

17 October 2011

Submissions
Electricity Authority
PO Box 10041
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by email: submissions@ea.govt.nz

**SUBMISSION ON CRITERIA FOR ASSESSING ALIGNMENT AGAINST INFORMATION
DISCLOSURE GUIDELINES AND PRICING PRINCIPLES**

- 1 Orion New Zealand Limited (**Orion**) welcomes the opportunity to comment on the “Criteria for assessing alignment against the Information Disclosure Guidelines and Pricing Principles” consultation paper (the **paper**) released by the Electricity Authority (the **Authority**) in September 2011 and the companion Concept Consulting report dated 6 July 2011.
- 2 The Electricity Networks Association (ENA) has also submitted on the paper. Orion also supports the conclusions and recommendations in the ENA submission.

General comments

- 3 Orion supports the principles-based approach to the regulation of distributor pricing backed up by information disclosure, and welcomes the paper’s continued endorsement of the approach. We also consider that the approach of conducting an initial review of a sample of distributor’s methodologies has been useful and insightful.
- 4 We strongly agree with the recommendation in the Concept report that the Authority work with the Commerce Commission to ensure that only one pricing disclosure is required and the regulatory approaches and requirements are aligned. We take para 3.4.11 of the paper as the Authority committing to do this.
- 5 In addition we urge the Authority to acknowledge that a principles-based / disclosure approach is of necessity a medium to long term instrument. It will take a while, and certainly at least several years, for it to show much if any impact on distributor pricing approaches. Distributors will need time to see how various approaches are assessed against the principles. There will also probably continue to be cases of (at least apparently) limited compliance. Given the Authority’s very appropriate conclusion that



there is a significant risk that pricing standardisation would compromise efficiency and innovation, it would be unfortunate if the Authority moved quickly or in an across-the-board fashion to move beyond the principles-based approach: it needs time to work.

6 Despite our general support for the approach, we consider that in some respects the paper (and the Concept report) expect more of the methodologies than is reasonable, and certainly considerably more than has been intended by Orion in the past. The following areas in particular concern us:

- The idea that the methodology should contain information as to why a particular pricing approach has been adopted (para 3.2.6 of the paper), which probably involves the consideration of many and perhaps all other possible approaches. To us this is a much higher level consideration, and in any event not something that could sensibly be reviewed every year.
- Overly prescriptive suggestions for the types of analysis that should be included in methodologies, and particularly:
 - That the methodology should indicate trends in costs over the longer term (3.4.6 (a)). We consider that these attributes are influenced by so many other factors that an annually updated speculation on them in the pricing methodology is unlikely to be useful. To the extent it is useful to comment on longer term trends, this is more appropriately dealt with in asset management plans. With respect to pricing, for a non-exempt distributor the two key factors (currently) are Commerce Commission regulation of both the distributor's own distribution prices, and transmission prices. Not only are these both largely beyond the control of the distributor, the nature of the regulation itself is subject to significant change over the long term.
 - That the methodology should "demonstrate" that prices are subsidy free (3.4.6(b) (ii)). As the Concept report notes (see page 39) the range encompassed by incremental to standalone is likely to be very broad. This suggests there will be little value in conducting significant further analysis to demonstrate the location in the range.¹ Moreover, the revocation of the GPS does not, in our view, give distributors complete freedom to vary rural and urban prices. The powers conferred on the Authority by section 113 of the Electricity Industry Act show a clear public policy intent in this area (and others relevant to pricing), and it would be imprudent for distributors to fail to have regard to this. A possible and perhaps outcome of regulation in these areas would be to effectively *require* some form of subsidy.

¹ If the concern here is that the pricing methodology is creating significantly (and inappropriately) different returns from the various consumer categories, then it seems to us that unless consumers (or some other party) have expressed the concern, there is little value in analysing it every year, and if consumers (or some other party) *have* expressed the concern, then response to that should be by means other than the pricing methodology. We note that the Commerce Commission has regulated in this area in the past.

- That the methodology should “demonstrate” the extent to which distributors have variabilised charges (actually prices) to recover costs which should be considered fixed, or vice versa (3.4.6 (c)). Leaving aside the significant regulatory constraints in this area (both distributors and retailers are required by the low fixed charge regulations to variabilise the recovery of a proportion of fixed costs) there is nothing inherently wrong with doing so. There are many markets where fixed costs are recovered via variable prices – one need look no further than electricity generation. We do not consider that there is any reliable method to determine whether the extent of variabilisation is appropriate. In any case we believe the Concept report has conceived the notions of “fixed” and “variable” too simplistically. It is not a dichotomy.

Concluding remarks

- 7 Thank you for the opportunity to make this submission. Orion does not consider that any part of this submission is confidential. If you have any questions please contact Bruce Rogers, DDI 03 363 9870, email bruce.rogers@oriongroup.co.nz.

Yours sincerely



Bruce Rogers
Pricing Manager

Appendix – responses to specific questions

Question No.	Question	Response
1	Do you consider the type of analysis suggested is appropriate given the pricing principles, and are there important aspects that have been omitted?	We consider that much of the analysis is beyond what is sensible or useful. Some of it is more appropriately located in asset management plans.
2	Do you consider that the Commerce Commission's template for gas distribution businesses would be an appropriate guide?	No. We consider that the context is quite different.
3	To what extent do the constraints listed in paragraph 3.2.10 impact on your ability to align your pricing methodologies with the pricing principles?	<p>We consider that our pricing (rather than the methodology) is already well aligned with the principles.</p> <p>The constraints listed are all potentially relevant to any changes to pricing, whether or not these improve alignment with the principles, and whether or not they improve efficiency.</p> <p>We do not consider that any of these constraints would stop us making changes to our pricing: they are just factors that need to be considered.</p>
4	Do you agree with the assessment criteria for Guideline (a)?	Please refer to the ENA submission.
5	Do you agree with the assessment criteria for Guideline (b)?	Please refer to the ENA submission.
6	Do you agree with the assessment criteria for Guideline (c)?	Please refer to the ENA submission.