

Distribution Pricing

12 October 2009

Rob Jamieson

Overall conclusion

- Pricing principles are a sound way forward (take time)
 - concern that methodological requirements (& compliance) will undermine the principles approach & add significant cost
- ‘Innovation and investment’ has been added to the purpose statement of Part 4 of Commerce Act
 - pricing is a key tool for innovation; standardisation in conflict with this
- Distribution pricing is a foundation for differentiation & competition
 - new retailers may have better ability to manage & reflect signals (AMI)
- Local pricing reflects local conditions
- Common terminology discussion has merit
 - without unintentionally creating barriers to innovation

Eastland Network response

1. Principles based approach to pricing

We support the Commission preliminary view on the adoption of a principles based approach to distribution pricing as opposed to a prescriptive model approach or in fact the adoption of a complete PAWG approach. We do not believe that overly prescriptive pricing methodologies will lead to efficiency gains or greater retailer competition and that this can be achieved through improvements to terminologies and definitions.

Eastland Network cont'd

2. Proposed methodological requirements

The Commission proposes to adopt a set of methodological requirements, modified from the requirements that were set out by the Commerce Commission during the gas determination for Powerco and Vector, that are designed to assist stakeholders with the implementation of the pricing principles. While these may be useful as guidelines, we do not believe that they should be reported on nor used as measure in compliance reporting. The requirements when applied to small, sparse, rural networks, will undoubtedly illustrate inefficiencies and high levels of cross subsidisation that are brought about by current legislative requirements. If these are not considered in the context of the legislation or the physical characteristics of the network, they will lead to erroneous or incorrect conclusions being drawn over the nature of the distributors pricing.

Eastland Network cont'd

3. Compliance reporting

The Commission proposes adopting compliance reporting where by distributors would submit information at the same time as the Information Disclosures. The Commission is proposing that this could be achieved through a statement of variation and could also include the Commerce Commission's "Pricing Methodology Report". We are concerned that this simply introduces the Commission's model pricing methodology by proxy since distributors will not only continue to price as they currently disclose but also have to develop the Commission's pricing model and then report on the differences. We are also concerned about the requirement to include an audit certificate of a cost of supply model as we believe this simply adds excessive levels of audit and compliance reporting.

Eastland Network cont'd

4. Common terminologies

We support industry wide common terminologies and definitions for aspects of distribution tariffs, however would not go as far as supporting a common tariff structure between all distributors. In particular we suggest that an improved definition of domestic premises, that specifically excludes holiday homes, would be beneficial. Holiday homes should not qualify for the Low Fixed Charges or standard domestic tariffs as they bring to the network issues of low average consumption with seasonal peaks.

Generally, holiday homes on our network are in isolated areas and unless they are excluded from domestic tariffs, they do not pay their cost of supply.

Eastland Network cont'd

5. Format for pricing schedules

We do not support a set of common tariffs across the industry as we believe that each distributor has developed their own tariffs to best suit the requirements of their end consumers as well as sending the pricing signals and generating the appropriate level of revenue for their business. We also have concerns that a common set of tariffs would attempt to introduce tariffs which may be appropriate in say large urban areas but completely inappropriate for sparse rural areas. Potentially, common tariffs could result in increased levels of cross subsidisation and send the wrong pricing signals.

Eastland Network cont'd

6. Specific details of distribution pricing that creates barriers to retail competition

Eastland Network at 25,196 ICPs can be considered to be middle of the pack compared with all other distributors, however we have seven retailers who have a Use of System Agreement with us including the main five retailers of Contact, Genesis, Trustpower, Meridian and Mighty River Power. While they do not all offer energy to consumers across all of our tariffs, we do not believe that this is due to our pricing structure rather issues relating to their own marginal cost of offering these services. An example of this is non-incumbent retailers are very unlikely to offer services in remote areas due to the cost of having to read the meters regularly. No changes to distributor pricing will encourage more retailers to supply consumers in remote or even semi remote areas.

Model of entry into retailing

- Put itself in the position of a new entrant retailer
 - What are the most critical things to consider (total 100)

Are there enough potential customers in the region?	50
How rational is the existing retail pricing level?	20
Can I manage the energy price risk?	20
What are the operating costs (e.g. metering services)?	9
What are the incremental distributor contracting costs?*	1

* *and what part of this is above-optimal?*

Conclusions from June pricing workshop

1. Excellent co-ordination between Commissions is needed
2. Pricing principles should be explored first as a solution
3. EC should communicate with the Government on low fixed charge regulations
4. Embedded network proliferation could mean any detailed methodology applied to ELBs would not greatly reduce number of tariffs
5. Advanced metering means price innovation – be careful not to hamstring this with ‘dumb’ pricing
6. We must address the ‘why’ question not just the ‘how’. What are we trying to achieve with distribution pricing?
7. Regulatory barriers to distributors innovating and rationalising should be explored.
8. Assertions of barriers needs justification and quantification (\$)

What has happened since June?

- Mercury Energy
 - 9,000+ new customers in 6 months in ChCh alone
- PowerShop
 - A complete new business model
 - 20% weekend daytime price reductions
- Loyalty incentives to retain customers
 - \$100 plus
- Nova Energy in Auckland
 - Solar/ electric

Default price path draft decisions

- *“The (Commerce) Commission considers that by providing EDBs with the flexibility to adjust pricing structures under the price path, the Commission is promoting incentives, and, in particular, avoiding disincentives to the promotion of energy efficiency. The Commission considers that this will contribute to meeting the Part 4 energy efficiency requirements set out in section 54Q.”*
 - Restricting the ability of EDBs to modify pricing structures would therefore undermine the Commerce Commission’s statutory responsibilities under the Commerce Act to incentivise energy efficiency.

Consumer first

- Principles approach desirable as would:
 - Benefit consumers through innovation
 - Allow evolution of distribution pricing at a time of advanced metering and smartgrid development
 - Price signals send benefits to the demand side
 - Avoid price shock caused by move to one-size-fits-all
 - Avoid lock-in by existing large retailers

Reality will overtake any static model

- Innovation and investment has been added as a specific clause of purpose statement of Part 4 of Commerce Act
 - Now's the time to reduce rigidities not increase them
- New entrant retailers are encouraged through 'complexity'
 - superior ability to manage/reflect distribution price signals
 - night rates, 20% weekend price reduction etc all distribution price based
- Model methodologies (as they were previously conceived) may be an impediment to necessary change
 - Last thing we want is to have to change the model before doing something new (a rigidity)
 - Model behaviours (consultation, notice periods, timely response to concerns) may be better than static methodologies

Overall conclusion

- Pricing principles are a sound way forward (take time)
 - concern that methodological requirements (& compliance) will undermine the principles approach & add significant cost
- ‘Innovation and investment’ has been added to the purpose statement of Part 4 of Commerce Act
 - pricing is a key tool for innovation; standardisation in conflict with this
- Distribution pricing is a foundation for differentiation & competition
 - new retailers may have better ability to manage & reflect signals (AMI)
- Local pricing reflects local conditions
- Common terminology discussion has merit
 - without unintentionally creating barriers to innovation