Submission on Draft Distribution Pricing Principles and Methodological Requirements Discussion Paper

30 October 2009

CONTENTS PAGE

INTRODUCTION 3

EXECUTIVE SUMMARY 4

ISSUES 7

ALIGNMENT WITH THE COMMERCE COMMISSION 7

WHAT PRICING PRINCIPLES PROMOTE THE BEST LONG RUN OUTCOMES FOR ELECTRICITY CONSUMERS? 8

Refinements to principles 8

Principle (a): Legislative requirements already take precedence 8

Principle (b): Economic concepts are confused 9

Principle (c): Change to include all instances of site negotiation 9

Principle (d): Simplification required 10

Principle (e): Use “have regard to” rather than “undue” 10

Principle (f): Delete “efficient use of electricity” objective 11

Principles must not exclude Wholesale Delivery Model (“WDM”) 11

HOW DOES THE COMMISSION ENSURE THAT ANY IMPROVEMENT IN OUTCOMES FROM PRICING IS NOT OUTWEIGHED BY THE COMPLIANCE COST? 12

Aims of the approach to compliance 12

A. What is the potential for improvement in outcomes from pricing regulation and how does this limit the size of the compliance cost? 12

B. How does the compliance cost vary with accuracy of information provided to the regulator? 12

C. What is the cost of different incentives or penalties? 13

Recommended approach 14

Benefits of recommended approach 15

INTRODUCTION

1 Powerco Limited ("Powerco") welcomes the opportunity to make a submission on the Electricity Commission's ("the Commission") *Discussion Paper: Draft Distribution Pricing Principles and Methodological Requirements* ("the Discussion Paper"), published by the Commission on 30 September 2009.

2 This submission is based on Powerco's experience in meeting the pricing principles and methodological requirements in the Commerce Act (Powerco Natural Gas Services) Authorisation 2008 ("the Authorisation").

3 Powerco appreciates the constructive approach of the Commission and active debate at workshops in June and October 2009. We welcome the Commission's shift away from the PAWG model and support a principles-based approach. This submission contains more detail on the implementation that we believe will deliver the best outcomes for consumers in the long term.

4 Powerco supports the establishment of an Industry Working Group to consider aspects of distribution pricing may be relatively easily standardised.

5 If the Commission wishes to discuss any aspects of this submission please contact:

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EXECUTIVE SUMMARY

6 Powerco welcomes the shift away from the PAWG approach and the adoption of the Gas Authorisation principles. We also acknowledge the efforts of the Commission to align with the regulatory instruments of the Commerce Act. The Commission however, is still proposing a separate report with separate requirements to the Commerce Commission. This is siloed Government. Powerco should not have to consider two sets of pricing principles and guidelines (even if they have similarities) because one regulator deems itself to have a wider remit than the other. There should be one "whole of government" set of regulations with an EDB providing one annual report.

7 The Commerce Act sets the objective for regulation (including the determination of pricing methodologies) as being to mimic the outcomes which would be expected in a market with workable competition. In a market with workable competition you see a myriad of pricing structures develop as firms innovate in a manner that improves allocative efficiency. In this submission we recommend changes to the principles based on the workable competition standard to align with the Commerce Commission's objectives, and also consider refinements to the principles so they are more easily implemented. Powerco's main recommendation is that the principles are kept focused on the key objective of allocative efficiency, and issues that can be better addressed by other regulatory instruments are removed.

8 Powerco recognises that the Commission is worried that pricing principles will not lead to change, and has suggested the Gas Authorisation compliance approach as a back-up. Powerco's experience from the Gas Authorisation is that this decision is flawed. There is a large degree of information asymmetry between regulators and EDBs with respect to pricing. Much of the required information is also unavailable or prohibitively expensive to collect. The cost of the regulator gaining adequate knowledge to robustly impose a penalty is likely to outweigh any benefits to consumers. Any in-between approach will require discretionary regulatory decisions, reducing investor certainty and incentives to innovate. Powerco strongly advises against this as reducing regulatory uncertainty was a key aim of the Commerce Amendment Act 2008.

9 We note that pricing methodologies have a similar degree of information asymmetry to asset management plans. In trying to improve asset management, the Commerce Commission chose to use information disclosure as the regulatory instrument, along with an annual report highlighting poorly performing EDBs. This approach seems to have worked with PB Associates stating that, "In our view the quality of disclosed AMPs has improved substantially since PB Associates undertook its first AMP reviews in 2005".

10 Powerco recommends this approach is adopted for pricing methodologies. The Commission and the Commerce Commission should produce one set of principles, require one annual disclosure and use one expert to assess the pricing methodologies.

11 Powerco does not think that compliance with the methodological requirements needs to be assessed. The Commission describes these as guidelines to "assist stakeholders with interpreting and implementing the principles". We agree that some smaller EDBs may not be as practiced in developing pricing methodologies and may welcome some non-mandatory guidelines on how to meet the Commission's expectations. Powerco however, would find the requirements a constraint, limiting our ability to innovate. We recommend the Commission consults further on non-mandatory guidelines as there has no been adequate time to consider these in this stage of consultation.

RECOMMENDATIONS

12 Powerco supports the use of the Gas Authorisation Pricing Principles. Powerco recommends that the Commission make the following changes (deletions shown as strikethrough and additions made in red):

Recommended principles

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;

~~II. to allow for price/quality tradeoffs;~~

II. allow negotiation to better reflect the economic value of specific services; and

III. where network economics warrant; encourage investment in distribution alternatives (e.g. distributed generation) and technology innovation.

~~b) 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.~~

c) Consultation with retailers should be undertaken before material changes in price structure are undertaken. Changes to prices should have regard to the likely impact on consumers.

~~d) Pricing structures should not place undue transaction costs on retailers and consumers, and should be competitively neutral across retailers.~~

e) Changes to prices should have regard to the likely cost impact on 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.~~

13 Powerco recommends the following compliance process, similar to the approach used to regulate Asset Management Plans:

Recommended approach
o The Commission's pricing principles form part of the Commerce Commission's annual pricing methodology information disclosure requirement (ie only one disclosure each year). o The Commissions publish non-mandatory guidelines, instead of methodological requirements and a model pricing methodology. These provide guidance on what the Commissions considers to be best practice disclosures. o The pricing methodology must be publicly disclosed by EDBs. o The Commission and the Commerce Commission jointly engage an expert to review each pricing methodology and to produce a published report. This report: ▪ assesses each pricing methodology for compliance with the principles and alignment with best practice; ▪ describes overall trends in industry; and ▪ makes observations on the use of best practice or innovative developments by EDBs. o In its next pricing review, an EDB is able to address any issues raised in the report and consider innovative/best practices approaches adopted by others.

14 Powerco recommends that the Commission consults further on non-mandatory guidelines that will assist EDBs to provide a compliant pricing methodology.

ISSUES

15 The Discussion Paper identifies three issues:

- What pricing principles promote the best long run outcomes for electricity consumers?
- How can Commerce Commission and Electricity Commission align regulatory instruments?
- How does the Electricity Commission ensure that any improvements in outcomes from pricing are not outweighed by the regulatory compliance cost?

ALIGNMENT WITH THE COMMERCE COMMISSION

16 Powerco considers it against best practice regulation to have two different annual pricing methodology information disclosure requirements and two different sets of principles and guidelines. While there are some issues to work through, Powerco believes it is possible to have one regulatory instrument for both Commissions.

17 A key issue, which the Commission notes, is that the workable competition standard must drive the Commerce Commission's decisions. There are two major considerations:

- the pricing methodology input methodology can be appealed by EDBs if they do not feel it meets the workable competition standard; and
- the purpose of information disclosure is to assist people in assessing if the s52A purpose statement (setting the workable competition standard) is being met.[1]

18 Consequently, the Electricity Commission's principles must align with the workable competition standard if the two Commission's are to align. When considering the outcomes of workable competition and the structure of prices, it is best to emphasise the importance of the cost structure of the industry - which in this case is one that is predominantly fixed costs. In long run equilibrium, we would expect the prices that relate to the different dimensions of usage (peak use, energy use etc) to reflect at least the associated marginal cost. After that the residual cost would be recovered in a manner than least distorts the pattern of consumption.

19 Depending on how customers can be segmented, this would most likely comprise of a number of different prices for different market segments and most likely a menu of choices for customers in a given market segment. In short, in workable competition there would be numerous different charging structures across firms that retailers would need to deal with.

20 The crux of the issue for deriving the optimal price for network industries is that we do not know what that optimal price is - hence, it is important to emphasis the provision of

[1] Section 53A of the Commerce Act 1986 states that the purpose of information disclosure is "to ensure that sufficient information is readily available to interested persons to assess whether the purpose of this Part [as set out in section 52A] is being met".

incentives to distribution businesses to innovate (i.e., pricing flexibility) and experiment in a manner that is expected to improve allocative efficiency.

WHAT PRICING PRINCIPLES PROMOTE THE BEST LONG RUN OUTCOMES FOR ELECTRICITY CONSUMERS?

Refinements to principles

21 Powerco supports a principles-based approach to regulating electricity distribution pricing methodologies and welcomes the use of the Gas Authorisation pricing principles ("Authorisation principles"). These principles reflect generally accepted economic theory and are based on a review of international best practice.[2]

22 The Commission has made a number of changes to the Authorisation principles that concern Powerco. We note that little explanation for the changes has been provided in the Discussion Paper, so it has been difficult to provide comprehensive comments.[3]

23 We are concerned that there are too many different ideas included in the principles, diluting the key objectives. It will be difficult for the Commission to assess compliance if numerous trade-offs are considered in pricing methodologies. The benefit of the Authorisation principles was their simplicity. They allowed a supplier to demonstrate a logical and transparent decision-making process, where the Commerce Commission could broadly track how trade-offs had been made. We also have considered how to align both Commission's objectives.

Principle (a): Legislative requirements already take precedence

24 The Commission has added "except where subsidies arise from legislation" to principle (1) of the Authorisation.

> 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)<u>, except where subsidies arise from legislation</u>;
>
> 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.[4]

25 Powerco notes that legislation takes precedence over the Commission's regulation, so this addition is not required.[5]

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[2] We note that Powerco and Vector provided a number of recommendations to improve the Authorisation principles during consultation. In practice the Commerce Commission's interpretation of the final principles was broadly sound, so Powerco supports the continued use of the principles.

[3] We note that the principles are very different to the set included in the June consultation paper. Powerco's submission on 10 July 2009 stressed the concepts that we felt should be included. In this submission we have focused on refining wording to ensure that the principles are implementable.

[4] Additions to the Authorisation Principles are underlined.

[5] We note that the additional wording was suggested by a number of EDBs, including ENA. On reflection Powerco considers that the words are not essential.

26 Powerco recognises that the additional words may help highlight to people reading the pricing methodologies that there is legislation is this area. We recommend the Commission provides a preamble to the principles that describes the legislative constraints on pricing.

Principle (b): Economic concepts are confused

27 The Commission has added “and/or the quality of service that they receive” to principle (2) of the Authorisation.

> 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 <u>(i.e. Ramsey pricing) and/or the quality of service that they receive,</u> to the extent practicable.

28 Powerco is unsure why the Commission has included this. Price quality trade off and demand responsiveness are different economic concepts. Demand responsiveness is an economic approach to mark up marginal costs to meet a total revenue requirement to fund the fixed costs of the business. It is based on the elasticity of different consumers’ demand curves, and the extent to which their consumption changes when prices change. It is about demand elasticities for one product.

29 The price quality trade-off is about EDBs providing a higher level of quality for a higher price (ie offering a different product). It is about the supply curve the EDB chooses to operate on. If EDBs operate at a higher quality level they would still under-recover the total revenue requirement as generally marginal cost will still be less than average cost. Therefore EDBs could not under-recover the shortfall of revenue by choosing a different price quality trade-off for some consumers.

30 The Commission may be referring to using the price quality trade-off as a proxy for demand responsiveness. We recognise that it is very difficult to measure price elasticity, although the Commerce Commission had some broad guidelines on this in the Gas Authorisation. Powerco recommends the text “and/or the quality of service that they receive” is deleted.

Principle (c): Change to include all instances of site negotiation

31 Principle (c) concerns allowing individual negotiation by customers where it is efficient. This concept captures agreeing non standard contracts to larger customers to cater to their specific needs.

> 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) <u>to allow for price/quality tradeoffs</u>.

32 Again, because the Commission provided no rationale for replacing Authorisation principle (3)(b), “allow negotiation to better reflect the economic value of specific services” with “allow for price quality trade-offs”, it is difficult to comment. Powerco prefers the original recommendation as it is broader and specifically mentions consultation with the customer.

33 Powerco notes that the concept of individual negotiation is also part of the Commission’s principle (f). Powerco recommends that these ideas are included under principle (c):

> “where network economics warrant; encourage investment in distribution alternatives (e.g. distributed generation) and technology innovation”.

Principle (d): Simplification required

34 The Commission has added that the development of prices "should be transparent" to principle (4) in the Authorisation.

> 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.

35 Transparency is important, but covered by information disclosure so there is no need for it to be included as a principle.

36 The Commission has replaced the word "customer" with the term "consumer. Powerco notes that the two terms have similar meanings in the Electricity Governance Rules:

- "customer" means a person who purchases, or has agreed to purchase, electricity from a retailer at a specific ICP;

- "consumer" means any person who is supplied electricity for consumption and includes a distributor, retailer or generator where the distributor, retailer or generator is supplied with electricity for its own consumption.

37 The main difference seems to be that a consumer includes people using electricity at an ICP, but not purchasing electricity from a retailer. As the principle refers to pricing, Powerco recommends the term refers to the purchaser of electricity, rather than all users of electricity.

38 The Commission has also removed "and changes should have regard to the impact on customers". Powerco assumes this is because "promote price stability" is already mentioned. Powerco prefers the Authorisation approach as "impact on customers" has a broader meaning and better serves customers' requirements.

39 The Commission has added that the development of prices should "lead to prices that are able to be understood by users". It is unclear who "users" are. Retailers are the predominant users of electricity prices, and this principle could relate to retailer consultation. Powerco would not support this principle if "users" referred to electricity consumers, as most electricity consumers have little interest in distribution price structures.

Principle (e): Use "have regard to" rather than "undue"

40 Principle (e) relates to the Commission's assertion that the transaction cost to retailers to enter a distribution network is sufficiently high that it is a barrier to retail competition.

> Pricing structures should not place undue transaction costs on retailers and consumers, and should be competitively neutral across retailers.

41 Powerco continues to dispute this as no robust evidence has been presented. Powerco however, supports pricing methodologies taking into account the cost impact on retailers where this does not conflict with legitimate investor and efficiency considerations. Powerco invests significant resources each year consulting with retailers on changes to prices and believes this principle, and principle (d), could reflect this best practice approach. Powerco also notes that the Industry Working Group could address some issues around labelling and definitions, and that these recommendations could be considered by EDBs.

42 The word “undue” sets a level of costs, which must somehow to measured. Powerco recommends “undue” is replaced by “have regard to”, meaning to give genuine attention and consideration to the issue. This requires EDBs to show how they have demonstrated consideration of retailers’ concerns in developing pricing methodologies, and have given weight that is appropriate or practical.

43 Again, because no explanation is included, for the idea that pricing structures should be “competitively neutral across retailers”, it is difficult to understand the Commission’s intent. Powerco has no knowledge of preferential EDB pricing, or any incentives that would make an EDB do this. The Commission should provide an example of what action would breach this principle.

44 Powerco recommends principle (e) is modified to, “Changes to prices should have regard to the likely cost impact on retailers.”

Principle (f): Delete “efficient use of electricity” objective

45 This principle relates to a number of objectives in the Electricity Government Policy Statement (“GPS”) that the Commission wishes to promote in pricing.

> <u>Prices and pricing structures should promote efficient usage</u> of <u>electricity and encourage investment in distributed generation (including renewable generation), distribution alternatives and technology innovation.</u>

46 Powerco recommends the ideas of distributed generation and technology innovation are either removed, or moved to principle (c).

47 The concept of “promote efficient use of electricity” should be removed. If the Commission is referring to critical peak pricing or time-of-use pricing, then principles (a)(i) and (a)(ii) address this. For example, the aim of peak pricing is to signal the level of spare capacity and the impact of usage of future investment costs.

48 If this principle relates to EDBs discouraging electricity consumption by having higher variable charges, it is unlikely to have any impact. The Commerce Commission’s price path regime encourages EDBs to sell more electricity. The correct regulatory instrument to address this problem is by a “D Factor” type mechanism in price regulation.[6]

Principles must not exclude Wholesale Delivery Model (“WDM”)

49 Powerco notes that the WDM is a valid approach to pricing and we raised a number of issues with a making the retail delivery model (“RDM”) compulsory in our submission in July 2009. Powerco’s interpretation of the pricing principles is that the WDM model would be compliant, but requests that the Commission state that both the WDM and RDM would be compliant models under the principles.

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[6] The D-factor is an example of a demand management incentive mechanism. An example of its operation is in New South Wales. It works by a yearly allowed adjustment to the price cap that enables an EDB to recover through prices the additional costs of demand management projects in a year, relative to the previous year. Typically, demand management projects recovered under the D-factor target network congestion, and cost recovery is based upon a reduction in planned network capex.

HOW DOES THE COMMISSION ENSURE THAT ANY IMPROVEMENT IN OUTCOMES FROM PRICING IS NOT OUTWEIGHED BY THE COMPLIANCE COST?

Aims of the approach to compliance

50 The cost of enforcing regulations must be less than the improvement to consumers' outcomes from the regulations. At the Commission's workshop on 12 October, participants discussed three parts to this issue:

- What is the potential for improvement in pricing outcomes and how does this limit the size of the compliance cost?
- How does compliance cost vary with the accuracy of information provided to the regulator?
- What is the cost of different incentives or penalties?

A. What is the potential for improvement in outcomes from pricing regulation and how does this limit the size of the compliance cost?

51 The gain in consumers' outcomes from regulating pricing methodologies is not high. The overall potential for allocative efficiency gains from changes to the prices of individual services or classes of regulated services is typically quite small, given that most types of regulated services are often relatively price inelastic.

52 Powerco also continues to dispute that transaction costs reduce outcomes as they act as a barrier to retail competition. The Commission's Discussion Paper included no additional evidence to support this assertion. For example, even if EDBs had identical price structures, there would still be different prices that retailers would have to take into account.

53 In addition, Powerco notes that often pricing is a symptom of another driver. Regulatory instruments should tackle the cause of an issue, rather than trying to impact its translation into pricing. As we stated earlier, the Commission will not be able to force the de-coupling of revenue and electricity volume by pricing principles to promote energy efficiency. This issue must be addressed by demand management incentive mechanisms in the price path formula.

54 In conclusion, the increase in consumers' outcomes from pricing regulation is likely to be fairly small, and correspondingly, the compliance costs of implementing regulation should be small.

B. How does the compliance cost vary with accuracy of information provided to the regulator?

55 The next issue to consider is what level of information can be provided at the appropriate compliance cost.

56 The information required to determine allocatively efficient price levels is generally unavailable (eg elasticity of demand) or prohibitively expensive. Consequently, regulators are limited to only shifting prices out of ranges that are demonstrably inefficient (i.e., prices that lie outside stand alone cost and incremental cost bounds).

57 There is also a high cost for a regulator to gain the substantial amount of knowledge to make robust decisions on how to balance trade-offs of the principles. Pricing is a complex process, and some of the areas the regulator would have to consider are:

- how regulations that require cross subsidisation have been taken into account;
- technical considerations, for example, ensuring electricity tariff groups align with the size of electricity transformers to provide a coherent pricing structure;
- knowledge of consumer reactions to price changes, including different demand preferences between regions and types of consumers;
- keeping prices stable to return consumers' commitment to using electricity;
- managing volume risk, for example, to manage variations in the weather;
- balancing retailers' preferences; and
- balancing the mix of different usage profiles on the network.

58 Finally, regulators often prefer an independent third party, such as an auditor, to verify information is accurate. This is very expensive, both in terms of the audit cost and the resource to respond to auditor's questions. For example, in the Authorisation, Powerco's auditor had over 200 queries on Powerco's cost of supply model that our analysts and engineers spent over 500 hours responding to. The total cost was in the hundreds of thousands of dollars, although no material changes were required to the cost of supply model as a result of the audit. While audit approval may provide additional assurance of the accuracy of a cost of supply model, this level of assurance is very expensive.

59 Powerco would like further consultation to consider what level of information on the principles could be provided at a low compliance cost due to limited time to complete this submission.

C. What is the cost of different incentives or penalties?

60 The Commission has proposed the following compliance approach:

Commission's proposed compliance approach

- An annual statement of variations/ compliance with pricing principles and methodological requirements at the time of the Commerce Commission disclosure report using the same data and formats as possible.
- Evaluation by the Commission.
- A full pricing report if the Commission disagrees with a proposed compliance arrangement. This would follow the same template as the Commerce Commission Authorisation Pricing Report and it would require an audited cost of supply model.
- A mandatory methodology for persistent non compliance.
- The Commission would also publish a model pricing methodology for information only, to provide guidance on a methodology that the Commission considers compliant.

61 The Commission's model is based on a series of penalties to act as incentives. For example, if a supplier's methodology is deemed to be non-compliant, the Commission will require an expensive audited cost of supply model and detailed pricing report. If the cost of supply model and pricing report are considered non-compliant the Commission will require a mandatory methodology.

62 This approach is flawed as the Commission will not have enough information at each stage to justify imposing the penalty. For example, the Commission will have to justify imposing a compliance cost in the hundreds and thousands of dollars on a company, although it will have limited information to prove non-compliance. It will also be very difficult for the Commission to use the pricing report to force implementation of a mandatory model. The Commission would have to demonstrate a principle has been clearly breached.

63 These decisions require highly discretionary decisions by the Commission as it will have limited information. A main purpose of the Commerce Amendment Act 2008 was to reduce regulatory discretion and to increase investor certainty. The Commission's proposal moves regulation in the opposite direction and increases uncertainty.

Recommended approach

64 Powerco has considered these issues and recommends the following process ("the recommended approach"):

Recommended approach

- The Commission's principles are adopted by the Commerce Commission's pricing methodology information disclosure requirement. An EDBs discloses its pricing methodology each year inline with the Commerce Commission regulations. This should include a description of the methodology and how the methodology has had regard to the pricing principles (inline with the Commerce Commission's current proposals).

- The Commission would not produce methodological requirements or a hypothetical/ model pricing methodology, but instead, would publish non-mandatory guidelines. These would provide the Commission's interpretation of the pricing principles and the issues that would need to be considered to show an EDB has had regard for the principles.

- The pricing methodology must be publicly disclosed (inline with current Commerce Commission requirements).

- The Commission and the Commerce Commission jointly engage a pricing methodology expert to review each pricing methodology and to produce a published report. This report:
  - assesses each pricing methodology for compliance and best practice
  - describe overall trends in industry; and
  - make observations on best practice or innovative developments.

- Assuming the reviews are available before the next pricing methodology is prepared; EDBs are able to address any issues raised in the report and consider the approaches adopted by others which are deemed to represent best practice.

Benefits of recommended approach

Based on success in promoting best practice in asset management

65 The approach described above is similar to the Commerce Commission's approach to Asset Management Plans ("AMPs").[7] This is because pricing methodologies have similar characteristics to AMPs. For example, there is a similar amount of information asymmetry between the regulator and supplier. Because of this, it is not efficient for the regulator to dictate the correct approach, but rather encourage best practice.

66 Also, like asset management, pricing is about the long term as change happens slowly to minimise rate shocks to customers. Pricing managers will have long term aims, but will have to make modifications each year to accommodate retailer actions and developments in consumption and technology. A major problem with the Gas Authorisation approach was that it locked in prices for three years. Pricing requires an annual process and a high compliance cost approach does not align with this.

Information disclosure works as an incentive

67 The recommended approach uses information disclosure as a lever. EDB's boards and management are incentivised to improve poorly regarded pricing methodologies to avoid the public perception that their methodology (and by implication, their business practices) are of low quality.

68 This has worked in asset management. PB Associates found, "In our view the quality of disclosed AMPs has improved substantially since PB Associates undertook its first AMP reviews in 2005."[8]

Mechanism to share best practice and innovation

69 There will also be benefits of an expert analysing all 29 EDB pricing methodologies. These include:

- Identifying best practice and innovative ideas: Not only will the recommended approach provide suppliers flexibility to trial new products, but it will actively promote best practice and innovative ideas in pricing.

- Allowing the Commission to be targeted in recommending improvements and providing an overview of the standards of pricing methodologies.

Methodological requirements are not required

70 This approach does not require compliance methodological requirements. In the Authorisation the methodological requirements were to ensure that the pricing methodology was consistent with the legal requirements of the Gas Authorisation. In contrast, the GPS states a preference for a voluntary approach.

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[7] Under the information disclosure requirements currently applicable to asset management reviews for EDBs, the Commission undertakes (assisted by external experts) and publicly discloses an annual review of AMPs as part of its summary and analysis obligations under the Act.

[8] PB Associates, on behalf of Commerce Commission, Summary Report: Electricity Lines Businesses, AMP Compliance Review, March 2008, page 3.

71 Powerco supports the Commission publishing non-mandatory guidelines of what the Commission would expect to be included in the pricing methodology and how EDBs could demonstrate compliance with the principles in a low cost manner.

72 Useful guidance, that EDBs are already familiar with, is already available in the form of requirement 22 and 23 of the Commerce Commission's Information Disclosure Requirements, as follows:

> **22. Disclosure of pricing methodologies—**
> Every disclosing entity must publicly disclose,—
>
> (a) At the beginning of each financial year, the methodology used at the beginning of that financial year to determine the line charges payable or to be payable; and
>
> (b) Any change in the methodology or adoption of a different methodology, within 1 month of the change or the different methodology taking effect.
>
> **23. Contents of pricing methodology disclosures—**
>
> Every disclosure under requirement 22 must—
>
> (a) Describe the methodology used to calculate the prices charged or to be charged; and
>
> (b) Include the key components of the revenue required to cover costs and profits of the disclosing entity's line business activities, including cost of capital and transmission charges, which must include the numerical value of each of the components; and
>
> (c) State the consumer groups used to calculate the prices charged or to be charged, including—
>
> (i) The rationale for the consumer grouping; and
>
> (ii) The method by which the disclosing entity determines which group consumers are in; and
>
> (iii) For each of these consumer groups, the statistics relating to that group which were used in the methodology; and
>
> (d) Describe the method by which the disclosing entity allocated the components of the revenue required to cover the costs of its line business activities amongst consumer groups, which must include the numerical values of the different components allocated to each consumer group and the rationale for allocating it in this manner; and
>
> (e) Describe the method by which the disclosing entity determined the proportion of its charges which are fixed and the proportion which are variable, and the rationale for determining the proportions in this manner.

73 Powerco also notes the Commission's intention to develop a relatively detailed distribution pricing methodology for information only. This will be a very difficult task as the Commission would have to create a hypothetical company with costs and constraints. It is also unlikely to be very useful to EDBs due to its simplicity and not representing EDBs circumstances.