Genesis, however it is our experience that even flat kilowatt hour charging for usage is a concept foreign to many of our customers. Consequently, demand tariffs would likely need to be significantly repackaged by retailers, muting the signal.
- Dynamic demand is unpredictable, which is not aligned with the Principles.
- The introduction of a spot market is not sufficient for retailers. We would need a forward market in which to hedge distribution prices. Further, a core principle of hedge markets is that there is competing bids which is unachievable in the monopoly distribution sector.

We understand that the Consultation Paper was intended to be future facing, looking at what the ideal pricing structure would be in the face of no limitations. We are also aware that what is seen as impossible now could very easily change as technology develops. However, it is important that the Authority recognises transitioning to TOU pricing in distribution is a huge step from where we are now and requires significant changes to be made by EDBs, retailers and the Authority to implement effectively. We expect that TOU pricing is sufficient to achieve the efficient investment goals and the benefits of moving to demand based tariffs are likely to be outweighed by the additional implementation costs.

We also note that the experience of The Lines Company (**TLC**) illustrates the unintended consequences that may result when the infrastructure to manage a complex pricing structure is not in place and consumers do not understand how their prices are derived. TLC have recently reversed their demand pricing as they found that the systems and processes used to derive demand were instead distorting price signals and aggravating consumers.

Priority should be given to the split between fixed and variable when rating EDBs on efficiency

We agree with the Authority that, for EDBs to attain cost-reflectivity, the first step is to understand cost drivers; i.e. what costs are driven by usage and which are fixed. In our view, a large part of the current distortion in distribution pricing comes from the very fact that pricing is predominantly variable but the majority of network costs are fixed. Section 6.7 of the Consultation Paper proposes that equal weight is given to each component of the tariff structure, however, in light of the fact that agreed estimates put 80% of distribution costs as fixed and 20% variable[2], we do not believe this is appropriate. Instead EDBs should be rated for how well they split the costs between fixed, variable and other, and ratings should be weighted to align with the cost breakdown.

Currently the main driver of this mismatch between cost and price is the Low User Fixed Charge (**LUFC**). It is the LUFC that drives the extreme variabilisation of the bill, even though a large portion of costs are fixed. This puts extra unnecessary pressure on household winter bills and drives higher returns on solar investment.

The Consultation Paper mentions that the LUFC regulations only apply to residential customers, who account for only part of electricity consumed on distribution networks[3]. Residential consumers are just one segment but

[2] Refer to the Consultation Paper section 6.14

[3] Refer to the Consultation Paper section 4.18

it is a segment that is largely responsible for the winter evening peak and hence a large contributor to aggregate energy demand. When we consider the majority of large industrials are already charged on a TOU basis, which is arguably far more efficient than the flat variable rate used in smaller use segments, it is actually residential pricing that should be the key focus for distribution pricing reform.

Accordingly, it is our view that the Authority is underplaying the influence of the LUFC on the ability of EDBs to adopt more cost-reflective distribution pricing and should be advocating for its removal.

EDBs have access to the data they need

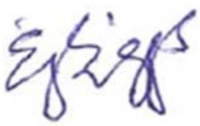
We are aware that several EDBs are resisting transitioning to more cost reflective pricing, saying they have limited access to the data needed and it is retailers standing in their way. Genesis is unclear why EDBs do not contract directly with metering equipment providers, particularly if they can justify that having such data would improve the service and / or cost of the service they provide.

It is correct that retailers contract to obtain some of this data and, we agree, it is unreasonable that customers should bear the cost of this data being collected twice. However, it is not cost free for retailers to provision data to an EDB either. Retailers only collect data they require to bill or deliver services to their customers and this is in a format that suits their unique billing system, which in most cases, does not meet the requirements of EDBs.

Further, data should only be exchanged with regard for the regulatory and contractual obligations that permit the use of data. This is why the data access provisions being proposed in the Default Distribution Agreement are of utmost importance. These provisions ensure that there is adequate clarity and transparency of the reason(s) for data requests relating to distribution of electricity and that customer privacy is respected and adequately protected. Retailers have a clear responsibility to adequately protect their customers personal information. If an EDB refuses to provide this level of transparency and assurance when requesting access to consumers' personal information, it cannot be a surprise that retailers decline these requests.

If you would like to discuss any of these matters further, please contact me by email: eleanor.briggs@genesisenergy.co.nz or by phone: 09 951 9350.

Yours sincerely



Eleanor Briggs
Group Manager Strategic Projects

Appendix A: Responses to Consultation Questions

Question	Response
Q1 Do you agree that distributors need to reform their prices? What is the reason for your answer?	Yes, current tariff structures do not reflect distribution cost drivers. Please refer to our cover letter.
Q2 How important and urgent are the issues identified by the Authority?	Genesis' view is that distribution pricing reform is urgent for the reasons given by the Authority in the Consultation Paper.
Q3 Do you agree with the proposed Distribution Pricing Principles?	Complexity in distribution pricing is a significant issue for Genesis and our view is that Principle (c) should be expanded to include simplicity and standardisation of tariffs. Otherwise, we agree with the Principles as they stand.
Q4 What if any changes would you recommend are made to the proposed Distribution Pricing Principles, and why?	See answer to Q3.
Q5 What if any changes would you propose to the star-ratings to better reflect the relative efficiency of distribution prices?	As per our cover letter, we recommend two refinements to the ratings: 1. Practicality should feature more strongly as we consider it on par with cost-reflectivity. If a new tariff structure is difficult to implement and consumers have limited understanding of how their behaviour links to their new pricing, progress will be delayed and signals will be muted. 2. The ratings given should assess an EDB's split between fixed and variable pricing, and the how closely that split reflects their cost base. Although a tariff may be weak on its own, in combination with other tariffs the shortcomings could be mitigated; i.e. TOU pricing may be a weaker signal for congestion, however if the majority of price is for access to the network and charged as contracted capacity overall the tariff structure would be strong.
Q6 How long do you think distributors would reasonably need to introduce the different price structures discussed above?	It is not only EDBs that face implementation change. Retailers and the Authority (via the Registry and mandated format changes) will also be impacted. We note an industry group has been recently tasked with determining these timeframes.

Q7	Can you illustrate how and to what extent the LFC regulation hinders price reform?	The LUFC regulation limits the ability of new tariffs to be cost-reflective. It is the LUFC that drives variabilisation of prices, which is inherently mismatched to distribution costs which are largely fixed. For an average customer on the LUFC tariff over 90% of their lines price is likely to be variable, compared to only 20% of the cost being variable. This is where the largest distortion in distribution pricing resides and therefore any reform with the LUFC in place is likely to be less effective at achieving the desired efficient investment signals.
Q8	How accurately has the Authority categorised distributor revenues and costs? How could this be done more accurately?	Genesis does not see a problem with how the Authority has categorised revenues and costs.
Q9	What if any would be better indicators of the efficiency of distribution prices, or the ambition of and progress being made by distributors on their price reforms?	In addition to what is noted above, we would also like to see, under the qualitative assessments, how EDBs are progressing at reducing complexity in both their tariff structures and in their communication with retailers.
Q10	What assistance could the Authority (or other stakeholders) offer distributors in order to speed up the reform process, or help to remove or reduce barriers to distribution price reform?	No comment.