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Electricity Authority
2 Hunter Street
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By email: submissions@ea.govt.nz

Dear Carl

No industry support for introduction of a framework for distribution pricing methodologies

Genesis Power Limited, trading as Genesis Energy, welcomes the opportunity to provide a cross-submission to the Electricity Authority (“the Authority”) on the consultation paper “Decision-making and economic framework for distribution pricing methodology review” dated 7 May 2012.

While most submitters¹ appear to support the Authority reviewing the existing regulatory measures² for distribution pricing against the Authority’s statutory objective, there is a strong level of opposition to introducing a decision-making and economic framework (“decision-making framework”) to assist with the Authority’s review of distributors’ pricing methodologies. We endorse the views put forward by many submitters that:

- the Authority has not demonstrated why a decision-making framework is required for distribution pricing. The consultation paper does not identify a clear problem that the Authority is trying to address through the introduction of a decision-making framework, nor has it provided a cost-benefit analysis of

¹ Electricity Networks Association (on behalf of 29 electricity distribution businesses), Vector Limited, Meridian Energy Limited, Mighty River Power Limited, Orion New Zealand Limited, Powerco Limited and TrustPower Limited.

² The pricing principles and the information disclosure guidelines.

the proposal. It is also not clear why distribution and transmission require the same decision-making framework, given the differences between the sectors;

- there will be practical difficulties applying the decision-making framework to distribution, particularly when trying to identify exacerbators and beneficiaries;
- there is already a complex regulatory environment for distribution pricing. The Authority needs to consider the barriers to efficient distribution pricing that arise from existing regulations such as the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004; and
- we support the Electricity Networks Association's (ENA) proposal³ to include a preamble to the pricing principles. We consider that this approach would enable the review of distributors pricing methodologies to proceed in September/October 2012 as planned.

We discuss these points below and set out our recommendations for how work on distribution pricing could be progressed.

No demonstrated need for framework for distribution pricing

We agree with the view, held by the majority of submitters, that a decision-making framework is not required for the review of distributors' pricing methodologies. As noted in our submission,⁴ it is not clear why the same decision-making framework is required for both distribution and transmission, given the differences between the two sectors. This point was expanded upon by a number of submitters who noted that:

"transmission investment is characterised by periodic and large capital costs which must be recovered in some form from users.....By way of comparison, investment in distribution is characterised by much smaller continuous incremental investments to maintain and upgrade the network and ensure reliability, particularly during peak periods";⁵

³ Page 16 of ENA's submission.

⁴ *Question value of framework for distribution pricing methodology review*, Genesis Energy submission to the Electricity Authority, 14 June 2012.

⁵ Page 2 of Mighty River Power Limited's submission.

“there are significant differences between the context for transmission pricing and the context for distribution pricing. These include [the] nature and number of the contracting parties”⁶; and

“in transmission, the problem is who should pay the charge (i.e. generators or consumers). In distribution, it is widely accepted that consumers, rather than generators, should pay for distribution assets”.⁷

Similar comments were also raised by ENA, Marlborough Lines Limited, PricewaterhouseCoopers (PwC), Unison Networks Limited and Vector Limited. In our view, the consultation paper does not properly consider these differences and does not justify why the decision-making frameworks for transmission and distribution pricing need to be the same.

No problem identified and no cost-benefit analysis undertaken

A number of submitters raised concerns that the Authority has not identified a clear problem that it is attempting to address through the introduction of a decision-making framework for distribution pricing.⁸ Submitters are also concerned that the Authority has not undertaken a cost-benefit analysis of this proposal and it hasn't considered other alternate solutions.⁹ We agree with these comments and are disappointed that a robust policy process has not been followed for this work.¹⁰

It is clear from submissions that there are a number of potential costs and negative consequences that could arise from the introduction of this decision-making framework. Submitters have outlined that:

- the application of the framework will lead to additional complexity and uncertainty¹¹ and will create transaction costs for distributors, who must now demonstrate alignment with both the decision-making framework and the

⁶ Page 5 of Orion New Zealand Limited's submission.

⁷ Page 6 of Powerco Limited's submission.

⁸ Points raised by ENA, Mighty River Power Limited, Orion New Zealand Limited, PwC, Unison Networks Limited and Vector Limited.

⁹ Points raised by ENA, Mighty River Power Limited, PwC and Vector Limited.

¹⁰ It has been noted that the Authority's approach is inconsistent with the process that is expected under its own consultation charter.

¹¹ Point raised in ENA's submission.

pricing principles.¹² Any analysis should take into account “the administrative and compliance costs of regulation, and the effect of regulatory uncertainty and ad-hoc interventions”;¹³

- the Authority has not considered the impact on retailers and domestic consumers from distributors’ application of the decision-making framework.¹⁴ As noted by Mighty River Power “the application of the framework could result in a greater emphasis on cost reflectivity, leading toward more granular network pricing, potentially to the ICP level which would be unworkable in a cost sense for retailers.”¹⁵ There is also a risk of price shock for consumers in 2014 resulting from dramatic changes in pricing methodologies;
- the framework is at odds with the Authority’s work on distribution standardisation.¹⁶ Vector notes that it is “acutely aware of the concerns of retailers about the transaction costs that a high degree of disaggregation can cause”;¹⁷ and
- introducing a decision-making framework would only delay the review process and would be detrimental to distributors, retailers and consumers in the long-term. As noted in our June 2012 submission⁴ and reinforced by Powerco, distributors require sufficient time to consult with retailers on distribution pricing methodologies (often requiring eight to nine months of development) prior to price changes becoming effective on 1 April. Even with no delays for changes in the regulatory settings, the earliest that distributors could consider changes to their pricing approaches would be 2014.

We suggest that these concerns must be carefully considered against the benefits of introducing the decision-making framework.

Support applying existing regulatory measures first

We support the call from submitters for a stable and predictable regulatory environment to govern distribution pricing methodologies. Distributors and

¹² Point raised in Powerco Limited’s submission.

¹³ Page 5 of PwC’s submission.

¹⁴ Point raised in Domestic Energy Users’ Network’s (DEUN) submission.

¹⁵ Page 3 of Mighty River Power Limited’s submission.

¹⁶ Point raised in PwC’s submission.

¹⁷ Page 4 of Vector Limited’s submission.

retailers have invested a significant amount of time working with both the Electricity Commission and the Authority to develop the existing regulatory measures and the pricing principles have already been rigorously debated.¹⁸ It is important that the Authority now “step back from the current proposal and allow distributors time to respond to the pricing framework it has already developed.”¹⁹ We consider that the Authority should only consider introducing further regulatory changes if the existing regulatory measures are found to be deficient.

Concerns regarding detail of the framework

Genesis Energy supports the decision-making framework that the Authority has developed for the Transmission Pricing Methodology review and considers that the framework establishes a suitable hierarchy of preferred allocation methodologies.²⁰ However, we do not agree that this decision-making framework is appropriate for distribution pricing.

As noted above, we consider that there are important differences between transmission and distribution that make applying the same decision-making framework unnecessary and impractical. We agree with submitters that distributors will face difficulties trying to apply the same hierarchy of pricing methodologies to distribution pricing. PwC, MainPower New Zealand Limited, Orion New Zealand Limited, Simply Energy, Vector Limited, ENA and Mighty River Power Limited have all outlined a number of specific concerns about the application of the proposed decision-making framework.

It is clear from distributors’ comments that further detailed guidance on how the framework would work in practice may be necessary, if the Authority expected distributors to fully apply the decision-making framework when reviewing their distribution pricing methodologies.²¹ Development of any guidance material would only further delay the first review of distributors pricing methodology. As noted in our submission,⁴ we consider that it is important that this workstream moves forward.

¹⁸ PwC also notes that the pricing principles have been applied in a number of other jurisdictions.

¹⁹ Page 3 of PwC’s submission.

²⁰ *Support decision-making framework to progress transmission pricing decisions*, Genesis Energy submission to the Electricity Authority, 23 February 2012.

²¹ Points raised by Unison Networks Limited and Vector Limited.

Complex regulatory environment for distribution pricing

It is important that the Authority carefully consider the impact that other regulatory interventions and legislation can have on efficient distribution pricing, as this may limit the progress that can be achieved under the Authority's existing regulatory measures. We agree with submitters²² that the consultation paper does not appropriately deliberate the impact of:

- the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004;
- Part six of the Electricity Industry Participation Code ("the Code") that governs pricing of connections for distributed generation;
- the ability of the Authority to initiate regulations to restrict the rate of change in rural prices relative to non-rural prices on the same distribution network;²³
- the Commerce Commission's regulation of electricity distribution businesses. In particular, concerns have been raised about revenue risk when re-structuring prices²⁴ and the incentives placed on distributor's to improve service quality; and
- the inter-linkages between the Authority's and Commerce Commission's regulatory regimes. PwC was particularly concerned about the piecemeal approach to the regulatory framework for distribution pricing.

We discuss below two possible projects the Authority could undertake to understand the impact the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 and Part six of the Code have on efficient distribution pricing.

²² Points raised by ENA, PwC, Mighty River Power Limited, Vector Limited, MainPower New Zealand Limited, Marlborough Lines, Meridian Energy Limited, Orion New Zealand Limited, TrustPower Limited.

²³ As specified in clause 113(1)(c) and 113(2)(e) of the Electricity Industry Act 2010.

²⁴ This point was of particular concern to Genesis Energy and was raised in our June 2012 submission.

Proposed approach going forward

Genesis Energy supports ENA's proposal to incorporate the following pre-amble at the start of the Authority's pricing principles:

"...these Pricing Principles are to be interpreted and applied in a manner that is consistent with the Statutory Objective of the Electricity Authority – to promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers."²⁵

We consider that the ENA proposal will ensure that the pricing principles remain consistent with the Authority's statutory objective and that distribution pricing methodologies are developed in a manner that focuses on the long-term benefit of consumers.²⁶

We also endorse PwC's recommendation that the Authority confirm and publish the pricing principles, the information disclosure guidelines and the assessment criteria in a stand-alone document.²⁷ It is important that the review material is easily assessable for distributors when they consider their pricing methodologies.

We consider that these changes will enable the Authority to undertake its first full review of distributors' pricing methodologies as planned in September/October 2012 and gather evidence of whether there are any systemic issues with distributors' pricing approaches. As noted in our June 2012 submission, this evidence is necessary to enable the Authority to assess whether further regulatory interventions are required to enable efficient distribution pricing.

Further workstreams to address efficient distribution pricing

In the Authority's 2012/13 work programme, the Authority has identified a potential research project to review the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004. This is currently signalled for completion in 2013/14 (or out-years). We strongly encourage the Authority to confirm this project and re-prioritise this work so it can be completed earlier. We consider that this work would resolve impediments for both retailers and distributors and could be progressed via the Retail Advisory Group, with support from the Ministry of Economic Development.

²⁵ Page 16 of ENA's submission.

²⁶ We note that this solution is supported by the majority of submitters.

²⁷ Page 11 of PwC's submission.

We also understand the Authority will be reviewing the pricing principles from Part six of the Code, as part of the distribution pricing review.²⁸ We encourage the Authority to seek direct feedback from participants on the Part six pricing principles, to enable the Authority to better understand participant's concerns and consider whether further analysis of this area of the Code is required.

If you would like to discuss any of these matters further, please contact me on 04 495 6354.

Yours sincerely



Karen Collins
Senior Regulatory Advisor

²⁸ As noted on page 17 of the Authority's 2012/13 work programme.