Distribution Group Submission

More efficient distribution prices – What do they look like?

Submission on the Electricity Authority's Consultation Paper

This submission is made on behalf of the following electricity distributors:

Alpine Energy

EA Networks

Eastland Network

Electra

Horizon Energy Distribution

Nelson Electricity

Network Waitaki

Northpower

PowerNet (representing:

Electricity Invercargill,

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Consultation Paper – More efficient distribution prices

Introduction

This submission has been prepared by a group of distributors with common views on a number of the topics raised in the Electricity Authority's (the Authority) Consultation Paper: *More efficient distribution prices – what do they look like? 11 December 2018*.

The Distribution Group comprises small and medium sized distributors, including regulatory exempt and non-exempt businesses, and those owned by consumer or community trusts or local bodies. Together this group supplies approximately 375,000 customer connections (18% of all connections), maintain 31% of total distribution network length and service 46% of the total network supply area in New Zealand. We note that members of this group may make their own submissions on topics of particular interest.

Initial comments

We appreciate the opportunity to respond to the Electricity Authority's latest proposals for electricity distribution pricing. The current pricing principles and disclosure guidelines have been in place since 2010, and consistent with good regulatory practice, it is timely to review them to determine whether they remain fit for purpose.

Over the past decade, improvements in metering technology, combined with the emergence of more affordable small scale solar generation, batteries and electric vehicles have created the opportunity, as well as the impetus, for more sophisticated distribution pricing structures for residential and small/medium commercial consumers. Distribution pricing for many larger commercial and industrial consumers already reflects the more efficient pricing features which are described in the Consultation Paper.

The distributors which support this submission agree that it is necessary to examine traditional approaches to distribution pricing and to evaluate and implement alternatives which may better reflect the underlying cost drivers of each distribution network. Providing improved pricing signals which enable consumers to respond appropriately to potential network constraints, and make economic investment decisions, can be expected to lower the total cost of supply over the medium to long term.

However, while we support the intent of the consultation, we do not fully support the recommendations. While the Consultation Paper provides explanations of pricing theory, and acknowledges a number of the complexities and challenges in achieving efficient distribution pricing, its recommendations do not sufficiently reflect the realities of implementing effective distribution pricing for consumers.

Consumer prices

If more efficient distribution pricing is to achieve the outcomes described in the Consultation Paper, there must ultimately be take-up of the prices by retailers, who have the responsibility of passing them on to end consumers. While we acknowledge that in a competitive market, retailers are free to price distribution services as they see fit, and therefore distribution pricing signals are often muted, it is in consumers' long term interests to receive fair prices for the services they acquire. In our view the Consultation Paper does not sufficiently acknowledge the role of consumers in developing, implementing and responding to new price structures.

Trade-offs

The paper evaluates multiple pricing options for recovering distribution cost components. The ENA's working group has undertaken similar assessments, identifying pros and cons of the various options. In undertaking these assessments it is necessary to make trade-offs between the efficient cost signals, the ability to recover target revenue through fixed and variable prices, the ability to implement pricing options in practice, and consumers' willingness and ability to respond. Unfortunately the proposals in the Consultation Paper are not sufficiently transparent about these trade-offs, and in our view, place undue weight on the theory, without sufficient attention to the practice.

Fact base

We are disappointed that the Consultation Paper does not accurately portray the current status of distribution pricing or distribution network characteristics. Not all distributors have the same demand growth, capacity constraints, take-up of new technology, access to smart meters, locational divergence or consumer profiles.

In addition not all distributors use the traditional (flat per kWh) pricing structures as described in the Consultation Paper. Most distributors use capital contributions to recover connection costs, and non-standard contracts for large consumers. Some distributors are well advanced on pricing trials. Other distributors have recently implemented more cost reflective prices for residential and commercial consumers. Other tools, such as peak load management are widely used to manage network investments, with controlled and uncontrolled supply options reflected in consumer prices.

We understand and support the Authority's effort to encourage more action in developing more efficient distribution pricing structures, however care needs to be taken to ensure that the discussion is fact based, and that the recommendations reflect the actual circumstances of distributors and their consumers.

A way forward

Distributors, with assistance from the ENA and contributions from retailers, ERANZ, consumer focus groups and consumer representatives, are making progress on implementing more efficient distribution prices. While the Consultation Paper raises concerns about the rate of progress, this collaborative approach is essential to ensuring that pricing reform is as effective as possible: minimising adverse consequences and maximising the benefits for consumers. Regulatory and policy support is also an important factor in helping the industry make this transition to new pricing structures for consumers.

For this reason we do not support the proposed star-rating scheme to attempt to facilitate pricing reform. A penalty regime based on theoretical judgements without adequate consideration of network characteristics, implementation and consumer considerations is a blunt regulatory tool. We anticipate that it will lead to:

- Unnecessary effort in defending, explaining or rebutting ratings
- Poor perceptions of the sector, at a time when consumer and community support will be critical
- Poor consumer outcomes as distributors are incentivised to chase ratings rather than optimal pricing outcomes for their consumers.

Recommendations

What is needed is a continued collaborative industry-led approach to pricing reform. We do not accept, as suggested in the Consultation Paper, that the industry-led approach will not deliver the desired outcomes. For example, the distributors which support this submission are sharing the findings of their pricing trials and consultations with consumers, retailers, and community stakeholders. These combined learnings will help to avoid false steps, and unnecessary complexity as common solutions are expected to emerge through collaboration, where appropriate.

We support the review of the pricing principles and pricing guidance but we encourage the Authority to adopt a more constructive regulatory approach. To do this we suggest that the Authority:

- Finalise the pricing principles and provide appropriate supporting guidance – we have made some suggested refinements to the proposed principles (refer to our responses to Q3, Q4 & Q9)

- Set clear expectations for distributors' pricing roadmap disclosures (refer Q6)

- Abandon the proposed star-rating scheme (refer Q5, Q8 & Q9)

- Undertake to meet with each distributor annually to provide feedback on their pricing roadmaps, objectives and progress (refer Q9)

- Contribute to and support industry-led initiatives for distribution pricing change (refer Q10)

- Recognise that consumers' ability to respond to price signals is critical to successful implementation of more efficient pricing (refer Q1)

- Help to ensure that electricity market and policy settings support distribution pricing reform including (refer Q7 & Q10):

    - Finalising transmission pricing

    - Evaluating the Low Fixed Charge (LFC) regulations using the following lens: '*Does LFC regulation support efficient distribution pricing?*' In our view the Consultation Paper clearly demonstrates that it does not, and the Authority should recommend that the regulations are reviewed for this reason.

The remainder of this submission responds to each of the consultation questions. Appendix A includes suggested refinements to the pricing principles, and Appendix B includes suggested refinements to the content of pricing roadmaps.

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Responses to consultation questions

Q1 – Need for reform

As noted above, the Consultation Paper only partially describes the current status of distribution pricing. The features of 'more efficient pricing' described are available for many consumers in many regions, including time and locational based pricing. Non-pricing tools are also used successfully by distributors to manage network investment requirements.

It is important to recognise that metering limitations, uncertainty about transmission charges, reluctance of retailers to take-up new pricing structures, compliance risk inherent in regulated price caps and the LFC regulations have hindered distribution pricing options and reforms to date. While there has been some progress in these areas, for example the Commerce Commission's change to revenue cap regulation, some uncertainties remain, including the basis of transmission charges and the future of the LFC regulations.

The Consultation Paper makes the case for changing network prices (refer page i). It highlights the need to minimise unnecessary network and consumer investment and therefore to avoid consumers paying more than they need to for their energy needs, and/or creating stranded assets.

We support these objectives, and agree with much of the discussion in the Consultation Paper on this need for change. However we note:

- The objectives outlined above will not be achieved if consumers do not receive the pricing signals which help them make efficient demand and investment decisions
- Optimal pricing outcomes will be achieved if distribution prices are designed in a way which:
  - facilitates pass-through by retailers
  - allows consumers to respond in a timely and rational manner
  - recovers fixed costs through fixed charges and variable costs through variable charges.
- Poor pricing design or implementation may compromise these objectives, result in unnecessary transaction costs and price shock, and damage consumer goodwill and engagement.

Distributor experiences with more cost reflective pricing for residential and commercial consumers have been mixed. In some instances there has been limited take-up by retailers, active public resistance, data measurement challenges and undue complexity for consumers. However, these learnings are valuable, and ongoing pricing trials and consultation with retailers and consumers will contribute to more effective pricing design.

Q2 – Urgency of reform

The review of the pricing principles is timely as they have been in place for nearly a decade, and need a refresh to reflect the current and expected future state of the electricity sector. As non-exempt distributors move to a revenue cap next year, smart meters are now more widespread, and the potential impacts of solar, batteries and electric vehicles on distribution networks are emerging, it is now more critical and possible for distribution pricing reform to be undertaken.

We note that the rate of take-up of the new technologies has varied to date:

- They are more evident in some locations than others

- They have been faster than anticipated for some but slower for others
- They have had little impact on current and expected network costs for some networks, although there is more learning required, and distributors are investing in research, collaboration and network performance monitoring to assist with this challenge.

The EDBs which support this submission agree that pricing reform can start now, and note that this is already occurring. Before substantive changes to pricing structures are introduced, distributors are working through transitional processes including:

- Updating cost of supply models and LRMC/SRMC cost estimates
- Pricing design and trials
- Consultation with consumers and retailers
- Metering, data access arrangements and fall-back options
- Retailer interfaces
- Price impact analysis
- Transition plans
- Communication plans.

In addition, the following regulatory developments will influence the scope and timing of pricing changes:

- DPP reset
- Transmission pricing decisions
- Future of LFC regulation
- Electricity Price Review recommendations
- Electricity Authority's pricing principles.

As noted above, transition to new pricing structures is complex and therefore will take time. If the introduction of new pricing structures is poorly executed, it may introduce undue transaction costs and result in inefficient pricing outcomes. Industry collaboration on pricing changes is also important, as common approaches are more likely to emerge through collaboration, where appropriate. This will help to manage transaction costs for retailers.

Accordingly it is important to acknowledge that pricing reform is underway, but appropriate care is being undertaken to ensure it is well reasoned and effectively implemented. This is essential for achieving the stated objective, which is to influence consumer behaviour and optimise investment decisions.

Q3/Q4– Proposed pricing principles

We appreciate the effort which has been invested in reviewing the pricing principles. We understand the intent of most of the proposed changes, but are concerned that the principles have been drafted with an overly narrow view of the optimal pricing approach, and have introduced unnecessary complexity. Accordingly, we make the following comments and suggestions. A complete version of our proposed amended pricing principles is included in Appendix A.

We also note that additional guidance for applying the principles can be provided, as it has been in the past. This guidance is a useful aid for interpreting the principles and assisting distributors with their pricing methodologies and associated disclosures.

Terminology
There are opportunities to simplify, improve and standardise the terminology used across principles. These include:

- Rationalising the terms 'stakeholders, users, potential users, consumers, consumer agents and retailers'. We suggest that 'consumers, consumer agents and distributors' is sufficient as it is only consumer prices which are being determined under these pricing principles. The term 'consumers' can be applied to current and potential consumers or users of the network

- Removing 'efficient' from the term 'incremental costs' in (b)(i) to align with the term 'incremental costs' in (a), as they are used in the same context

- Changing the term 'allowed revenues' to 'target revenues' as allowed revenues only apply to a non-exempt EDBs under Part 4 of the Commerce Act, and distributors may choose to set prices below those permitted by regulatory allowances.

Principle (a)
Subject to the suggestions above, the proposed changes to principle (a)(i) and (iv) are supported.

However, the proposed changes to principles (a)(ii) and (iii) are not supported because they are not consistent with principle-based regulation, and the existing language conveys the same concepts in a more principle-based manner. In particular:

- (ii) does not need the term 'signalling the effect' as that term is already in (a)

- The terms 'losses, opportunity costs of capacity constraints and other avoidable costs' is another way of saying incremental cost – which is dealt with in (i). The possibility of incremental cost reductions can be included within the existing principles, as shown below

- The term 'time and location' is another way of expressing 'available service capacity'. However 'being time and location specific' assumes a particular network cost model which may not be relevant for all consumers on all networks. Reference to capacity constraints is more accurate and appropriate

- Distributors' fixed costs will also vary by location due to network characteristics such as connection density, underground or overhead reticulation, age of network, security standards and maintenance needs. This concept is adequately addressed in (b)(i) and therefore the reference to location in principle (a) is likely to cause confusion between principles (a) and (b)

- We note that retailers generally price at the network region level, and have been reluctant to pass on more targeted locational pricing signals. If this continues, the costs of implementing more complex locational pricing may not be justified.

We therefore suggest that the existing principles (a)(ii) and (iii) are retained, but improved by combining them as follows:

> (ii) *having regard to the level of available service capacity, including the impact of changes in usage on current and future network costs.*

Principle (b)
In our view, the proposed change to the introductory statement to principle (b) has added unnecessary complexity and unhelpfully removes linkages to the subclauses. We suggest the following improvements:

> *(b) Provided that prices satisfy (a) above, prices should be responsive to the requirements and circumstances of consumers, including in response to services provided by consumers, such that:*

We support the proposed change to principle (b)(i) subject to the comments above regarding terminology.

We note that non-standard arrangements are common for larger consumers, but not commonly negotiated with residential or smaller commercial consumers. This is consistent with contestable market practice.

Principles (c) and (e)
We support the intent of the changes reflected in the proposed new principle (c), but consider that the reference to prices should be retained, as it is prices which must reflect the principles. In addition, this principle overlaps with the proposed new principle (e) and they can be combined. We therefore suggest the following refinement which more clearly defines the objective of the principle:

> *(c) In order for consumers to make well-informed decisions about network use:*
>
> *(i) the application of these principles to the development of prices should be transparent; and*
>
> *(ii) prices should be predictable, including for consumers connecting to the network.*

Principle (d)
We support the intent of the changes reflected in the new principle (d) but suggest improvements which simplify the terms, and acknowledge the potential costs to distributors, as well as consumer agents, of implementing overly complex pricing.

In addition, we do not support the proposed removal from principle (d) of the requirement to consider the impact of changes to prices on stakeholders. The impact on consumers is an important consideration, particularly as the objective of pricing reform is to generate consumer response.

We acknowledge the proposal to remove the reference to pricing stability, and agree that pricing predictability is important. However pricing stability also helps consumers make efficient investment decisions because those investments generally have long lives.

The need for potential transitional arrangements when moving to new pricing structures is recognised in the Consultation Paper. It is unreasonable for the pricing principles to ignore this reality, it is consistent with good regulatory practice, and we suggest, with government policy. Undue price shocks for some consumers will need to be managed. However this principle is also about the ability of consumers to understand and respond appropriately to the pricing signals.

We therefore submit that the impact of changes to prices on consumers is retained within the principle, as follows:

> *(d) Prices should not place unreasonable costs and requirements on consumer agents or distributors, be economically equivalent across consumer agents, and changes to prices should have regard to the impact on consumers.*

Q5 – Star-ratings and pricing options

As noted in our opening statements, we do not support the proposed star-rating proposal. There are three key reasons for this:

- A 'name and shame' approach is not a constructive or appropriate regulatory mechanism for incentivising more efficient distribution pricing
- The proposed approach to the ratings does not reflect the range of network circumstances or the balance of pricing characteristics which are needed to generate the appropriate consumer response
- The judgements made in assigning the ratings do not and cannot adequately reflect the complexities and trade-offs that are made in deriving distribution prices.

The proposed ratings are theoretically based, and make assumptions about networks and consumers which may not be appropriate in all circumstances. For example, they do not reflect the discussion in section 4 of the Consultation Paper about how to set more efficient prices and the trade-offs or compromises that are required. The Consultation Paper does not fully explain how the proposed ratings are derived. As there is significant judgement required, and compromises between the principles, it is not possible to establish a direct line of evidence between the star-ratings and the principles.

We note that it is not possible to reconcile the analysis of the different pricing options against the pricing principles (as set out in Appendix B of the Consultation Paper), to the proposed star-ratings in section 4 of the Consultation Paper. In Appendix B, the trade-offs between each of the principles and the pricing options are explored. However, the absolute ratings for three pricing options considered in section 4 disguises these complexities, and appears to focus primarily on principles (a)(ii) and (b)(i).

In addition, the analysis in Appendix B includes observations which are inconsistent with distributor experience. For example:

- During pricing trials distributors have been told by retailers that it is not currently possible for billing systems to accomodate TOU pricing for general (residential and small commercial) consumers
- Consumers may understand maximum demand or critical peak prices, but they may not understand the quantity measure, including maximum demand or critical peak periods.[1] Understanding the quantity measure is just as important as the price, as it is the quantity, not the price which consumers are able to influence
- Regional pricing can reflect locational costs. None of the pricing options are rated as providing a locational signal under principle (a), which is inconsistent with the proposed new requirements of principle (a)(iii)
- Metering capability is as important as billing capability, otherwise deemed quantities must be established, which adds unnecessary complexity for consumers, distributors and retailers
- Some price options may be more efficient than suggested because they are easy to respond to, able to be understood, and more likely to be passed on by retailers. The responsiveness of consumers should be factored into any rating

[1] This was the experience for some consumers of The Lines Company during their peak demand pricing era.

- The proportion of cost that is to be recovered via marginal cost prices (ie: for network use) may be very low for the foreseeable future for some networks, especially those with flat or declining demand

- The proportion of network costs to be recovered through use based charges is significantly lower than other cost drivers. Accordingly it is not appropriate to place equal weight on network use pricing and network access pricing.

Therefore, our suggestion is for the proposed star-rating system to be abandoned. Instead we encourage the Authority to focus on:

- Understanding each distributor's pricing plan, their network cost drivers and process for developing and implementing new pricing structures, including any barriers which need to be overcome

- Meeting with each distributor (at least annually) to discuss progress, options and potential road blocks to pricing reform

- Facilitating industry and stakeholder forums on pricing reform

- Actively seeking resolutions to industry structural issues and regulatory arrangements which are inconsistent with the pricing principles and the consumer outcomes being sought.

Q6 – Time to introduce different price structures

The distributors which support this submission agree that there is no reason work should not commence now on developing and implementing changes to pricing structures. But it is incorrect to suggest that distributors have not embraced the need to develop more cost reflective pricing structures, as this work has and is being undertaken. Some distributors have already introduced substantive changes to their pricing structures, and more of these will come into effect from 1 April 2019. Others have introduced more moderate changes, and others are actively consulting and undertaking pricing trials.

The pace of change for each distributor will depend on a number of factors including:

- Current pricing structures

- Network characteristics and cost drivers

- Consumer and retailer consultation

- Research and investigation, including pricing trials

- Transitional and default/fall-back arrangements

- Systems, access to data, metering capability and billing functionality

- Clarification of regulatory settings including the pricing principles, transmission pricing, recommendations of the Electricity Price Review, the LFC regulations, and the DPP3 revenue cap.

Accordingly, the timeframes will not be the same for all distributors. The pricing roadmaps are a useful mechanism for demonstrating the timeframes which are appropriate for each distributor.

Roadmaps

We agree that it is timely for the Authority to clarify its expectations for pricing roadmaps. This will assist distributors to meet the Authority's expectations and inform the Authority and other stakeholders of progress and plans. We note the intent for roadmaps to provide 'detailed, concrete and time-bound' plans for price reform, however we note that these plans will be flexible and subject to revision (including timeframes). This is necessary to allow information gathered during initial research, consultation and trials to be taken into consideration, pricing plans to be developed and refined, and transition plans to be put in place.

For example, new pricing may initially be introduced on an opt-in basis, and following assessment of consumer experience or take-up, may change to opt-out or become mandatory for some or all consumers. The preferred transition approach may not be known for some time.

Accordingly it is appropriate that the roadmaps are updated from time to time and reflect the progress that has been made at the time each roadmap is published. We have made suggested refinements to the requirements for roadmaps to reflect this perspective, and have corrected some of the terminology used. These are included in Appendix B.

The Consultation Paper suggests that the Authority plans to publish a template to be used for the 31 March 2019 roadmap disclosures. We note it would have been more useful to have the template available well in advance of this deadline, which is only six weeks away, and that it may be more appropriate for the template to be applied for the first time in September.

We fully support the Authority communicating directly with each distributor about its pricing roadmap and plans. We believe this is a more constructive and effective regulatory approach than the other options presented in the paper, as noted above.

Q7 – How does LFC regulation hinder price reform?

The LFC regulations limit the maximum fixed price (inclusive of distribution, transmission and pass-through prices) able to be charged by distributors to residential consumers using less than 8000kWh or 9000kWh p.a, (depending on location). [2] Average residential consumption is now well below 8000kWh and the ENA has estimated that approximately 60% of residential consumers are eligible for the LFC. This is over half of all electricity consumers and therefore affects a significant proportion of distributor revenue. This is not an insignificant regulatory constraint.

The Consultation Paper demonstrates exactly why the LFC regulation hinders pricing reform. Section 4 of the Consultation Paper describes a method for calculating efficient distribution prices. It includes the following statements:

> *4.29 ..identify the efficient costs to be recovered through variable and fixed tariffs:*
> - *the variable tariff would recover the marginal cost of using the network*
> - *the fixed tariff would cover costs that do not vary in the short run.*
>
> *4.31 Fixed costs will likely form the bulk of a distributor's costs.*

However the LFC regulations impose constraints which prevent this approach being applied in practice for more than half of all consumers.

The Consultation Paper suggests that the LFC regulations do not prevent distributors from progressing pricing reforms because of the work-arounds suggested by the Authority, which involve adopting capacity and peak demand prices as variable charges.

One illustration of the contradiction in the Consultation Paper is that under the proposed star-rating system, LFC regulation would limit the ratings able to be achieved for efficient cost recovery (as described in Appendix D of the Paper) because fixed costs must be recovered through variable charges

[2] It also applies similar constraints to electricity retail prices.

for a large proportion of consumers. This is contrary to the 'non-distorting recovery of fixed costs' criterion to be applied in the star- rating system.

We are unable to reconcile these opposing views. We note that the Consultation Paper appears to describe per kW (contracted or installed capacity) charges as a fixed charge for recovering residual (non-marginal) costs (paras 4.36 and 4.37), but also describes them as variable charges for LFC regulation compliance purposes (para 4.18).

Further the LFC regulations were clearly implemented with the intent that a kWh variable price structure would apply, as the crossover test is specified as a kWh test (not kVA or kW)[3], as are the eligibility thresholds.

We therefore submit that the Consultation Paper poses the wrong question about the LFC regulations. A more appropriate question is: **Does LFC regulation support efficient distribution pricing?**

We do not think it does, because it prevents the adoption of one of the most straightforward options for the recovery of fixed costs ($/day charge) from a large proportion of consumers. As the Consultation Paper acknowledges (in Appendix B) this form of charge is easily understood by consumers, is predictable, readily implemented, and is a non-distortionary method for recovering fixed costs. As noted throughout the Consultation Paper, fixed costs make up the largest component of distribution costs.

We note that the initial report of the Electricity Price Review also acknowledged that LFC regulation does not support efficient distribution pricing, as follows:

> *Current regulations may hinder the ability to change pricing structures. As discussed in 'Regulation', low fixed charge regulations are exacerbating inefficient price signals to consumers, and causing some unintended shifting of costs, including on to some of those in greater energy hardship.*
>
> *We think distribution pricing should more accurately reflect the costs of distribution networks. We also think that prices need restructuring in time to catch a wave of investment starting to build.*[4]

We therefore challenge the Authority to consider the alternative question posed above. As the regulator responsible for administering the LFC regulations, we suggest that it is within the Authority's remit to critically review the effectiveness of the regulation, and make recommendations for change when necessary. To do so now would be entirely consistent with the Authority's push for more efficient distribution prices.

Q8 – Categorising distributor revenues and costs

Section 6 and Appendix C of the Consultation Paper includes analysis of distributor cost bases. This attempts to define variable and fixed costs in the context of distributor revenue requirements. The analysis is based on data extracted from annual information disclosures.

However, the analysis is misleading because it does not correctly distinguish between:

- The building block components of target revenue, including for example opex, depreciation, tax, revaluations, return on capital, wash-ups and incentives

- Opex and capex (cash costs)

[3] We note the challenges for The Lines Company in complying with the LFC regulations in practice during their kW demand pricing period.
[4] Electricity Price Review, Initial Report, page 56

- Current and forecast costs
- Incremental costs and residual costs.

It also ignores the recoverable and pass-through costs which are recovered by distributors through prices.

The interpretation of revenue disclosures (in para 6.9) also appears to be inconsistent with the current Electricity Distribution Information Disclosure Determination (2012). The revenue groupings described are not specified in the Determination, or reflected in the Schedule 8 revenue disclosures.

We do not support the proposed star-rating assessment of fixed and variable cost recovery, for this reason. It is not possible to determine from disclosure information, the incremental costs that best align with variable pricing, residual costs that align with fixed pricing, and connection costs that align with connection charges or customer contributions. For example incremental costs will need to be derived from a longer term view (such as LRMC) as described in section 4 of the Consultation Paper.

The Consultation Paper proposes an assumed cost structure for distributors, which is 20% variable and 80% fixed for the purpose of assessing whether price structures are efficient. However, it is overly simplistic to make this assumption on the basis that it is estimated that system growth capex was 25% of total distributor capex between 2013 - 2018 and all opex is fixed not variable.

In addition, as described above, distributors are set to fail this assessment because of the LFC regulations. The Authority's suggested work-around does not solve this.

As stated earlier, we consider that a 'rule of thumb' rating proposal has limited merit, and is likely to lead to unnecessary debate and effort for individual distributors, and the Authority, in correcting the misconceptions it will create.

Q9 – Indicators of pricing efficiency and progress by distributors

As stated above, we do not support the star-rating system. We do however think that the proposed qualitative assessment has merit, and encourage the Authority to communicate directly with distributors over their pricing plans, ambitions and progress. The recent visits by Authority staff to discuss pricing plans and progress with many distributors have been positive and beneficial for distributors.

It is important that the Authority understand the actual plans and circumstances of each distributor before making any judgements. We do not believe that the star-rating proposal will achieve this due to the significant judgements to be made.[5] In this respect, we suggest that each distributor include an assessment of progress against their plan in the roadmap to assist the Authority. Our recommendations for the content of the roadmaps, set out in Appendix B, reflect this suggestion.

We note that the Consultation Paper is silent on the Information Disclosure Guidelines which accompany the current distribution pricing principles and the Commerce Commission's pricing methodology disclosure requirements. We suggest that the Authority could clarify its expectations for the application of the pricing principles and cost recovery with appropriate guidance material. This could include expectations about explanations of fixed and variable cost recovery within published pricing methodologies.

Q10 – Assistance from Authority or other stakeholders to speed up reform or reduce barriers

[5] We note that initial ratings against the new pricing principles or assessment criteria set out in the Consultation Paper cannot be made at 1 April 2019, as they were not known at the time prices or pricing plans were set.

As described elsewhere in this submission we encourage the Authority to:

- Acknowledge that the LFC regulation is inconsistent with the objectives for more efficient distribution pricing because it restricts the use of a fixed charges (including a simple daily fixed charge) to recover fixed costs for a large proportion of consumers. The fixed daily charge is an economically efficient and low cost distribution pricing option which is easily understood and acceptable to residential consumers. We encourage the Authority to recommend that the regulations are reconsidered for this reason.

- Resolve outstanding issues with transmission pricing

- Publicly support distributors during the transition to more efficient pricing

- Recognise that consumers' ability to respond to price signals is critical for successful implementation of more efficient pricing, otherwise the new price structures will not influence investment decisions.

In addition, distributors need support from other industry participants, with:

- Access to metering information to help with trials, price development and price shock analysis

- Improved metering infrastructure and coverage in some regions, and recognition of opt-out arrangements where metering infrastructure is inadequate

- Active engagement from retailers and a willingness to develop systems where necessary and to pass on distribution pricing signals to consumers.

Appendix A – Proposed Pricing Principles

(a) Prices are to signal the economic costs of service provision by:

(i) being subsidy free (equal to or greater than incremental cost, and less than or equal to stand-alone costs), except where subsidies arise from compliance with legislation; and

(ii) having regard to the level of available service capacity, including the impact of changes in usage on current and future network costs.

(b) Provided that prices satisfy (a) above, prices should be responsive to the requirements and circumstances of consumers, including in response to services provided by consumers, such that:

(i) where prices based on incremental costs would under-recover target revenue, the shortfall should be made up by prices that least distort network use and reflect the value that consumers derive from the network;

(ii) they allow for negotiation to reflect the economic value of services and enable consumers to make price/quality trade-offs or non-standard arrangements; and

(iii) where network economics warrant, encourage investment in transmission and distribution alternatives (eg, distributed generation or demand response) and technology innovation.

(c) In order for consumers to make well-informed decisions about network use:

(i) the application of these principles to the development of prices should be transparent; and

(ii) prices should be predictable, including for consumers connecting to the network.

(d) Prices should not place unreasonable costs and requirements on consumer agents or distributors, should be economically equivalent across consumer agents, and changes to prices should have regard to the impact on consumers.

Appendix B – Explanations to be included in pricing roadmaps

(a) The planned date(s) at which the distributor will decide on, publicise and describe their new ~~tariff~~ price structures, including progress to date

(b) The planned date(s) that any ~~tariff~~ price trials will begin and end and details of the trials, including progress to date

(c) The planned date(s) at which the distributor will introduce new ~~tariff~~ price structures, including progress to date

(d) How and when the~~y~~ distributor plans to consult on proposed changes to ~~tariff~~ price structures with consumers, retailers and other interested stakeholders, including progress to date

(e) How the~~y~~ distributor will gather the necessary data for setting price structures and~~s~~ levels and ensuring revenue requirements are met, including progress to date

(f) How the~~y~~ distributor plans to identify and address implementation issues, including progress to date

(g) What the~~ir~~ distributor's strategy is to date for transitioning ~~from legacy tariffs~~ to new ~~tariff~~ price structures, including ~~is~~:

   i. What are the risks of adopting new price structures?

   ii. Who bears these risks?

   iii. How will the risks be efficiently mitigated?

   iv. How will ~~tariff~~ price changes be communicated, including progress to date?

   v. How and when will retailers be involved in the process, including progress to date?

   vi. Whether the new ~~tariffs~~ prices will be/are mandatory or not, and opt-in or opt-out?