24th September 2019

Submissions
Electricity Authority
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By e-mail: submissions@ea.govt.nz

Electric Kiwi does not support the Authority's TPM proposals

Electric Kiwi does not support the Electricity Authority's TPM proposals, including (i) any shift away from the well established arrangements under which South Island generators pay the full cost of the HVDC link; (ii) removal of coincident peak-usage charges; and (iii) the default option to base transmission charges to load customers on Anytime Maximum Demand. We also don't support the TPM work being prioritised over projects which could help address the substantive competition problems that exist, and have been neglected, in the retail and wholesale electricity markets.

Retail and wholesale market reform is necessary and increasingly urgent

The TPM review has diverted and resources away from addressing serious competition problems in the electricity market.

While Electric Kiwi has not submitted previously to the Electricity Authority on the TPM review, we have been increasingly uneasy about the amount of time and resources dedicated to the review, while projects that could improve competition and consumer outcomes, such as hedge market development, spot market trading conduct and saves and winbacks, have languished over a number of years and remain unresolved.

If the Authority finally makes a decision, next year, that the TPM will be replaced this will result in substantial ongoing and additional work, including the hands-on approach the Authority is proposing with its so called 'checkpoints' during the TPM development phase and then with the review and approval of the new TPM.

Electric Kiwi would like to instead see a lower key review in which distributors and Transpower focussed on ensuring distribution and transmission pricing are well co-ordinated, including through complementary dynamic and peak-usage pricing, with the Authority's resources and priorities on fast-tracking competition reforms.

The Authority has failed to heed its own warnings about risk of unintended consequences

In response to the Electricity Price Review, the Electricity Authority warned "Proposed regulatory changes need to be carefully examined and worked through with relevant parties. There have been some notable examples in the past where policy initiatives have resulted in unintended or undesirable outcomes, such as the Low Fixed Charge Tariff Regulations and the development of Avoided Cost of Transmission payments".

The Authority also engaged in scare-mongering, warning the Price Review "While the Authority can introduce mandatory market making under urgency, it is also aware there is a serious risk of unintended consequences arising from interventions in this area where the implications of changes in trading arrangements have not been fully worked through. At worst, blunt mandatory market making requirements could threaten the viability of a market maker". In subsequent delay in review of the hedge market trading requirements the Authority has disregarded the risk of unintended consequences from doing nothing.

Despite the multiple warnings to the Price Review that it needs to consider the "risk of unintended consequences", the Electricity Authority has failed to heed to its own warning in the TPM review. The only acknowledgement the Authority has given to such risks is to note concerns have been "raised by Transpower and other submitters about potential unintended consequences from removal of the RCPD charge" and inclusion a transitional peak-usage charge as an optional, additonal component, in the TPM proposals. This is despite widespread concerns raised by Transpower and others about the risks major changes to the TPM could have for the wholesale electricity market, future electricity industry investment requirements, the impact on carbon emissions and electrification etc.

Electric Kiwi cannot think of any Electricity Authority proposal or project that has greater risk of unintended consequences than the TPM proposals. It appears "the risk of unintended consequences" is an argument of convenience used only when the Electricity Authority does not want to intervene or introduce new regulation.

The Electricity Authority should not propose TPM changes which would grant windfall gains to incumbent generators

Electric Kiwi would not support any changes to the TPM that result in wealth transfers from consumers to generators.

The Electricity Authority's priorities should be projects which would help to lower electricity prices for end-consumers, and improve choice and service quality. The Electricity Authority's proposal to replace the existing TPM would result in end-consumers paying nearly $50m more per annum towards the cost of the HVDC. While this would be bad for consumers, we are also concerned about what the large windfall gains to Contact, Meridian and Trustpower could mean for retail competition. The incumbent retailers have spent a lot of time focusing on how electricity distribution monopoly profits could harm competition. These arguments have direct parallels with any windfall gains the incumbent retailers could get from TPM and HVDC changes.

At the same time the Electricity Authority is proposing consumers pay an additional $50m for HVDC, the issue that consumers are paying $500 million per annum in loyalty taxes remains unresolved. We note the Electricity Authority has stopped updating its loyalty tax calculation since the size and growth in loyalty taxes were pointed out in submissions on saves and winbacks, with the last calculation for the 2017 calendar year. Resolving the loyalty tax/two-tier retail market issue would result in consumer benefits which would dwarf any plausible benefits (if any) from changing the TPM.

Focus of any TPM reform should be on enhancing the existing peak-usage pricing signals

The Electricity Authority has stated “The current TPM enables Transpower to recover its maximum allowable revenue, and signals to customers that their demand drives future investment in transmission capacity”. We agree. We consider these to be essential characteristics of any TPM.

The Electricity Authority should adopt an orthodox-economic approach to transmission pricing which encourages network pricing that signals the forward-looking costs of network investment. The TPM review focus should be on whether there is potential to better and more efficiently target the existing peak-usage charges, and how they can best be integreted with distribution pricing reform.

A focus on ensuring the TPM sends efficient forward-looking pricing signals is the best way to ensure the TPM is to the long-term benefit of consumers, and supports the transition to a low-emissions economy at least cost to consumers. The distributors and Transpower should be able to do this without the Authority having to divert large amounts of its resources away from competition matters.

Electric Kiwi considers the Electricity Authority's thinking on transmission pricing reform was more or less on the right track in its LRMC working paper; albeit that it overstated the challenges in adopting LRMC pricing, particularly given that its benefit-based charging proposals would be far more complex to introduce. The LRMC working paper provided robust, orthodox economic explanation why nodal pricing only provides short-run pricing signals and is not adequate for signalling the cost of consumer demand decisions on the future cost of transmission.

Our views on distribution pricing also apply to transmission

We have included our submission on the Electricity Authority's distribution pricing principles as part of our TPM submission as our views on distribution pricing also apply to transmission.

We reiterate that we consider the focus of network pricing, which includes both transmission and distribution, should be on benefits to consumers from incentivising efficient consumption behaviour and cost-reflectivity should be the key criterion (not benefit-based or service-based charging). We also reiterate it should be recognised that the primary driver for network cost and investment, at both the distribution and transmission levels, is network capacity. Network pricing should signal the cost of potential future investment needs.

Network pricing should be consistent between distribution and transmission, including:

- Peak-usage pricing should be applied at both the transmission and distribution levels. Our submission on distribution pricing principles detailed that we consider Coincident Maximum Demand pricing should be extended to distribution as well as transmission, and

- Anytime Maximum Demand is not cost-reflective and should be excluded.

The way to ensure the prices consumers pay don't exceed the benefits they receive is via clear cost-reflective pricing

We have considered carefully the Electricity Authority's proposal to require Transpower to apply benefit-based charges. With respect, we consider this to be a fool's-errand. Any benefit-determination, whether calculated by Transpower or the Electricity Authority will invariably be wrong.

The Electricity Authority's view, which it has maintained since the first Issues Paper in 2011, that South Island consumers are net beneficiaries of the HVDC link highlights how unsafe a benefit-based approach to network charging is. South Island consumers would be better off if Transpower 'cut the cable' and it would be very unlikely they would accept any HVDC charges as either fair or reasonable as the Authority claims. Adoption of benefit-based charges would simply result in unproductive disputes about who benefits from what and by how much.

The only reliable way of ensuring consumers don't pay more for transmission, or any other services, than they benefit is to ensure there are clear pricing signals consumers (and/or their service providers) can respond to. If there are clear pricing signals which reflect the cost (including future cost) of transmission, consumers will only consume where the benefit outweighs the cost. This does not require the Electricity Authority or Transpower to determinate what they think individual consumer-benefits are.

Recommendations

Electric Kiwi has the following principal recommendations for the Electricity Authority's TPM review:

The Electricity Authority's work programme priorities should be changed

- Electric Kiwi **recommends** resolution of hedge market development (mandatory market-making), the two-tier market (saves and winbacks), spot-market trading conduct and wholesale disclosure requirements are fast-tracked and given priority over the TPM review and DDA;

The correct application of the statutory objective would take wealth transfers into account

- Electric Kiwi **recommends** the Electricity Authority adopt a consistent approach to interpretation of "long-term benefit of consumers" with the Commerce Commission under Part 4 Commerce Act and the Telecommunications Act, and recognise wealth transfers impact on consumer-benefits and not just efficiency;

The nature of the potential TPM changes should be substantially re-considered

- Electric Kiwi **recommends** that if the Electricity Authority perseveres with the TPM review, it should adopt a lower key review approach which:
    - retains the requirement that only South Island generators are charged for the HVDC,
    - retains RCPD or some alternative form of dynamic or peak-usage charges,
    - considers how transmission pricing-signals could best be integrated into distribution pricing and passed-through into the distribution prices, and
    - abandons any proposals for benefit-based or Anytime Maximum Demand charges.

Yours sincerely,

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Appendix A

19 February 2019

Jean-Pierre de Raad
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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.

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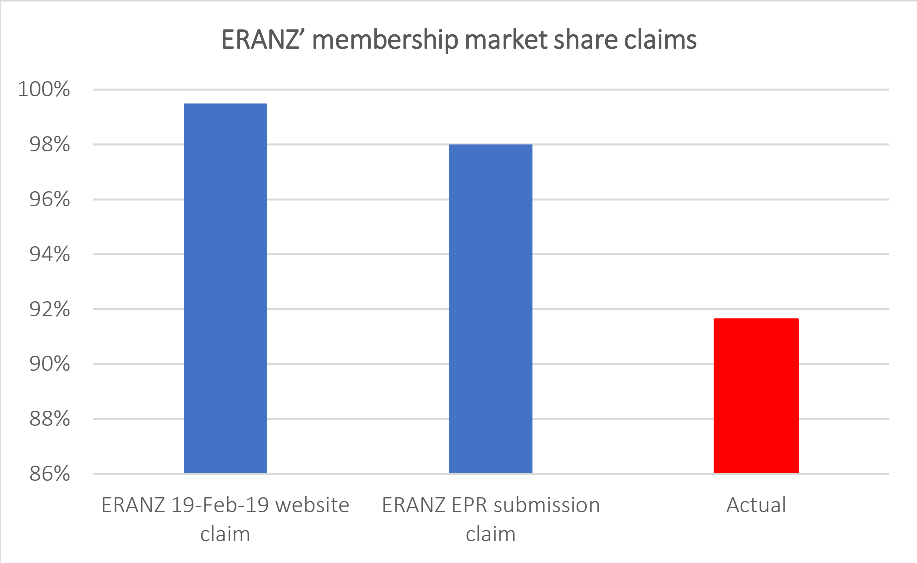
[3] https://www.emi.ea.govt.nz/Retail/Download/DataReport/CSV/R_MSS_C?_si=v|4

[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) discourages 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.

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[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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