Discussion Paper - Draft Distribution Pricing Principles and Methodological Requirements

Prepared by the Electricity Commission

30 September 2009

Executive summary

On 5 June 2009, the Electricity Commission (**Commission**) published a consultation paper outlining a proposed model approach to an electricity distribution pricing methodology (**Consultation Paper**). This approach used as a starting point the model pricing methodology of the Pricing Approaches Working Group (**PAWG**) (**PAWG model approach**).

The Commission:

(a) has completed an assessment of the submissions received on the Consultation Paper and presentations made at the workshop held on 17 June 2009. The assessment has led to a reconsideration to the degree of prescription contained in its model approach to a distribution pricing methodology;

(b) notes that there no longer appears to be widespread acceptance by distributors and retailers of the PAWG model approach. Primarily, this appears to be a result of the relatively prescriptive nature of the PAWG model approach;

(c) notes the widespread support from distributors in particular and, to a slightly lesser extent, retailers for the Commerce Commission's preliminary view, in the context of Part 4 of the Commerce Act, that a principles-based approach to pricing methodologies is appropriate for distributors[1];

(d) has formed the following preliminary view on a model approach to a distribution pricing methodology:

    (i) a principles-based approach to a distribution pricing methodology should be adopted; and

    (ii) guidelines (methodological requirements) should be provided to assist stakeholders with interpreting and implementing the proposed pricing principles.

The Commission concludes that, where it accords with the objectives of each commission, consistency should be sought between itself and the Commerce Commission in respect of the treatment of distribution pricing. Accordingly, the Commission has prepared draft pricing principles based on the principles contained in the Commerce Commission's gas authorisation for Powerco and Vector, and the Commerce Commission's input methodologies discussion paper.

The Commission has then reformulated the pricing principles where appropriate to reflect:

(a) additional objectives set out in the Electricity Act 1992 (**Act**);

(b) relevant objectives in:

[1] Noting that CC93 supported the use of both a principles-based approach and a standard methodology.

(i) the transmission pricing methodology (**TPM**)[2]; and

(ii) the Electricity Governance (Connection of Distributed Generation) Regulations 2007; and

(c) feedback from submissions on the Consultation Paper.

The proposed pricing principles are as follows:

(a)	Prices are to signal the economic costs of service provision, by:	
	(i)	being subsidy free (equal to or greater than incremental costs, and less than or equal to standalone costs), except where subsidies arise from legislation;
	(ii)	having regard, to the extent practicable, to the level of available service capacity; and
	(iii)	signalling, to the extent practicable, the impact of additional usage on future investment costs.
(b)	Where prices based on ‘efficient’ incremental costs would under-recover allowed revenues, the shortfall should be made up by setting prices in a manner that has regard to consumers’ demand responsiveness (i.e. Ramsey pricing) and/or the quality of service that they receive, to the extent practicable.	
(c)	Provided that prices satisfy (a) above, prices should be responsive to the requirements and circumstances of users in order to:	
	(i)	discourage uneconomic bypass; and
	(ii)	to allow for price/quality tradeoffs.
(d)	Development of prices should be transparent, promote price stability and certainty for consumers, and lead to prices that are able to be understood by users.	
(e)	Pricing structures should not place undue transaction costs on retailers and consumers, and should be competitively neutral across retailers.	
(f)	Prices and pricing structures should promote efficient usage of electricity and encourage investment in distributed generation (including renewable generation), distribution alternatives and technology innovation.	

[2] The TPM is set out in Schedule F5 of section IV of part F of the Electricity Governance Rules 2003 (**Rules**). The Commission is currently conducting a review of the TPM, and a consultation paper is expected to be published in October 2009.

Similarly, the Commission has prepared draft methodological requirements as guidelines based on those set out in the Commerce Commission's gas authorisation for Powerco and Vector, and updated these where appropriate to reflect any additional requirements specific to the Commission's principal objectives and specific outcomes.

The proposed methodological requirements are as follows:

(a) Prices should be based on a well-defined, clearly explained and published methodology, with any revisions notified and clearly marked.

(b) Price development should incorporate, to the extent practicable, an analysis of the cost of service provision that includes:

- (i) definition of the classes of service provided and the parameters by which the quality of service in each class are measured;
- (ii) an examination of the cost elements that arise from the use, operation and expansion of the network;
- (iii) identification of the relationship between the quality of service provided and the level of current and future cost for each class of service;
- (iv) an allocation of existing and future network costs to service classes, and an explanation of the cost allocation methodology used;
- (v) the translation of allocated costs into service prices at the defined level of quality of service – including the re-allocation of transmission charges while preserving the transmission pricing signal;
- (vi) analysis of the extent to which costs are marginal, and whether the associated price components in the tariff structure reflect those marginal costs;
- (vii) analysis of the development of time of use prices and critical peak pricing where these can practically be applied;
- (viii) estimates of the range of subsidy-free prices for each service class and the extent to which subsidies, if any, are caused by legislation; and
- (ix) development of pricing arrangements that will be used to reflect the cost / value of deferral of investment in distribution assets, where this is practicable.

(c) Information relating to standard services on customer class price levels and structures, quality of service standards, underlying costs, price derivation methods and rationale, and medium term price and quality of service strategies should be publicly disclosed.

(d) Underlying service classifications, cost data, cost allocations and other elements that contribute to pricing decisions should be periodically reviewed and updated where relevant to reflect industry developments and changes in user requirements and preferences, methods of service provision and costs.

(e) Pricing structures should:

(i) consist only of the minimum number of tariffs necessary to meet the provisions of the pricing principles; and

(ii) employ industry standard tariff formats and nomenclature, where possible.

(f) Where a change to the existing pricing methodology is proposed to improve compliance with the pricing principles, details of the impact on customer classes and the transition arrangements proposed to mitigate the effect of redistribution of costs and "rate shock" should be publicly disclosed.

The Commission notes the feedback received from submitters in relation to compliance reporting and will factor this into its discussions with the Commerce Commission. In particular, the Commission will investigate Vector's suggestions relating to:

(a) the development of a template compliance statement for distributors to use in demonstrating that their pricing methodologies have complied with the pricing principles, with the compliance statement only needing to be updated when distributors have materially changed pricing structures and/or cost allocation methodologies; and

(b) targeted regulation of distributors, rather than general regulation, in instances where non-compliance is limited to specific distributors.

To assist it in forming a final view on a model approach to a distribution pricing methodology, the Commission is seeking written submissions on the proposed draft distribution pricing principles and methodological requirements and will facilitate a workshop for industry participants and other interested stakeholders on 12 October 2009. This workshop will have the following objectives:

(a) understanding retailers concerns as to the aspects of distribution pricing that can be a barrier to retail competition;

(b) identifying what aspects of distribution pricing may be relatively easily standardised. To confirm common terminology and definitions for distribution access and pricing, as well as the basis for a common tariff format across distributors (including standardisation of customer categories). This will probably require the formation of an industry working group;

(c) seeking feedback from stakeholders on revised draft pricing principles and methodological requirements; and

(d) discussing the merits, or otherwise, of a more or less mandatory approach.

The proposed timetable is set out in the following table.

Table 1 Process to finalise the model distribution pricing methodology approach

Date	Event
12 October 2009	Commission facilitates workshop on distribution pricing
30 September 2009	Commission publishes draft final pricing principles and methodological requirements
22 October 2009	Consultation on the draft distribution pricing principles and methodological requirements closes
November 2009	Industry working group reports back on areas that can be standardised
End December 2009	Final pricing principles and methodological requirements published

Glossary of abbreviations and terms

Act	means the Electricity Act 1992
AMI	means advanced metering infrastructure
Commerce Act	means the Commerce Act 1986
Commission	means the Electricity Commission
Consultation Paper	means the consultation paper entitled "*Distribution Pricing Methodology – consultation paper on a model approach*", published by the Commission on 5 June 2009
Consumer	(a) means any person who is supplied, or who applies to be supplied, with electricity; but (b) does not include any generator or distributor or retailer, except where the generator or distributor or retailer, as the case may be, is supplied with electricity for its own consumption and not for the purposes of resupply to any other person
Distributed Generation Regulations	means the Electricity Governance (Connection of Distributed Generation) Regulations 2007
Distributor or Electricity Distribution Business (EDB)	means any electricity industry participant who owns or operates a network (that is not an embedded network) other than Transpower
ENA	means the Electricity Networks Association
GPS	means the Government Policy Statement on Electricity Governance, released in May 2009
GXP	means a grid exit point as defined in part A of the Rules
ICP	means a point of connection on a local network or embedded network, having the attributes set out in rule 1 of schedule E1 of the Electricity Governance Rules 2003
Load Group	means a category of consumers from which load-dependent costs (i.e. costs incurred by a distributor to provide network capacity to supply the load on its network) will be recovered
Network	means the lines, and associated equipment, owned or operated by a distributor in a contiguous geographic area or areas;

PAWG	means the Pricing Approaches Working Group, which was a consultative group formed by the Electricity Networks Association for the purpose of developing voluntary model approaches to distribution pricing in New Zealand
PAWG model approach	means the recommended model approach for distribution pricing set out in the PAWG report
PAWG report	means the PAWG report, *Model Approaches to Distribution Pricing* dated February 2005
Retailer	has the meaning set out in part A of the Rules
Rules	means the Electricity Governance Rules 2003
TPM	means the Transmission Pricing methodology set out in Schedule F5 of Section IV of part F of the Rules

Contents

1. Introduction

1.1 Consultation Paper and workshop

1.1.1 On 5 June 2009, the Electricity Commission (**Commission**) published a consultation paper (**Consultation Paper)** outlining a proposed model approach to an electricity distribution pricing methodology and asking submitters to comment. This approach used as a starting point the model pricing methodology of the Pricing Approaches Working Group (**PAWG**) (**PAWG model approach**).

1.1.2 The Commission also held a workshop on 17 June 2009 for interested parties to discuss the content of the Consultation Paper and to facilitate the preparation of submissions. Submissions on the Consultation Paper closed on 10 July 2009. The Commission received 27 submissions[3].

1.2 Proposed approach

1.2.1 The Commission has now completed an assessment of the submissions[4] and presentations made at the June 2009 workshop and has formed the following preliminary view on a model approach to a distribution pricing methodology:

(a) a principles-based approach to a distribution pricing methodology should be adopted.

(b) guidelines (methodological requirements) should be provided to assist stakeholders with interpreting and implementing the proposed pricing principles.

1.2.2 In addition, the Commission proposes to publish a relatively detailed model distribution pricing methodology, which is intended to provide distributors with an example of a methodology that, in the Commission's view, satisfies the pricing principles and methodological requirements. This supplementary document will be for information only.

1.2.3 Where practicable the Commission has sought to align the revised proposed model approach to a distribution pricing methodology with the approach adopted by the Commerce Commission in the gas authorisation for Powerco and Vector[5],

---

3 http://www.electricitycommission.govt.nz/submissions/substransmission/distrib-pricing

4 The Summary of submission document is available at http://www.electricitycommission.govt.nz/pdfs/opdev/transmis/distrib-pricing/subssummary.pdf

5 Commerce Commission, *Authorisation for the Control of Supply of Natural Gas Distribution Services by Powerco Ltd and Vector Ltd, Decision Paper*, 30 October 2008; Commerce Commission Authorisation, *Decision No.656*, 30 October 2008; Commerce Commission Authorisation, *Decision No. 657*, 30 October 2008.

taking into consideration the Commerce Commission's preliminary views on pricing methodologies, as set out in its 19 June 2009 discussion paper on input methodologies[6].

1.3 Commerce Commission

1.3.1 The Commission will also be working with the Commerce Commission to make consistent the information disclosure requirements of the two entities in respect of distribution pricing. As set out in the Consultation Paper, the Commission's preliminary view is that the level of reporting on the pricing methodology should be in line with the obligations on distributors under the relevant Commerce Act 1986 information disclosure requirements[7] (i.e. distributors would submit information using the same format, to the extent possible, as they would when submitting information to the Commerce Commission).

1.3.2 Any reporting requirements should require the distributors to submit this information to the Commission at the same time that they submit the information to the Commerce Commission.

1.4 How to provide feedback

1.4.1 The Commission is seeking stakeholders' feedback on the proposed draft distribution pricing principles and methodological requirements through written submissions and at a workshop[8].

1.4.2 The Commission's preference is to receive written submissions in electronic format (Microsoft Word). It is not necessary to send hard copies of submissions to the Commission, unless it is not possible to do so electronically. Submissions in electronic form should be emailed to submissions@electricitycommission.govt.nz with "Discussion paper - Draft distribution pricing principles and methodological requirements" in the subject line. The Commission will acknowledge receipt of all submissions electronically. Please contact Kate Hudson if you do not receive electronic acknowledgement of your submission within two business days.

---

6 Commerce Commission, *Input Methodologies Discussion Paper*, 19 June 2009.

7 These are provided for in sub-part 4 of part 4 of the Commerce Act (came into force from 14 October 2008) and will be set out in a section 52P determination made by the Commerce Commission. The Commerce Commission is required to make a determination specifying how information disclosure regulation applies to each EDB and Transpower "as soon as practicable" after 1 April 2009. The Electricity Distribution (Information Disclosure) Requirements 2008 and the Electricity Information Disclosure Requirements 2004 continue to apply until the determination takes effect.

8 http://www.electricitycommission.govt.nz/opdev/transmis/distrib-pricing/index.html

1.4.3 Your submission is likely to be made available to the general public on the Commission's website. Submitters should indicate any documents attached, in support of the submission, in a covering letter and clearly indicate any information that is provided to the Commission on a confidential basis. However, all information provided to the Commission is subject to the Official Information Act 1982.

1.4.4 If submitters do not wish to send their submission electronically, they should post one hard copy of their submission to the address below.

Kate Hudson
Electricity Commission
Level 7, ASB Bank Tower
2 Hunter Street
Wellington

Tel: 0-4-460 8860

1.4.5 Submissions should be received by **5pm** on **Thursday 22 October 2009**. Please note that late submissions are unlikely to be considered.

2. Background

2.1 The Commission’s initial view on a model approach

2.1.1 The Consultation Paper set out a voluntary model approach to a distribution pricing methodology, which in the Commission’s view furthered the Commission’s principal objectives under the Electricity Act 1992 (**Act**) and gave effect to the objective in paragraph 100 of the 2009 Government Policy Statement on Electricity Governance (**GPS**), which states that “*the Commission should develop, in consultation with interested parties, principles or model approaches to distribution pricing and monitor their uptake*”.

2.1.2 Consistent with the outcome of the distribution pricing process facilitated by the Electricity Networks Association (**ENA**) in 2004 - 2005, which culminated in the early 2005 report setting out the PAWG model approach (the **PAWG report**), the Commission noted in the Consultation Paper its view that a single model for distribution pricing, with flexibility in its implementation, would be the most efficient means of furthering the objectives described above.

2.1.3 The proposed model approach set out in the Consultation Paper was based on the PAWG model approach, which the Commission understood received widespread acceptance from distributors and retailers at the time of its development and publication.

2.1.4 To guide the development of a model approach, the Commission developed a set of guiding principles, which built on the guiding principles used by the PAWG, and took into account the Commission’s objectives and required outcomes, as set out in the Electricity Act 1992 (**Act**) and the GPS.

2.1.5 In the Consultation Paper the Commission updated the PAWG model approach, primarily to reflect changes in the regulatory environment, but also to introduce more flexibility in its application. The regulatory changes reflected the development of the transmission pricing methodology (**TPM**), and the Electricity Governance (**Connection of Distributed Generation**) Regulations 2007 and the Electricity (**Low Fixed Charge Tariff Option for Domestic Consumers**) Regulations 2004. In addition, the proposed model approach set out in the Consultation Paper differed from the PAWG model approach in that it made firm recommendations on disaggregating costs by service level and on adopting the retail delivery model (where distributors charge retailers on the basis of sales volumes measured at the ICP) over the wholesale delivery model (where distributors charge retailers on the basis of reconciled sales volumes at GXPs).

2.1.6 The proposed model approach set out in the Consultation Paper aimed to improve the transparency of the allocation of costs, in particular load dependent costs[9], and to facilitate efficient pricing. It also aimed to promote efficient use of distribution networks and efficient investment in these networks, by signalling the cost of network congestion and augmentation, while ensuring that distributors and consumers received stability and certainty in revenues and costs (respectively). Finally, the proposed model approach set out in the Consultation Paper aimed to achieve a greater degree of commonality and consistency of distribution pricing across New Zealand's 29 distributors, thereby reducing the complexity and costs faced by retailers operating across multiple distribution networks, thus enhancing retail competition.

2.2 The Commerce Commission's approach

2.2.1 The Commerce Commission has considered the matter of distribution pricing in several contexts, including:

(a) post-breach inquiries and subsequent administrative settlements with Unison Lines[10] and Vector[11] in regards to their (respective) provision of electricity distribution services;

(b) information disclosure for distributors that it regulates;

(c) the authorisation for Powerco and Vector in regards to their controlled gas pipeline services[12]; and

(d) forming a preliminary view on the level of detail specified in the input methodology on pricing methodologies for distributors that it regulates[13].

2.2.2 The primary focus of the Commerce Commission on distribution pricing has been in the context of part 4 of the Commerce Act and has not been related to enhancing retail competition.

2.2.3 In its consideration of pricing methodology issues for the gas authorisation decisions, the Commerce Commission considered experience on pricing methodologies in overseas jurisdictions. This included commissioning a report

---

9 Load dependent costs are the costs incurred by a distributor to provide network capacity to supply load on its network.

10 Commerce Commission, Regulation of Electricity Lines Businesses, Targeted Control Regime, Reasons for Not Declaring Control, Unison Networks Limited, 11 May 2007.

11 Commerce Commission, Regulation of Electricity Lines Businesses, Targeted Control Regime, Reasons for Not Declaring Control, Vector Limited, 30 May 2008.

12 Commerce Commission, Authorisation for the Control of Supply of Natural Gas Distribution Services by Powerco Ltd and Vector Ltd, Decisions Paper, 30 October 2008; Commerce Commission Authorisation, Decision No.656, 30 October 2008; Commerce Commission Authorisation, Decision No. 657, 30 October 2008.

13 Commerce Commission, Input Methodologies Discussion Paper, 19 June 2009.

on approaches to (electricity and gas) distribution pricing adopted in Australia and the United Kingdom[14].

2.2.4 The Commerce Commission considered three levels of intervention when deciding on the appropriate pricing approach for the gas authorisation:

(a) allowing businesses the flexibility to set prices according to their chosen pricing methodology;

(b) the Commerce Commission setting pricing principles and guidelines that the businesses must have regard to in developing a pricing methodology; and

(c) the Commerce Commission developing and consulting on its own pricing methodology and setting disaggregated prices for each customer load group on this basis[15].

2.2.5 The Commerce Commission's preliminary view in the case of the gas authorisation, which was subsequently confirmed as its final view, was:

(a) The first option was insufficient to ensure that an appropriate pricing methodology would be developed or implemented, as evidenced by no systematic methodological approach having been applied or developed for gas distribution (and metering) tariff setting at the time.

(b) The third option could impose significant direct and indirect costs, as a consequence of factors such as:

(i) the information asymmetry between the businesses and the Commerce Commission; and

(ii) the limited scope the businesses had to respond to changes in market conditions and demand, potentially resulting in uneconomic bypass.

Furthermore, the Commerce Commission noted that the effectiveness of regulatory intervention in price setting may be constrained if the regulator was unable to address directly the potential for pricing distortions in downstream unregulated markets, which is the case for the controlled gas distribution services.

(c) The Commerce Commission adopted the second option for the gas authorisation, as it provided more guidance for the businesses, while still allowing the businesses to retain a high degree of pricing flexibility. The pricing flexibility would enable the businesses to use their superior

---

14 Meyrick and Associates, Gas Distribution Pricing Principles, 6 November 2007.

15 Commerce Commission, Authorisation for the Control of Supply of Natural Gas Distribution Services by Powerco Ltd and Vector Ltd, Decision Paper, 30 October 2008, pp 267-268.

information on customer demand and their cost structures to set efficient prices and to respond to competitive constraints that may exist for some of the controlled services[16].

2.2.6 In the Vector administrative settlement, the Commission evaluated Vector's cost of supply model and referred to its draft decision on the gas authorisation, noting that it considered Vector's model to be broadly consistent with the high-level pricing principles set out in the draft decision as well as with the principles in the October 2006 GPS on electricity governance[17].

2.2.7 In its consultation on options for pricing methodologies under input methodologies[18], the Commerce Commission's preliminary view[19] is consistent with its gas authorisation decision; namely that "…*where intervention is appropriate at all, an approach based on setting pricing principles is likely to be most appropriate for input methodologies for the relevant regulated services*"[20].

2.2.8 The Commerce Commission goes on to note that, in general, it considers that the type of 'intermediate' approach applied in the gas authorisation is likely to be appropriate under individual or default/customised price-quality regulation. However, as default price-quality paths are intended to be a relatively low-cost means by which a price-quality path is set, the benefits of the 'intermediate' approach may be outweighed by the costs of implementing it, meaning that it might only be applied to customised price-quality regulation. Also, a number of distributors will be exempt from the Commerce Commission's input methodologies for pricing methodologies and will be subject only to information disclosure regulation.

2.2.9 However, as it noted in the administrative settlements with Unison and Vector, the Commerce Commission is aware that the Commission is tasked with developing model approaches to electricity distribution pricing. The Commerce Commission has expressed a preference for the Commission to develop its work in this area before it (the Commerce Commission) makes any further decisions in respect of pricing methodologies for electricity distribution businesses[21].

---

16 Ibid, p 268.

17 Commerce Commission, Regulation of Electricity Lines Businesses, Targeted Control Regime, Reasons for Not Declaring Control, Vector Limited, 30 May 2008.

18 Specifically, the Commerce Commission documents entitled," *Input Methodologies Discussion Paper*" dated 19 June 2009.

19 The Commerce Commission's preference for a pricing principles approach reflect its view that such an approach as being more appropriate to price setting under part 4 of the Commerce Act, taking into account the factors the Commerce Commission can consider in that context. It has acknowledged that the Electricity Commission has a wider mandate.

20 Commerce Commission, Input Methodologies Discussion Paper, 19 June 2009, p 277, para 9.54.

21 Ibid, p 340.

2.2.10 The Commerce Commission summarises its current preliminary view, in the context of part 4 of the Commerce Act, on distribution pricing as follows:

(a) "*a principles based approach to pricing methodologies is appropriate for [distributors that it regulates]; and*

(b) *the principles should be based upon the output of the Electricity Commission's Distribution Pricing Project, to the extent that:*

(i) *such principles, guidelines and/or model distribution pricing methodology or approaches are consistent with the relevant provisions of the Commerce Act; and*

(ii) *are available in sufficient time for the [Commerce] Commission to take those decisions into account within the statutory timeframes for determining input methodologies*"[22].

2.3 Feedback from submitters

2.3.1 The Commission received substantial feedback on the appropriate level of detail that should be contained in a model approach to a distribution pricing methodology. The submissions fell broadly into three categories:

(a) those that favoured an approach based on the use of pricing principles;

(b) those that agreed with the use of pricing principles accompanied by a relatively prescriptive methodology; and

(c) those that did not have a preference between a principles-only approach and a relatively prescriptive methodology.

Pricing principles approach

2.3.2 Twelve submitters[23] favoured the development of a model approach based on pricing principles rather than a prescriptive methodology.

2.3.3 ENA recommended that the Commission confine itself to identifying principles and standard definitions for distribution pricing at this point in time.

---

22 Ibid, p 341, para 11.12.

23 Eastland, Electricity Networks Association (**ENA**), Counties Power, Horizon, Marlborough, Northpower, Orion, Powerco, PricewaterhouseCoopers, Unison, Vector and Wellington Electricity.

2.3.4 PricewaterhouseCoopers, on behalf of 22 distributors[24], and Marlborough Lines noted that the Commerce Commission's discussion in its June 2009 Input Methodology discussion paper drew on its pricing methodology experience with the electricity distribution businesses of Unison and Vector and the gas pipeline businesses of Powerco and Vector, and that this experience has contributed to the Commerce Commission's preliminary view on pricing regulation in the context of Input Methodologies to be developed under the recently amended Part 4 of the Commerce Act.

2.3.5 Marlborough Lines submitted that a highly prescriptive approach will restrict distributors in meeting their individual characteristics of demand, consumer density, consumer mix, geography, etc. Marlborough Lines submitted that a principles-based approach should be adopted rather than a prescriptive model approach.

2.3.6 Powerco recommended that the Electricity Commission should simplify its pricing principles and align them with the pricing principles adopted by the Commerce Commission in its gas authorisation for Powerco and Vector.

2.3.7 Orion considered that significant industry changes have occurred since the PAWG report was released[25], all of which in Orion's view support a principles-based approach. Orion submitted that a principles-based approach to pricing that allows distributors flexibility to innovate and adapt to change is essential, as this enables distributors to maintain system reliability in a more dynamic environment.

2.3.8 Vector considered that a principles-based approach will better enable distributors to provide innovative pricing arrangements to encourage better use of networks and promote improvements in economic efficiency (e.g. enabling the potential of smart meters to be realised through innovations in distribution pricing). In contrast, Vector considered that model-based approaches stifle such innovation.

2.3.9 Vector noted that the Commerce Commission recognises that "the more prescriptive the Electricity Commission's approach is, the more likely a change would need to be made during the seven years in which the input methodologies

---

[24] Alpine Energy Limited, Aurora Energy Limited, Buller Electricity Limited, Counties Power Limited, Eastland Network Limited, Electra Limited, Electricity Ashburton Limited, Electricity Invercargill Limited, Horizon Energy Distribution Limited, MainPower New Zealand Limited, Marlborough Lines Limited, Nelson Electricity Limited, Network Tasman Limited, Network Waitaki Limited, Northpower Limited, OtagoNet Joint Venture, ScanPower Limited, The Lines Company Limited, The Power Company Limited, Top Energy Limited, Waipa Networks Limited and Westpower Limited.

[25] In particular: the commencement of the rollout of AMI; the implementation of global reconciliation; the Commerce Act requirement that ELBs be under economic regulatory control, rather than be under a threshold regime; the introduction of the Distributed Generation Regulations and pricing principles; the Commerce Commission's decision to adopt pricing principles for the gas industry rather than a detailed prescriptive pricing methodology such as that proposed in the PAWG report; and the existence of an increasing number of embedded networks.

determinations could potentially apply before being reviewed”[26]. In Vector’s view this provides further support for the adoption of a principles-based approach.

2.3.10 Unison considered that the Commission’s proposed methodology was unnecessarily prescriptive, and that there is not a demonstrable benefit associated with changing methodologies.

2.3.11 Wellington Electricity considered that a principles-based approach should be adopted rather than one that is based on a prescriptive model and that:

(a) distributors must have pricing principles that allow sufficient flexibility such that tariff structures meet the needs of their networks and customers; and

(b) that there is a pragmatic approach to pricing methodologies over the competing interest of economic principles.

Principles and model approach

2.3.12 There were eight submissions[27] that noted a preference for the principles-based and model approach.

2.3.13 CC93 believed that a standard methodology should be adopted as a default.

2.3.14 Contact Energy noted that the principles-based approach with an intermediate level of detail specified in the input methodology, as per the Commerce Commission’s gas authorisation for Powerco and Vector, appears to be leading to positive results for retailers, given the rationalisation in pricing structures.

2.3.15 Mighty River Power’s view was that the greater the flexibility granted to distributors, the greater the risk that nothing will be achieved. However, Mighty River Power noted that if insufficient flexibility is given, then innovation in electricity distribution pricing will be stifled and there will be risks of anomalous outcomes arising from the rigid application of a highly prescriptive methodology. The amount of discretion that distributors should be granted should depend on the impact of the particular aspect of distribution pricing, in terms of reducing transaction costs and enabling retail competition.

2.3.16 Simply Energy believed that the distribution pricing methodology should include a fall-back right for network users to select standard pricing (as per their load group, consumer class and service quality), with any investment not covered within that pricing (as defined by the distribution pricing methodology) to be explicitly identified by the distributor so that its cost can be transparently negotiated.

---

26 Commerce Commission, *Input Methodologies Discussion Paper*, 19 June 2009, pp 342-343, para 11.127.

27 CC93, Contact, Energy Market Services (**EMS**), Meridian, Major Electricity Users’ Group (**MEUG**), MRP, PowerNet and Simply Energy.

No preference between principles or a model approach

2.3.17 Three submitters[28] appeared to have no preference between a model approach based on pricing principles and/or a more prescriptive methodology.

2.3.18 Genesis Energy considered that the optimal regulatory approach would balance compulsion with flexibility. Genesis noted that there is a range of ways that this could be achieved, but some elements could include:

(a) regulation at the level of pricing principles, rather than at the level of a detailed methodology;

(b) one or more model methodologies either as a 'safe harbour' means of implementing the principles or as a default;

(c) an ability for distributors and their customers to agree on an alternative pricing methodology, provided it does not favour affiliated or incumbent retailers; and

(d) an ability for distributors to deviate from the principles or the model methodology if they can demonstrate a net public benefit.

2.3.19 Genesis submitted that it wants rationalisation of tariff structures, but it does not believe that rigid and prescriptive regulation of tariff methodologies is the best approach, as it would be costly for many distributors and it would limit scope for innovation.

2.3.20 Network Waitaki, whilst agreeing with the pricing principles as ideals, noted that in practice it has found there to be too many conflicting regulatory constraints for it to implement the principles anymore than at a system-wide level, and certainly not at an individual consumer level. Network Waitaki considered that the pricing principles proposed in the Consultation Paper were focussed on regulatory and industry structure rather than on the issues that at least its consumers would prefer to see addressed, including:

(a) fixed tariffs with a small variable component to limit excessive use;

(b) consistency in the size of the bill from month to month; and

(c) confidence that they are paying the same rate as every other consumer on the distribution network.

---

28 Genesis, Network Waitaki (**NWL**) and the Lines Company.

3. The Commission's preliminary view on a model approach

3.1 PAWG model approach no longer supported

3.1.1 The Commission has now completed an assessment of the submissions and has given consideration to the degree of prescription contained in its model approach to a distribution pricing methodology.

3.1.2 The Commission notes that there no longer appears to be widespread acceptance by distributors and retailers of the PAWG model approach. Primarily, this appears to be a result of the relatively prescriptive nature of the PAWG model approach.

3.1.3 The Commission also notes the widespread support from distributors in particular and, to a slightly lesser extent, retailers for the Commerce Commission's preliminary view, in the context of Part 4 of the Commerce Act, that a principles-based approach to pricing methodologies is appropriate for distributors[29].

3.1.4 Noting the lack of industry support for a model approach consisting of a prescriptive methodology, coupled with the relatively broad industry support for a principles-based approach, the Commission has revisited the intent behind a model approach to a distribution pricing methodology.

3.2 Primary reasons for a model approach

3.2.1 As noted in the Consultation Paper, the primary reason for the development of a model approach to a distribution pricing methodology is to assist distributors in structuring their distribution prices so as to deliver the most economically efficient outcome[30].

3.2.2 The other reason put forward in the Consultation Paper for developing a model approach to a distribution pricing methodology is to facilitate retail competition by reducing the transaction costs faced by retailers competing for electricity consumers across multiple distribution networks. In particular, it should benefit consumers on smaller distribution networks where retailers do not have the same economies of scale in systems and processes to accommodate varying approaches to distribution pricing[31].

---

[29] Noting that CC93 supported the use of both a principles-based approach and a standard methodology.

[30] Distribution Pricing Methodology, Consultation paper on a model approach, 5 June 2009, p11.

[31] Distribution Pricing Methodology, Consultation paper on a model approach, 5 June 2009, p11.

3.3 An appropriate level of prescription

3.3.1 In the Commission's view, adopting the PAWG model approach is consistent with seeking to further the retail competition objective described above. By seeking to ensure that distributors' pricing methodologies are developed in largely the same manner, the PAWG model approach should lower the transaction costs faced by retailers competing across multiple networks.

3.3.2 However, as also noted by the Commerce Commission, there are problems with the PAWG approach, as it relates to intervention in the context of price setting under part 4 of the Commerce Act,[32] including:

(a) the information asymmetry between distributors and the regulator in determining the level of prescription[33];

(b) the lack of flexibility on the part of distributors to respond to changes in market conditions and consumers' demand; and

(c) the compliance costs associated with greater prescription[34].

These problems mean that adopting a model approach based on the PAWG model approach could have lower economic efficiency benefits over time than adopting a methodology whereby the regulator provides guidance in a less prescriptive manner.

3.3.3 As noted earlier in this paper, the approach adopted by the Commerce Commission in its gas authorisation for Powerco and Vector, and endorsed by many submitters (particularly distributors), is less prescriptive than the PAWG model approach; with the Commerce Commission establishing pricing principles and methodological requirements that businesses must have regard to (unless they are exempt from the provisions of the price quality threshold regulation) when developing a pricing methodology to assist in interpreting these pricing principles.

3.3.4 The Commission is attracted to this approach of specifying an intermediate level of detail for the following reasons:

---

32 The Commerce Commission's views would exclude any benefits associated with facilitating retail competition.

33 In the 5 June 2009 consultation paper the Commission sought to address this issue by providing for distributors to vary from the model approach to a distribution pricing methodology if they had good reason.

34 Commerce Commission, Authorisation for the Control of Supply of Natural Gas Distribution Services by Powerco Ltd and Vector Ltd, Draft Decisions Paper, 4 October 2007, p 302; Commerce Commission, Input Methodologies Discussion Paper, 19 June 2009, p 270.

(a) The economic efficiency benefits of a principled approach may be greater than under a more prescriptive methodology because of the reasons in paragraph 3.3.2 above. In fact, the benefits of a more prescriptive approach may be close to zero where there is no ability to prevent retailers from rebundling distribution price structures in a manner that weakens their economic signalling effect. Hence, the ineffectiveness of such prescription has to be balanced against relatively high compliance costs.

(b) Insofar as efficient pricing is concerned, it aligns with the approach that the Commerce Commission has to date adopted across both the gas and electricity sectors, and which the Commerce Commission has provisionally indicated as being appropriate under the input methodologies regime, at least for the gas sector,[35] and possibly the electricity sector too (noting the Commission's current work on this area)[36]. A significant concern raised by various distributors in their submissions to the Commission is the potential for inconsistencies between the Commission and the Commerce Commission in respect of each regulator's approach to electricity distribution pricing. The Commission agrees that, where appropriate, consistency should be sought across the treatment of distribution pricing by the two regulatory bodies.

(c) The pricing principles and methodological requirements approach can be adapted to encompass the extended mandate of the Commission.

(d) The feedback to the Commission from both retailers and distributors during the recent consultation (including the June Workshop), indicates that at least some of the issues affecting retail competition, which retailers previously indicated as relating to the absence of a common distribution pricing methodology, may be resolved without requiring a common pricing methodology, for instance, by standardising terminology, invoice information, presentation format.

3.4 A principles-based approach

3.4.1 The Commission has formed the following preliminary view on a model approach to a distribution pricing methodology:

(a) a principles-based approach to a distribution pricing methodology should be adopted.

(b) guidelines (the methodological requirements) should be provided to assist stakeholders with interpreting and implementing the proposed pricing principles.

---

[35] Commerce Commission, Input Methodologies Discussion Paper, 19 June 2009, p 449.

[36] Ibid, p 353.

3.4.2 In addition, the Commission proposes to publish a relatively detailed model distribution pricing methodology, which is intended to provide distributors with an example of a methodology that, in the Commission's view, satisfies the pricing principles and methodological requirements. This supplementary document will be for information only.

4. Pricing principles

4.1 Summary of feedback

4.1.1 Significant feedback was received from submitters on the proposed guiding principles for the development of a model approach to a distribution pricing methodology in the Consultation Paper. Appendices 1 and 2 set out the detailed comments on principles put forward by submitters.

4.1.2 The overwhelming majority of submitters recommended alignment of the Commission's principles with those set out by the Commerce Commission in its gas authorisation of Powerco and Vector and in its June 2009 input methodologies discussion paper. A number of submitters considered that the Commission should incorporate the purpose statement of Part 4 of the Commerce Act into the Commission's principles.

4.1.3 Vector suggested the inclusion of an additional principle to account for the costs of unnecessary tariff complexity, which are eventually imposed on consumers[37].

4.1.4 Contact submitted that the proposed principles did not adequately cover the principles of most concern to retailers – namely pricing structure and prices.

4.1.5 The Energy Market Services Limited (**EMS**) considered that the principle of not creating barriers for retail competition should be qualified. This principle should not mean imposing high costs on distributors or inefficiencies due to information issues or inaccuracies, or by oversimplifying the range of pricing signals in the interest of simplifying information exchange processes.

4.1.6 A number of submitters noted actual or potential conflicts within principles, and suggested that the Commission needs to consider how to assess and manage trade-offs between principles.

4.1.7 Several submitters also noted that the suggested principles conflict with government policies (e.g. the Low Fixed Charge Regulations and the government expectation, set out in the GPS, that distributors will keep any changes in rural line charges in line with changes to urban line charges). The Lines Company considered that there should be principles regarding the recovery of subsidies arising from government policy (i.e. the low fixed charge and rural cost indexing).

4.1.8 Orion recommended that the principles associated with the TPM and the Distributed Generation Regulations need to be considered.

4.1.9 Simply Energy agreed with the content of the proposed guiding principles.

---

[37] Vector, Submission to the Electricity Commission on Distribution Pricing Consultation Paper, p 3.

4.2 Consistency

4.2.1 As noted earlier in this paper, the Commission agrees that, where appropriate, consistency should be sought between itself and the Commerce Commission in respect of the treatment of distribution pricing. Accordingly, the Commission has prepared draft pricing principles based on the principles contained in the Commerce Commission's gas authorisation for Powerco and Vector, and the Commerce Commission's input methodologies discussion paper.

4.2.2 The Commission has reformulated the Commerce Commission's principles into draft pricing principles where appropriate to reflect:

(a) additional objectives set out in the Act, ensuring electricity is delivered to all classes of customers in a fair, reliable and environmentally sustainable manner and that is used efficiently;

(b) relevant objectives in the TPM[38] and the Distributed Generation Regulations[39]; and

(c) feedback from submissions on the Consultation Paper and the June workshop.

4.2.3 Similarly, the Commission has prepared draft methodological requirements based on those set out in the Commerce Commission's gas authorisation for Powerco and Vector, and updated these where appropriate to reflect additional requirements specific to the Commission's objectives and specific outcomes.

4.2.4 The Commission has adopted the Commerce Commission's manner of describing economic efficiency, in the context of developing a model approach to a distribution pricing methodology – i.e. defining economic efficiency as comprising allocative, productive and dynamic efficiency, rather than as comprising static[40] and dynamic efficiency. Accordingly, the Commission defines economic efficiency as follows:

(a) *Allocative efficiency* – when a firm prices its services to reflect the efficient costs of supplying those services, thereby earning "normal" returns (after allowing for the degree of risk involved);

(b) *Productive efficiency* – when a firm produces services at the desired quality at minimum cost; and

---

38 Schedule F5 (Transpower's transmission pricing methodology), Section IV, Part F, Electricity Governance Rules.

39 Refer to the Electricity Governance (Connection of Distributed Generation) Regulations 2007.

40 Which consists of allocative and productive efficiency.

(c) *Dynamic efficiency* – when a firm has the appropriate incentives to invest, innovate and improve the range and quality of services, increase productivity, and lower costs over time[41].

4.2.5 Lastly, the Commission is seeking, as far as possible, to ensure consistency in implementing the proposed approach to distribution pricing with the Commerce Commission's implementation of its input methodologies for distribution pricing methodologies.

4.3 Relevant statutory objectives for the Commission

4.3.1 In developing principles or model approaches to distribution pricing, the Commission must take into account a range of statutory requirements and policy considerations.

Electricity Act

4.3.2 The principal objectives of the Commission set out in section 172N(1) of the Act are as follows:

(a) To ensure that electricity is produced and delivered to all classes of consumers in an efficient, fair, reliable, and environmentally sustainable manner; and

(b) To promote and facilitate the efficient use of electricity.

4.3.3 Consistent with those principal objectives the Commission must seek to achieve, in relation to electricity, the following specific outcomes[42]:

(a) Energy and other resources are used efficiently;

(b) Risks (including price risks) relating to security of supply are properly and efficiently managed;

(c) Barriers to competition in the electricity industry are minimised for the long-term benefit of end-users;

(d) Incentives for investment in generation, transmission, lines, energy efficiency, and demand-side management are maintained or enhanced and do not discriminate between public and private investment;

---

[41] Commerce Commission, Authorisation for the Control of Supply of Natural Gas Distribution Services by Powerco Ltd and Vector Ltd, Decisions Paper, 30 October 2008, p 54.

[42] See section 172N(2) of the Act.

(e) *The full costs of producing and transporting each additional unit of electricity are signalled;*

(f) *Delivered electricity costs and prices are subject to sustained downward pressure.*

(g) *The electricity sector contributes to achieving the Government's climate change objectives by minimising hydro spill, efficiently managing transmission and distribution losses and constraints, promoting demand-side management and energy efficiency, and removing barriers to investment in new generation technologies, renewables, and distributed generation.*

4.3.4 The Commission considers that outcomes (a), (c), (d), (e), (f) and (g) are relevant to its development of a model approach to a distribution pricing methodology.

Government Policy Statement

4.3.5 One of the Commission's functions in the Act[43] is also to give effect to GPS objectives and outcomes, which include the Government's requirements for distribution pricing methodologies, as set out in paragraphs 100, 101 and 102 of the GPS:

"Distribution pricing methodologies

100. The Commission should develop, in consultation with interested parties, principles or model approaches to distribution pricing and monitor their uptake. The Commission should recommend regulations if required to ensure compliance. As part of this work the Commission should investigate barriers to demand side participation.

101. The diversity and complexity of the terms and conditions offered by different lines companies for use of their lines is often cited as a significant barrier to expansion of retail competition. The Commission should consider whether standardisation and simplification of tariff schedules and contractual arrangements would facilitate market entry by retailers.

102. The Government expects distribution companies to keep any changes to rural line charges in line with changes to urban line charges. The Commission should monitor developments in rural charges".

4.3.6 In addition, there are a number of outcomes that the government has included in the GPS that are relevant to developing the proposed model approach, including the following:

---

[43] See section 172O of the Act.

(a) Whenever possible, the Commission should use its powers of persuasion and promotion, and provision of information, guidelines and model arrangements, to achieve its objectives rather than recommending regulations and rules. The Commission should monitor compliance with these guidelines and model arrangements and recommend regulations or rules if voluntary arrangements prove unsatisfactory (paragraph 2).

(b) Transmission and distribution companies should have incentives to manage transmission and distribution losses and constraints. The Commission should promote pricing structures that provide appropriate signals to manage transmission and distribution losses and constraints (paragraph 63).

(c) The Commission should promote and facilitate the efficient use of electricity by end users in multiple and mutually-reinforcing ways, including by:

  (i) providing financial incentives for investment in electricity efficiency where it is cost-effective to do so and in response to market failures and barriers;

  (ii) promoting cost-reflective pricing;

  (iii) seeking innovative ways to enable residential and other consumers to respond to pricing incentives to use electricity more efficiently;

  (iv) facilitating the progressive introduction of advanced/smarter meters for consumers, through publishing technical guidelines, and reporting on the need for regulations by December 2009;

  (v) encouraging and facilitating demand-side participation in the wholesale, distribution and retail markets; and

  (vi) promoting the efficient use of load management (paragraph 64).

(d) The Commission should have regard to any provision by the Commerce Commission requiring distributors to engage with local communities on the trade-offs they wish to make concerning price, quality and reliability of supply (paragraph 40).

(e) Undue barriers to investment in renewable electrical energy should be reduced or removed and efficient uptake of renewable generation should be promoted (paragraph 66).

(f) Interacting with the Commerce Commission (through the Memorandum of Understanding between the Commission and the Commerce Commission) to improve incentives for distributors in respect of:

  (i) managing distribution losses;

(ii) facilitating uptake of advanced metering infrastructure and more efficient distribution pricing;

(iii) ensuring target security levels for distribution networks are met at least cost; and

(iv) facilitating investment in energy efficiency (including consumer end-use efficiency), demand side management and distributed generation (paragraph 109).

4.4 Relevant statutory objectives for the Commerce Commission

4.4.1 Because the Commission is basing its draft pricing principles on principles the Commerce Commission has previously promulgated, it is relevant to consider (and contrast) the Commerce Commission's statutory objectives.

4.4.2 The following statutory objectives are relevant to implementing part 4 of the Commerce Act including determining a pricing methodology as an input methodology:

(a) the new overall purpose statement for Part 4 of the Commerce Act in section 52A; and

(b) the secondary purpose statement specific to input methodologies set out in section 52R of the Commerce Act.

4.4.3 The overall purpose of Part 4 of the Commerce Act is:

"…to promote the long-term benefit of consumers in markets referred to in section 52 by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services –

(a) have incentives to innovate and to invest, including in replacement, upgraded, and new assets; and

(b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and

(c) share with consumers the benefits of efficiency gains in the supply of the regulated goods or service, including through lower prices; and

(d) are limited in their ability to extract excessive profits"[44].

4.4.4 The Commerce Commission has interpreted the new purpose statement as follows:

[44] Commerce Commission, Input Methodologies Discussion Paper, 19 June 2009, p 13, para 2.3.

- *"first, there is the central purpose, to promote the long term benefit of consumers in markets where there is little or no competition and little or no likelihood of a substantial increase in competition; and*
- *second, there is the means of achieving that purpose, by promoting outcomes that are consistent with those produced in competitive markets. In particular, the outcomes must be promoted such that suppliers of regulated goods or services:*
  - *have incentives to innovate and invest, including in replacement, upgraded, and new assets;*
  - *have incentives to improve efficiency and provide services at a quality that reflects consumer demands;*
  - *share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and*
  - *are limited in their ability to extract excessive profits"[45].*

4.4.5 The Commerce Commission also notes that the Commerce Act has been amended in other ways to include features that promote incentives for investment and innovation – notably the provisions that are intended to promote regulatory certainty. In this respect, the most important provisions are those that require the Commerce Commission to set upfront regulatory rules, requirements, and processes (i.e. the 'input methodologies') in subpart 3 of Part 4 as they apply to the various regulatory instruments.

4.4.6 Section 52R provides that the purpose of subpart 3 is:

> *"to promote certainty for suppliers and consumers in relation to the rules, requirements, and processes applying to the regulation, or proposed regulation, of goods or services under this Part"[46].*

4.5 Consistency of statutory objectives across the Commissions

4.5.1 The Commerce Commission notes "*the objectives and desired outcomes for the Electricity Commission…share a number of common elements with the purpose of Part 4 of the Commerce Act*[47]."

---

[45] Ibid, p 14, para 2.7.

[46] Ibid, p 15, para 2.12 and para 2.13.

[47] Ibid, p 341, para 11.117.

4.5.2 The Commission shares the Commerce Commission's view of the similarities between the objectives and desired outcomes in section 172N of the Act, and the purpose of Part 4 of the Commerce Act[48].

4.5.3 The Commission also notes (and agrees with) the Commerce Commission's comment that the scope of the Commission's objectives is broader than the Commerce Commission's objectives under Part 4 of the Commerce Act[49]. Therefore, it considers it appropriate for the Commission to include pricing principles in its model approach that extend beyond the principles that the Commerce Commission might otherwise use.

4.5.4 Additionally, the Commission notes that not all distributors are subject to default/customised price-quality path regulation under Part 4 of the Commerce Act: suppliers of electricity lines services[50] that are "consumer-owned"[51] are exempt[52], and are therefore not required to apply the Commerce Commission's input methodologies for pricing methodologies. Also, the Commerce Commission does not have an objective of facilitating retail competition. Consequently, the Commission's model approach to distribution pricing has a much broader application than does the Commerce Commission's approach to distribution pricing.

4.6 Proposed pricing principles

4.6.1 The Commission proposes the following pricing principles for the proposed model approach to a distribution pricing methodology after having considered the:

(a) pricing principles set out in the Commerce Commission's gas authorisation of Powerco and Vector;

(b) Commerce Commission's June 2009 input methodologies discussion paper;

(c) detailed recommendations on pricing principles put forward in submissions on the Consultation Paper.

---

48 Ibid, p 341, para 11.117.

49 Ibid, p 341, para11.118.

50 as defined in section 54C of the Commerce Act.

51 as defined in section 54D of the Commerce Act.

52 unless that exempt status is lost in accordance with section 54H of the Commerce Act.

4.6.2 Underlined text shows changes to the principles used in the Commerce Commission’s gas authorisation for Powerco and Vector.

(a)	Prices are to signal the economic costs of service provision, by:	
	(i)	being subsidy free (equal to or greater than incremental costs, and less than or equal to standalone costs), except where subsidies arise from legislation;
	(ii)	having regard, to the extent practicable, to the level of available service capacity; and
	(iii)	signalling, to the extent practicable, the impact of additional usage on future investment costs.
(b)	Where prices based on ‘efficient’ incremental costs would under-recover allowed revenues, the shortfall should be made up by setting prices in a manner that has regard to consumers’ demand responsiveness (i.e. Ramsey pricing) and/or the quality of service that they receive, to the extent practicable.	
(c)	Provided that prices satisfy (a) above, prices should be responsive to the requirements and circumstances of users in order to:	
	(i)	discourage uneconomic bypass; and
	(ii)	allow for price/quality tradeoffs.
(d)	Development of prices should be transparent, promote price stability and certainty for consumers, and lead to prices that are able to be understood by users.	
(e)	Pricing structures should not place undue transaction costs on retailers and consumers, and should be competitively neutral across retailers.	
(f)	Prices and pricing structures should promote efficient usage of electricity and encourage investment in distributed generation (including renewable generation), distribution alternatives and technology innovation.	

4.6.3 Where conflicts arise in applying the pricing principles, they should be resolved with the objective of best satisfying the Commission’s principal objectives under the Act.

4.7 Proposed methodological requirements

4.7.1 As noted above, the Commission proposes to publish guidelines to assist stakeholders with interpreting and implementing the proposed pricing principles. In seeking consistency with the Commerce Commission’s approach to the treatment of distribution pricing, the Commission has adopted the methodological approach used by the Commerce Commission in its gas authorisation for Powerco and Vector.

4.7.2 The Commission's proposed methodological requirements for the proposed model approach to a distribution pricing methodology are as follows (underlined text shows changes to the methodological requirements used in the gas authorisation):

(a) Prices should be based on a well-defined, clearly explained and published methodology, with any revisions notified and clearly marked.

(b) Price development should incorporate, to the extent practicable, an analysis of the cost of service provision that includes:

(i) definition of the classes of service provided and the parameters by which the quality of service in each class are measured;

(ii) an examination of the cost elements that arise from the use, operation and expansion of the network;

(iii) identification of the relationship between the quality of service provided and the level of current and future cost for each class of service;

(iv) an allocation of existing and future network costs to service classes, and an explanation of the cost allocation methodology used;

(v) the translation of allocated costs into service prices at the defined level of quality of service – including the re-allocation of transmission charges while preserving the transmission pricing signal This amendment is to reinforce the need to pass through the signals produced by the TPM to meet the GPS requirement that incentives for investment in transmission are maintained or enhanced;

(vi) analysis of the extent to which costs are marginal, and whether the associated price components in the tariff structure reflect those marginal costs;

(vii) analysis of the development of time of use prices and critical peak pricing where these can practically be applied. This requirement is added to reflect the GPS requirement to promote demand side management and energy efficiency;

(viii) estimates of the range of subsidy-free prices for each service class and the extent to which subsidies, if any, are caused by legislation; This requirement is added to reflect concerns raised in submissions that legislation is leading to cross-subsidies and the desirability of making these transparent; and

(ix) development of pricing arrangements that will be used to reflect the value of deferral of investment in distribution assets, where this is practicable. This requirement is added to encourage demand side participation and to reflect the GPS requirement to promote demand-side management and energy efficiency.

(c) Information relating to standard services on customer class price levels and structures, quality of service standards, underlying costs, price derivation methods and rationale, and medium term price and quality of service strategies should be publicly disclosed.

(d) Underlying service classifications, cost data, cost allocations and other elements that contribute to pricing decisions should be periodically reviewed and updated where relevant to reflect industry developments and changes in user requirements and preferences, methods of service provision and costs.

(e) Pricing structures should:

(i) consist of the minimum number of tariffs necessary to meet the provisions of the pricing principles. This requirement is added to reflect concerns of some submitters about the large number of tariffs and associated transaction costs in some networks and to facilitate retail competition; and

(ii) employ industry standard tariff formats and nomenclature, where possible. This requirement is added to assist in reducing costs to retailers to facilitate retail competition.

(f) Where a change to the existing pricing methodology is proposed to improve compliance with the pricing principles, details of the impact on customer classes and the transition arrangements proposed to mitigate the effect of redistribution of costs and “rate shock” should be publicly disclosed. This requirement is added to improve information about re-structuring of distribution pricing.

4.8 Template Pricing Methodology

4.8.1 The Commission proposes to publish a relatively detailed model distribution pricing methodology, which is intended to provide distributors with an example of a methodology that, in the Commission’s view, satisfies the pricing principles and methodological requirements. This supplementary document will be for information only.

5. Implementation issues

5.1 General

5.1.1 The Commission notes that the proposed approach has less prescription than that proposed in the Consultation Paper. This may result in distributors not complying with the intent of the pricing principles which is to ultimately ensure the objectives of the Act and the GPS are met. The non-specific nature of the pricing principles may enable the distributors to argue that they are conforming already and no change is necessary.

5.1.2 The Commission considers that this is an opportunity for distributors to show that a light handed approach will result in improvements. Improvements to the way distributors set their prices therefore need to be demonstrated in a transparent manner so that the Commission and interested parties can confirm that distributors have set or are in the process of setting their prices in accordance with the pricing principles.

5.2 Compliance reporting

5.2.1 As set out in the Consultation Paper, the Commission's preliminary view is that the level of reporting on the pricing methodology should be in line with the obligations on distributors under the Information Disclosure Requirements set out in subpart 4 of part 4 of the Commerce Act or subsequent developments (i.e. distributors would submit the same information to the Commission as they would submit to the Commerce Commission). This is to avoid duplication in the provision of information by distributors to the Commission and to the Commerce Commission.

5.2.2 Any reporting requirements should require the distributors to submit this information to the Commission at the same time that they submit the information to the Commerce Commission

5.2.3 In addition, each distributor would be expected to submit a statement of its compliance with the Commission's pricing principles and methodological requirements or a statement of variation, where the distributor has not met the pricing principles or the methodological requirements

5.2.4 The Commission will work with the Commerce Commission to make consistent the information disclosure requirements of the two organisations. This could include adopting the Commerce Commission's '*Pricing Methodology Report*' used in the gas authorisation for Powerco and Vector in situations where a distributor is not considered compliant with the Commission's pricing principles and methodological requirements.

5.2.5 The Commission notes the feedback received from submitters and will factor this into its discussions with the Commerce Commission. In particular, the Commission will investigate Vector’s suggestions relating to:

(a) the development of a template compliance statement for distributors to use in demonstrating that their pricing methodologies have complied with the pricing principles, with the compliance statement only needing to be updated when distributors have materially changed pricing structures and/or cost allocation methodologies; and

(b) targeted regulation of distributors, rather than general regulation, in instances where non-compliance is limited to specific distributors.

6. Process to complete the model distribution pricing methodology approach

6.1.1 To assist it in forming a final view on a model approach to a distribution pricing methodology, the Commission is seeking written submissions on the draft pricing principles and methodological requirements set out in this paper and will facilitate a workshop for industry participants and other interested stakeholders on 12 October 2009. The workshop will have the following objectives:

(a) understanding retailers' concerns as to the aspects of distribution pricing that can be a barrier to retail competition;

(b) identifying what aspects of distribution pricing may be relatively easily standardised. To confirm common terminology and definitions for distribution access and pricing, as well as the basis for a common tariff format across distributors (including standardisation of customer categories). This will probably require the formation of an industry working group;

(c) seeking feedback from stakeholders on revised draft pricing principles and methodological requirements; and

(d) discussing the merits, or otherwise, of a more or less mandatory approach.

6.1.2 The proposed timetable for finalising the model distribution pricing methodology approach is set out in the following table.

Table 2 Process to finalise the model distribution pricing methodology approach

Date	Event
12 October 2009	Commission facilitates workshop on distribution pricing
30 September 2009	Commission publishes draft final pricing principles and methodological requirements
22 October 2009	Consultation on the draft distribution pricing principles and methodological requirements closes
November 2009	Industry working group reports back on areas that can be standardised
Late December 2009	Commission publishes final pricing principles and methodological requirements

Appendices

Appendix 1 Submissions regarding *the proposed* principles

This appendix needs to be viewed in conjunction with the submissions relating to the Consultation Paper Q1 on Guiding Principles. The details provided here are from the submission tables provided by the individual companies. Many other submissions on Guiding Principles were received but not in this format. Those submissions have been considered and are summarised in the body of the paper in section 2.3.

Proposed Principle	**ENA and Unison**	**Powerco**	**Wellington Electricity**	**Marlborough**	**Orion**
(a) A distribution pricing methodology should:					
(i) encourage the efficient and fair allocation of costs, avoiding cross-subsidisation and unfair discrimination;	(a)(i) encourage the efficient and fair allocation of costs, avoiding cross-subsidisation <u>except where this is mandated by the government</u>, and unfair discrimination. ENA comments that the consultation paper is silent on the Electricity Act requirement (s62) for electricity lines businesses to be maintained to remote customers. A mandated requirement to supply high-cost, low density	This principle mixes value judgements with economic concepts resulting in a lack of clarity and trade-offs within a principle. For example: • the most allocatively efficient way to allocate costs for Distributors (above marginal costs) is by Ramsey pricing. This however takes into account customers' dependence on electricity, rather than their total	The terms efficiency and fairness are used without regard to how each is measured and to whom a price is fair. While these are good objectives, consideration should be given to how it is measured and how it is used to support a pricing methodology. Note: cross subsidisation is already a feature of distribution pricing – rural/urban, maintain connections to uneconomic pre 1 April 1993 customers and low	Marlborough considers avoiding cross subsidisation impossible to achieve particularly with the GPS provisions regarding changes in urban and rural line charges remains in place.	

Proposed Principle	ENA and Unison	Powerco	Wellington Electricity	Marlborough	Orion
	remote users of distribution services at prices similar to charges in high customer density urban areas can only be met through cross-subsidies.	income. An economically 'fair' approach would mean customers with low incomes, but high reliance on electricity (eg medically dependent customers) would pay higher charges. • How can a business make value judgements about 'fair allocation' and 'unfair discrimination'? The principle should refer to economic definitions or mandatory social regulations. **Powerco recommends:** • **Subsidy free** • **Cost reflective** • **Ramsey compliant**	fixed charges. Whilst Wellington Electricity (**WE**) supports avoidance of cross subsidies they question how if can be a guiding principle when it is not supported by government policy and legislation.		

Proposed Principle	ENA and Unison	Powerco	Wellington Electricity	Marlborough	Orion
(ii) be stable and predictable in respect of revenue for the distributor and charges to consumers; and	(a)(ii) be stable and predictable in respect of prices for the distributor and charges to consumers or intermediaries. Distributors may have no direct control over charges to end users as retailers repackage distribution costs.	Powerco supports this principle. This principle will mean that any methodology that requires large price changes to customers will take a long time to implement. **Powerco recommends:** • **Stable** • **predictable**	WE supports this principle		Orion does not believe stable and predictable revenue and charges are sensible principles. Stable and predictable prices would be more appropriate.
(iii) be practicable to implement, without placing significant transaction costs on consumers and distributors.	(a)(iii) be practicable to implement, without placing uneconomic transaction costs on consumers and distributors. Allow scope for higher transaction costs where the net benefits warrant them. For example, changes in technologies, small scale distributed generation, electric vehicles. These may	Powerco supports this principle. **Power recommends:** • **practical**	The principle of costs to consumers should refer to retailers as the competitive market will see savings in transaction costs to end consumers over time.		Given that consumers are not normally parties to the arrangements, transactions costs are irrelevant. Orion suggests '…without imposing undue transaction costs on retailers or distributors'.

Proposed Principle	ENA and Unison	Powerco	Wellington Electricity	Marlborough	Orion
	warrant quite extensive transaction costs to balance issues such as billing costs and arrangements, tariff diversity and metering and reconciliation complexity.				
(b) Changes to distribution pricing methodology (and the rationale for them) should be widely publicised and follow consultations with interested parties. The revised distribution pricing methodology should be transparent, with the results predictable and readily verifiable.	ENA considers this obscure	This is a methodological requirement rather than a principle. **Powerco recommend:** • **transparent**	Is more of a framework rather than a principle. While supporting the principles of consultation and transparency, ultimately the distributor must have the sovereign power over its pricing methodology.	Marlborough considers if interested parties means retailers (they have interposed use of systems agreements with retailers) then this is acceptable, if it means consumers – Marlborough consider this impossible to effect. Marlborough has concerns with the transparent, predictable and verifiable as there is a huge amount of information taken into account when establishing line charges, and it is questionable	Not sure what 'transparent', 'predictable' and 'verifiable' mean in this context.

Proposed Principle	ENA and Unison	Powerco	Wellington Electricity	Marlborough	Orion
				whether any consumer or retailer would have the capability to verify the calculations made.	
(c) Distribution prices should:					
(i) encourage the efficient use of electricity distribution services;		It is not clear what type of efficiency is referred to here? Economic, allocative, productive, dynamic or energy efficiency?	(i) encourage efficient investment in distribution, transmission, distributed generation (including renewable generation), and technology innovation (including AMI); Efficiency needs to be driven by the needs of customers and distributors also need to earn an adequate rate of return on their assets. WE also points out that there are safety issues to consider such as the need for a Public Safety Management System		

Proposed Principle	ENA and Unison	Powerco	Wellington Electricity	Marlborough	Orion
			requiring additional distribution services and associated costs to demonstrate a distributor's duty of care – the drive for efficiency cannot rule these out. WE would like to see thought given to how distributors can be incentivised to operate more efficiently rather than mandating.		
(ii) encourage efficient investment in distribution, transmission, distributed generation (including renewable generation), and technology innovation (including AMI);		This principle duplicates the first principle. If costs are allocated efficiently (and if efficiency relates to dynamic and allocative efficiency), then prices should encourage efficient investment in other products related to distribution charges. If efficiency above refers to dynamic efficiency then the word 'distribution' can be	WE is supportive of this principle; however it wants the Commission to manage efficient investment signals versus incentives that are not applied in a fair and equitable way. For example WE does not wish to see distributed generators' distribution lines being cross subsidised by distributors.		

Proposed Principle	ENA and Unison	Powerco	Wellington Electricity	Marlborough	Orion
		deleted here. This principle adds significant complexity to what distribution pricing can achieve. The pricing methodology should concentrate on pricing principles. Investment in distributed generation, transmission and other technology innovation is best encouraged via other mechanisms.			
(iii) not create barriers for retail competition and the provision of distribution or other services;	(c)(iii) not create inefficient barriers for retail competition and the provision of distribution or other services. ENA comments that distribution pricing methodologies will have an impact on competitive markets, for example by reducing load at peak times.	Powerco recommends the word significant is added before 'barriers for retail competition'. Powerco does not think a principle on pricing being a barrier to providing distribution services required. The term 'other services' should be removed. This is vague and the only way to meet this principle	WE supports this principle.		Should perhaps be two principles? Also, since potentially any distribution pricing could be seen as a barrier, it should be qualified with 'undue'.

Proposed Principle	ENA and Unison	Powerco	Wellington Electricity	Marlborough	Orion
		is to not charge for any distribution service. Powerco recommends: Not create significant barriers to retail competition			
(iv) provide appropriate signals to manage transmission and distribution losses and constraints;	(c)(iv) provide appropriate signals to manage distribution losses and constraints; ENA comments that they have not seen a case made for distribution pricing being used to manage transmission losses.	This principle may replicate 'encourage efficient investment in transmission'. Powerco recommends a principle where 'prices signal to the extent practicable, the impact of additional use on future investment costs'. Powerco does not think that minimising electricity losses is best addressed by distribution pricing methodologies. The customised and default price paths are better avenues to address this issue.	WE considers that distribution losses and constraints are already addressed in the efficient investment and energy efficiency principles and restatement is not necessary.	Marlborough considers that end use prices set by their retailers often diminish the line pricing signals. Marlborough also doubts that with current metering practices the vast majority of mass market consumers can be provided with appropriate signals, or if they were whether they would act on them.	Should distribution pricing help manage transmission losses and constraints?

Proposed Principle	ENA and Unison	Powerco	Wellington Electricity	Marlborough	Orion
		Powerco recommended: • Signal future investment costs			
(v) relate to the quality and reliability of service delivered, including the risks of delivery; and	(c)(v) relate to the quality and reliability of service delivered, including controllable and reasonable risks of delivery; and ENA comments that the principles should acknowledge that a number of delivery risks are beyond the reasonable control of distributors (requirement of distributors to impose rolling outages in times of supply shortages). Also maintaining a standard voltage level to all customers would if efficient and fair cost prevailed mean higher charges to rural and remote customers.	Reliability is normally a subset of quality. It is not clear what the 'risks of delivery' refer to. Powerco recommends; Signal price quality trade off	WE supports this principle. Distributors Asset Management Plans already largely cover the price quality trade offs inherent in networks so WE considers it unnecessary to cover this in the pricing methodology.		

Proposed Principle	ENA and Unison	Powerco	Wellington Electricity	Marlborough	Orion
(vi) be easily understood.	(c)(vi) be commercially clear ENA expects retailers to understand a distribution pricing methodology and notes that regulatory requirements necessitate complex wording.	Balancing these principles will result in a very complex methodology. Should this be sacrificed for ease of understanding? This principle partly duplicates 'transparency', as part of being transparent is communicating in a way that people understand.	WE supports this principle however incorporating the previously noted principles into distribution prices will inherently create complexity in distribution pricing.		By whom?

Appendix 2 Principles – submissions regarding *additional* principles

This table needs to be viewed in conjunction with the submissions in response to Q1 on Guiding Principles in the Consultation Paper.

CC93	(a) No cross-subsidies; (b) Discourage uneconomic bypass; (c) Cost-reflective; (d) Signal costs of new investment; (e) Signal price-quality trade-offs; (f) Ramsey compliant; (g) Price stability and impact on customers is considered; and (h) Tariffs should not place undue transaction costs on retailers and consumers.	CC93 set out the principles presented by Vector at the June Workshop.
PWC, Orion, Powerco, Vector	(a) Prices are to signal the economic costs of service provision by: (i) being subsidy free (equal to or greater than incremental costs, and less than or equal to stand alone costs) (ii) having regard, to the extent practicable, to the level of available service capacity; and (iii) signalling, to the extent practicable, the impact of additional usage on future investment costs. (b) Where prices based on 'efficient' incremental costs would under-recover allowed revenues, the shortfall would be made up by setting prices in a manner that has regard to consumers demand responsiveness, to the extent practicable. (c) Provided that prices satisfy (1) above, prices should be responsive to the requirements, and circumstances of users in order to: (i) discourage uneconomic bypass;	Gas authorisation principles

	and (ii) allow negotiation to better reflect the economic value of specific services. (d) Development of prices should promote price stability and certainty for customers, and changes to prices should have regard to the impact on customers. (e) Tariffs should not place undue transaction costs on retailers and consumers.	
MRP and Orion	Commerce Commission (a) The overall level of prices should be such that firms are limited in their ability to extract excessive profits (i.e. Profits in excess of a normal risk-adjusted return over time). However, revenue should be sufficient to provide adequate reward to business for investment and operating efficiencies as well as for innovation (b) To the extent that costs are marginal, the associated price components in the tariff structure should reflect those marginal costs, where practicable; (c) Efficient prices can depend not just on cost, but on demand and/or quality as well; (d) Where on group of consumers is less price-responsive than another group of consumers of the same service, then-all else being equal-one would expect the prices of the less price-responsive consumers to be higher; (e) The stand alone and incremental costs associated with supply services to any combination of consumers will usually, but not always) be expected to provide necessary bounds on subsidy-free and efficient levels of revenue. However, these bounds will not necessarily provide sufficient constraints on subsidy-free levels of revenue.	Commerce Commission principles

MRP	(a) Electricity distribution prices must be clear, unambiguous, transparent and avoid unnecessary complexity; (b) Electricity distribution prices must enable retailers to be able to determine (ex ante) what charges will apply to any ICP; (c) Electricity distribution prices must be stable eg. Customer pricing should not be subject to annual fluctuations; (d) Electricity distribution prices must be competitively neutral amongst different retailers (including distributors own retail business, if applicable); (e) Electricity distribution prices must send economically efficient signals (eg. To encourage off-peak consumption), to the extent that consumers are capable of responding to them; (f) Electricity distribution prices must align with established metering configurations, and periods of control; (g) Distributors must not adopt excessive number of customer categories (with a set minimum number of customers within any given category) eg. Electricity distribution prices must not differentiate between rural and urban areas and distributors must eliminate differential pricing methodologies within their networks.	MRP consider that these principles should be adopted in conjunction with those of the Commerce Commission above. MRP also notes that Contact's principles could be adopted.
Contact	(a) Prices should be sustainable, not changing year on year; (b) Pricing structure should be appropriate to the various customer categories and metering widely deployed, while providing signals for efficient use of the network	Contact considers there is little point in having summer/winter pricing or loss factors for domestic customers who cannot shift load from winter to summer, but if a distributor has summer/winter pricing or loss factors then retailers are forced to repackage (cross subsidise) or pass through transparently with the added complexity of changing prices to customers twice a year. Contact considers it inappropriate to have critical peak pricing for domestic customers when it is not

	(c) Prices must be predictable and billable, and not pass on network pricing risks to retailers who in turn are forced build additional risk into retail prices. The key requirement is that there should be certainty of cost at ICP level in published prices. (d) Prices must be practicable to implement and not unnecessarily complex when simpler pricing would achieve essentially the same customer behaviour, same demand profile on the network, and same revenue for the distributor. (e) All fixed prices should be daily rather than annual, reflecting a competitive market (daily switching) and not exposing retailers to revenue risk should the customer close its business or shift location.	supported by the metering infrastructure widely deployed and that critical peak pricing for domestic consumers will be counter productive for most as the amount of load shifted at peak periods via consumer demand response will likely be less that the amount of load able to be shifted at peak periods by involuntary control of hot water load by distributors. Contact outlines the following circumstances that leave the retailer with unpredictable line charges and having to deal with network pricing risk, and an inability to provide transparency: • Prices that include a scaling element when billing line charges, where metered volumes are scaled to allow for losses such that the effective price to the retailer is not the published price; • Prices that are not directly recoverable without repackaging; • Prices that are not billable using standard billing systems in the industry; and • Bulk charges for line services not included in published prices (eg. Transmission administration charges). Several distributors set annual charges/prices – some expect to recover the annual costs off the retailer if the customer closes its business or shifts location to another network area, while others accept this circumstance as the

		distributors' risk.
Meridian	(a) Transparency (b) Consistency of price signals (c) Rationalisation of pricing methodologies	Meridian also notes that the principles should be aligned with those of the Commerce Commission. The impact of a price on a particular customer whose use is known could be easily calculated without having to model the customer's use in relation to the other customers at the GXP. A consistent approach on price signals will: • Allow retailers to send appropriate price signals to customers allowing (where possible) loads to be shifted and peaks avoided; • Retailers to pass pricing signals to customers more easily; and • Allow clear messages to be sent to all of retailers customers arose multiple regions, irrespective of the network they are in. Meridian notes that retailers who operate over multiple networks do not want to have to devise tariffs with different timing of peaks, they want to provide the same 'pattern' of peak and off peak to all customers. Meridian also notes the importance that price signals are not unnecessarily complex. Meridian do not expect there to be much interest from customers in complex or punitive price signals. Meridian notes that there are numerous fragmented pricing groups which they question are necessary, and that these load groups have little meaning form the majority of customers.

MEUG	(a) Reflect the quality and price trade-off demanded by consumers; and (b) Be sufficiently transparent and detailed to ensure prices do not contain excessive profits.	MEUG suggests that s.52A Purpose Statement of the Commerce Act is taken into account.
Powerco	Powerco suggests the following principles (a) Prices are subsidy free (b) Cost-reflective (c) Ramsey compliant (d) Stable (e) Predictable (f) Low cost to administer (g) Transparent (h) Future investment cost and signal price quality trade-off	
TrustPower	(a) Distribution pricing, while reflecting the true cost of supply, should also consider the ability of the end user to take advantage of pricing signals. The recovery of the cost of investment by end consumers should be considered when changing price signals.	TrustPower considers this principle is added.
Vector	(a) prices are subsidy-free by falling within incremental and stand-alone costs; (b) discourage uneconomic bypass; (c) cost-reflective pricing; (d) signal costs of new investment; (e) signal price-quality trade-offs; (f) prices should be set in a manner that has regard to consumers' demand responsiveness; and (g) price stability and impact on customers is considered.	Following the Commerce Commission's release of the Gas Authorisation in October 2008, Vector developed a pricing methodology and cost of supply model to comply with a number of pricing principles.

Appendix 3 Draft reporting requirements

The Commission proposes adopting the form of the Commerce Commission's '*Pricing Methodology Report*' used in the gas authorisation for Powerco and Vector as a template for reporting, when a distributor's pricing is not compliant with the Commission's pricing principles and methodological requirements.

The *Pricing* Report provides an opportunity for the distributor to explain and support its proposed methodology and the prices derived from applying the methodological requirements.

Section 1 Overview

Description of business' tariff setting policy framework, including the outcomes sought by the business from its tariff policy.

Summary of overall tariff strategy for *the next five years (the period)*

.**Section 2 Pricing Methodology**

a) Description of pricing methodology.

b) Description of the development of the pricing methodology, including, but not limited to:

   i. description of the development of the cost of supply model and an explanation of how the model operates;

   ii. definition of the classes of service provided and the parameters by which the quality of service in each class are measured;

   iii. Identification of the relationship between the quality of service provided and the level of current and future cost for each class of service;

   iv. explanation of the cost allocation methodology used to allocate existing and future network costs to service classes;

   v. analysis of the extent to which costs are marginal, and whether the associated price components in the tariff structure reflect those marginal costs;

   vi. description of the methodology to estimate the range of subsidy-free prices for each service class; and

   vii. demonstration of compliance with the pricing principles.

Section 3 Impact of Applying the Proposed Pricing Methodology

a) Tariff reform and/or restructuring required, including an explanation for why it is necessary.

b) Extent to which rebalancing of prices (if any) between service classes is required, including an explanation for why it is necessary. Discussion of the approach to implementing rebalancing over the period and justification for taking this approach.

c) Proposed tariffs for the next pricing year.

d) Comparison of proposed tariffs per service class for the next pricing year with tariffs per service class in the previous pricing year.

e) Estimates of subsidy-free prices for all service classes and any cross subsidies arising from legislation.

f) Schedule setting out a reconciliation of how the proposed next pricing year's tariff schedule has been derived from the overall revenue requirement through the application of the methodology.

g) Schedule setting out the pricing arrangements for determining the value of deferral of investments in distribution assets, where practicable.

Section 4 Medium Term Pricing Strategy

a) Expected tariff reform and/or restructuring for the remainder of the period.

b) Expected tariff movements for each service class in each remaining year of the period.

c) Any further rebalancing that is required to complete the rebalancing between service classes as discussed in Section 3.

d) Excluded services (not required).

e) Description of the proposed framework for periodically reviewing underlying service classifications, cost data, cost allocations and other elements that contribute to pricing decisions.

f) Discussion of any expected further pricing development in future years that may lead to changes in the *Pricing* Report.

Section 5 Public Disclosure

Proposals for public disclosure of information on pricing.

Attachments to be provided with the *Pricing* Report

a) Director's certificate of compliance of the pricing methodology with the pricing principles and the Pricing Report with the Commission's requirements.

b) Cost of supply model.

c) Auditor's certificate for cost of supply model.