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Submissions
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CONSULTATION PAPER – MORE EFFICIENT DISTRIBUTION PRICES

Opening comment

Unison Networks Limited (Unison) welcomes the opportunity to submit on the Electricity Authority's (Authority) consultation paper: *More efficient distribution prices*. We understand that the purpose of the paper is a review of the pricing principles to support distribution pricing reform.

Unison supports the Authority's general overall aim to promote distribution price reforms that are in the long-term interest of consumers. Key to ensuring that the outcome of reform is efficient and durable prices is the need for carefully designed transition plans to allow customer preparation, changes to operational matters and review of the Low Fixed Charge Regulations.

We have contributed to, and support, the submission from Electricity Networks Association (ENA).

Network distribution prices need reform

1. Do you agree that distributors need to reform their prices? What is the reason for your answer?

Unison agrees that distribution prices need to change. The electricity industry is becoming increasingly dynamic, with distributors having a key role in facilitating the integration of new technologies in an efficient manner into the industry. New pricing structures are needed to more accurately reflect the actual network costs and the service that customers receive so that customers understand the costs and benefits of using the network in different ways. The current standard approach to pricing does not reflect costs and therefore creates inefficiencies.

We agree with the Authority that there are issues to be addressed. Positively there is broad industry recognition that reform is needed, and the process has already been initiated¹. We believe the industry is aligned with the object to achieve durable and sustainable prices, that better reflect the underlying cost structures of the distribution service.

¹ For example: ENA consultations on pricing reform in 2015 and 2016, ENA's 2017 publication *A Guidance Paper for Electricity Distributors*, ENA working groups looking into the design and implementation of pricing reform, joint distributor and retailer working group to review practical implementation issues and impacts of pricing change, and submissions in relation to the *Electricity Pricing Review (2018)*.

2. How important and urgent are the issues identified by the Authority?

Unison views the issues as important and believes EDBs and the industry is committed to pricing reform. The work to date by ENA members and industry consultation highlights any reform will be multifaceted and involved. Pricing reform is complicated, and if poorly executed or without an appropriate transition period, will result in unduly disruptive outcomes.

Unison's key concern is that the consultation paper does not allow for an appropriate transitioning period of reform. It is vital that there is adequate time for due consideration of the challenges and impacts of any proposed changes. Research conducted by the ENA has conclusively shown that vulnerable customers (who are unlikely to have access to new technologies) who benefit in the long-term from reform are overly represented in facing increased bills in the short-term under particular pricing approaches. Pricing reform inevitability results in winners and losers. The affordability of electricity is an important focus in the Electricity Price Review², particularly for vulnerable consumers.

Unison is in the process of also mapping census data to ICPs to assist our consumer consultation process. Our experience to date indicates vulnerable customers in our network areas will be overly represented in facing increased bills in the short-term. This highlights how important it is that the real impacts on consumers are examined alongside economic theory.

A transitioning period will likewise assist in the process of consumer engagement and general acceptance of new pricing structures. International research suggests a long-term communication strategy is needed through the transition period and beyond to raise awareness and motivate consumers to change. Short-lived campaigns will often have a discouraging effect.

In addition, practical operational issues have been highlighted by the industry, including: billing and data management systems, technical implementation, and the current Low Fixed Charge Regulations. Without a transitional plan these issues will impact on the effectiveness of what is trying to be achieved, durable and stable price structures.

Unison agrees with the Authority's view that retailers should not be obligated to directly pass-through network prices. Retailers need to see the value of passing through our prices. Care is therefore required that distributors are not suddenly restrained to text-book cost reflective pricing approaches that are overly complex and would add risks to retailer businesses associated with rebundling. By expanding our direct engagement with consumers, we hope to determine prices within our pricing objectives, that consumers will find in general acceptable, and therefore agreeable for retailers to pass through to consumers.

What needs to be done?

3. Do you agree with the proposed Distribution Pricing Principles?

Unison strongly supports principles-based regulation, rather than prescriptive requirements. We have contributed to the ENA's specific comments on the principles.

4. What, if any, changes would you recommend are made to the proposed Distribution Pricing Principles, and why?

Unison agrees with comments provided in the ENA submission. We recommend:

² First Report for Discussion – 30 August 2018.

1. the removal of the proposed (a)(iii). Prices do not necessarily provide efficient outcomes by being time-based. In respect to prices being location-specific, we believe further consultation is required as it is a significant departure from the current norm of prices applying across broad regions. We also think confusions should be avoided between the role of delivery prices and new arrangements to procure distribution alternatives in constrained areas of the network.
2. retaining the inclusion of promoting price stability and certainty for stakeholders, alongside having regard to the impact on stakeholders. The industry focus is on greater stakeholder engagement, and therefore it would be inconsistent to not recognise the importance of engagement in the revised principles.
3. the removal of the proposed principle (e), on the basis that it is retailers that set the final bill for the end consumer, bundling the applicable charges. The proposed principle conflicts with the view that retailers should not be obligated to directly pass-through distribution prices.

How can distributors do this?

5. What if any changes would you propose to the star-ratings to better reflect the relative efficiency of distribution prices?

Unison is concerned that the Authority's proposed star-rating system will not adequately provide for the distinctiveness/uniqueness of each distributor (i.e., location, size, customer mix, network configuration and penetration of smart meters).

As previously outlined by ENA³, the appropriate pricing structure for the individual distributor in each location depends on a range of factors including:

- Whether the network has enough capacity to cope with consumer demand (when it is at its peak) or has substantial spare capacity
- Whether consumer demand on any given network is growing or shrinking
- Variability and predictability of demand, which may differ between distributors

For example, Time of Use (ToU) pricing would be considered by distributors that are not necessarily capacity constrained but seeking a more cost reflective price structure, or where benefits of shaping consumer behaviour to avoid future network congestion can be seen.

We understand that due to the number of distributors in New Zealand, it would be wise to encourage alignment by identifying a key set of pricing for distributors to focus on. However, though we support guidance from the Authority, a certain price structure should not be advocated as superior for all distributors in general. The specific local environment of each distributor will reflect how it reforms pricing including the required pace of reform. Efficiency of a pricing option will be shown by a distributor validating compliance with the principles, and how the pricing structure chosen is efficient for their network make-up. Distributors should not be incentivised by a rating system to accommodate a price structure, if that pricing is not the most efficient option for their network. Such an action would defeat the purpose of pricing reform.

Finally, the application of the proposed star-rating system on current prices would not yield any benefits as we are at the beginning of the reform process. Based on our comments in this submission, and the commencement of the new default price-quality path in 2020, we believe substantive pricing reform cannot commence until the year beginning 1 April 2020. The

³ *A Guidance Paper for Electricity Distributors on new pricing options – August 2017, page 81.*

implementation of a star-rating system now would only add complexity to the stakeholder engagement process.

6. How long do you think distributors would reasonably need to introduce the different price structures discussed?

Unison⁴ has been actively involved in the ENA industry working group that has been developing several pricing options. Several of these options have been tested on a large sample of anonymised consumption information to assess the impacts on different consumers of different pricing arrangements. Testing resulted in significant impacts on some consumers' bills – both up and down.

Unison is using the information as a basis for further customer consultation in 2019. We intend to analysis the extent of price shocks and how we can best transition our customers to mitigate unnecessary hardship on already vulnerable customers. Preferred pricing options will be developed that can be understood and broadly palatable to our customers. Trials will then be undertaken on customer groups if required to validate consumer feedback. Consumer understanding, and acceptance of change are key goals of an engagement process.

In conjunction with considering the other operational matters highlighted in this submission we believe price reform could take up to six years before success is measurable.

In summary, the ENA's *Guidance Paper for Electricity Distributors on new pricing options – August 2017*, highlighted key considerations of transitioning to new network pricing:

- Change can be phased in
- A purely opt-in approach may not achieve overall objectives
- Immediate implementation for all consumers may lead to confusion and complexities
- A clear pathway to implementation is important, with transparency on timeframes
- A series of smooth price changes over time
- Consumer education and communication is vital, with consistency and coordination across industry
- Effects on vulnerable consumers need to be managed, including by coordinating with relevant agencies and other parts of industry.

To ensure pricing options are efficient and stable in the long term, a robust process needs to be implemented over an appropriate timeframe.

7. Can you illustrate how and to what extent the LFC regulation hinders price reform.

Unison strongly recommends the removal of the Low Fixed Charge (LFC) Regulations. We fully support the reasoning provided in the ENA's submission.

Our key concern is that the LFC Regulations require distributors to recover significant fixed costs through high variable charges. Although this does not prevent reform, retaining the requirement in its current form is problematic as it distorts energy choices. As outlined in the ENA submission, while new structures might solve one perceived "problem" (e.g., over-investment in solar) it is

⁴ Unison has already made some progress in introducing more cost-reflective, service-based price offerings⁴. Despite these new price offerings, most residential consumers remain on legacy prices. In April 2016, Unison introduced a solar/distributed generation price category to reflect the different usage profile of solar consumers. In April 2017, Unison improved its TOU offering by raising the difference between off-peak and peak prices and extended eligibility of this price category for consumers installing solar.

likely to create other new incentives on consumer behaviour, that could be far worse from an efficiency perspective. The result is significant design and implementation hurdles for distributors.

In addition, the prohibitions on stepped and tiered charges make the design of new pricing options very difficult. An example of this, is the new efficient approach of kilowatt-based charging would ideally involve stepped and tiered pricing. Such an approach is prohibited under the LFC Regulations.

We think that the LFC Regulations is likely to create a strong risk of non-durable responses and may well over-encourage consumer investment in storage batteries and other load shifting technologies to avoid variable charges rather than underlying costs.

When should distributors do this?

We agree that pricing reform needs to be timely, before material numbers of consumers make significant investment decisions. However, we believe substantive pricing reform cannot commence until the year beginning 1 April 2020. We understand that retailers are likely to need to make significant system investments to process data for billing, as well as adopt potentially new processes to transfer information during switching, or changes in customer requirements.

Although pricing reform needs to be timely, there are significant downside risks if a transitional approach is not taken. We strongly recommend that full implementation of new pricing structures is staged over time to ensure operational matters are in place, robust consumer consultation is undertaken, and unnecessary consumer hardship is mitigated.

We will monitor distributor's progress

8. How accurately has the Authority categorised distributor revenues and costs? How could this be done more accurately?

No comment.

9. 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?

Unison recommends that outcome-based measures are the preferred indicators for progress. Unison, alongside the industry, intends to undertake consumer consultation in 2019. The development of pricing options from this step, alongside a shared roadmap with retailers (in aggregate) will be an important milestone. The responsiveness of customers to the options and uptake by retailers will demonstrate the efficiency of pricing structures.

We agree with the measures proposed by ENA as examples of efficient pricing:

- load shapes less peaky than today;
- off-peak EV charging;
- are solar panels installed with batteries or are stand-alone solar arrays being installed only for non-economic reasons (e.g., personal resilience, environmental consciousness), given rooftop solar currently costs more on a c/kWh equivalent than large scale generation.

Transition

10. 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?

Industry wide communication that prices need to be more reflective of actual network costs and the services that consumers receives is key to support price reform. Overseas experience, alongside recent ENA research, has shown that consumers to date are simply not interested in engaging about their electricity network bill unless it suddenly increases. Unison recommends that industry communications that are easily understood and demonstrate the impact will assist in the process.

As discussed above we recommend the removal of the LFC Regulations. We believe it hinders the process of reform and is likely to result in much more complex pricing options than is necessary to achieve more efficient outcomes.

Concluding comments

We agree that timely price reform is needed. Price reform is, however, not simple and if poorly executed or without appropriate transition could be unduly disruptive to customers.

Customers and other important stakeholders such as retailers, must support changes. Pricing reform therefore needs to focus on the end consumer and encourage consumers' active participation around new pricing options. Pricing structures that retailers can transparently pass-through to consumers, should they wish to do so, are more likely to effectively promote efficiency in practice.

The support of the Authority with communications that demonstrate the value of new pricing, and the review of the LFC Regulations will greatly support the achievement of a timely reform process.

For any questions relating to this submission, please contact Amanda Watson, Senior Regulatory Affairs Advisor by phone (06) 873 9372 or email Amanda.Watson@unison.co.nz.

Yours sincerely,



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