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**Submission to the Electricity Commission
on its
Discussion Paper - Draft Distribution
Pricing Principles and Methodological
Requirements**

Submitted by

Wellington Electricity Lines Limited

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1. Introduction

1.1 Wellington Electricity Lines Limited (“Wellington Electricity”) welcomes the opportunity to provide feedback to the Electricity Commission (“EC”) on its Discussion Paper on Draft Distribution Pricing Principles and Methodological Requirements (“the Discussion Paper”).

1.2 Wellington Electricity’s comments follow in table form.

1.3 For any questions related to this submission, please contact:

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2. Comments on Pricing Principles and Methodological Requirements

- 2.1 Wellington Electricity supports the EC's approach to base its proposed pricing principles on those contained in the Commerce Commission's gas authorisation for Powerco and Vector ("the gas authorisation").
- 2.2 However, Wellington Electricity does not consider the Commerce Commission's compliance process in the gas authorisation, which was set-up for the implementation of controlled prices and which incorporates a highly prescriptive format, detailed reviews and audit criteria, is appropriate for the purposes of verifying compliance with a **non-mandatory** Distribution Pricing Methodology.
- 2.3 We recommend that the same type of compliance and review process that applies now to Asset Management Plans ("AMP(s)") should be adopted by the EC instead of the proposed gas authorisation "type" compliance process. An AMP "type" review process would be much lower cost than the EC's has proposed process.
- 2.4 The AMP process has proven to be a reliable and low cost method of compliance where each Electricity Distribution Business ("EDB(s)") publishes an AMP, the Commerce Commission engages a consultant to review the published AMPs and to rank each EDB's level of compliance. The process has driven EDBs to improve their ranking, often adopting best practice from other EDBs. We note for example that in a recent compliance review, the Commerce Commission's consultant PB Associates noted that the quality of disclosed AMPs has improved substantially since it undertook its first AMP reviews in 2005.¹ Wellington Electricity believes this would also be the case if Distribution Pricing Methodologies were assessed for compliance in the same way as AMPs. Wellington Electricity encourages the EC to open a dialogue with the Commerce Commission on how the AMP process has driven best practice.

¹ *Electricity Line Business Asset Management Plan Compliance Review 2007/08*, p. 3, PB Associates. Source: http://www.comcom.govt.nz/IndustryRegulation/Electricity/ElectricityInformationDisclosure/ContentFiles/Documents/AMP%20Summary%20Report%202007-08%20-%20676349_1.pdf.

- 2.5 Regarding the **Proposed Methodological Requirements**, Wellington Electricity considers that any reference to these should be removed. To specify Methodological Requirements is not consistent with a principles based approach as it presupposes a pricing based approach and removes flexibility to adapt to changing environments.
- 2.6 In place of proposed Methodological Requirements the EC should refer to the Commerce Commission's existing Information Disclosure requirements relating to Pricing Methodology disclosures.
- 2.7 Wellington Electricity now gives comments on each of the proposed pricing principles in turn.

3. Pricing Principles

<p>(a) Prices are to signal the economic costs of service provision, by:</p>
<p>(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>;</p> <p>Wellington Electricity supports this principle, but we suggest that in addition to legislation it also refers to the Electricity Governance Government Policy Statement (“GPS”) . The GPS is not legislation, but it is an important directive.</p>
<p>(ii) having regard, to the extent practicable, to the level of available service capacity; and</p> <p>Wellington Electricity supports this principle.</p>
<p>(iii) signalling, to the extent practicable, the impact of additional usage on future investment costs.</p> <p>Wellington Electricity supports this principle.</p>
<p>(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 (<u>i.e. Ramsey pricing</u>) and/or the <u>quality of service that they receive</u>, to the extent practicable.</p> <p>Wellington Electricity does not support the use of Ramsey Pricing. We draw the EC’s attention to the Commerce Commission’s June 19 Discussion Paper on Input Methodologies, paragraphs 5.59 to 5.64, p. 104 - 105, which notes the widely recognised difficulties in implementing Ramsey Pricing.</p> <p>We also consider that any reference to quality of service should be removed. This is already addressed by other proposed pricing principles such as (a) and (c) and also by the Commerce’s Commission’s Price-Quality regulations which set a price path and assume no reduction in service with that price path.</p>
<p>(c) Provided that prices satisfy (a) above, prices should be responsive to the requirements and circumstances of users in order to:</p>
<p>(i) discourage uneconomic bypass; and</p> <p>Wellington Electricity supports this principle.</p>
<p>(ii) to <u>allow for price/quality tradeoffs</u>.</p> <p>Wellington Electricity does not support this principle as it is already required under the Commerce Commission’s Price-Quality regulations.</p>

A more appropriate principle is contained in gas authorisation principle 3b,² that “prices should be responsive to the requirements and circumstances of users in order to: b) allow negotiation to better reflect the economic value of specific services.” Wellington Electricity considers that by including this principle, it will recognise that some customers place a higher value on different levels of service.

(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.

Wellington Electricity considers that promoting price stability and certainty should be removed from this principle. EDBs require flexibility to come up with innovative solutions to cope with the unique circumstances facing their respective networks and to do this they need to send pricing signals to consumers’ to change their behaviour. Sending these signals does not necessarily align with stability and certainty.

With respect to “...prices that are able to be understood by users.” there is no definition of “users” in the Discussion Paper, however, there are significantly different levels of understanding of pricing principles amongst different users (i.e. a domestic consumer compared with an electricity retailer both of whom could be considered users). In addition there is an inherent conflict between achieving other principles such as being subsidy free and with the principles being easily understood. The principles must allow EDBs to manage such trade-offs.

**We therefore recommend that the following changes are made to (d):
d) Development of prices should be transparent and regard should be given to the impact changes to prices have on consumers.**

We also note that the above change is consistent with gas authorisation principle No. 4.³

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

Wellington Electricity considers that the term ‘undue transaction costs’ is not relevant in relation to the economic principles.

**We also consider that ‘economically equivalent’ treatment of retailers is the appropriate definition for economically-based pricing principles rather than ‘competitively neutral’. We suggest that (e) is reworded as follows:
e) *Changes to prices should have regard to the likely cost impact on retailers. Retailers should be treated in an economically equivalent manner.***

(f) Prices and pricing structures should promote efficient usage of electricity and encourage investment in distributed generation (including renewable generation),

² Schedule 3 Pricing Principles and Methodological Requirements, Part 1: Pricing Principles No. 3(b), p. 18, of Commerce Commission Decision No, 656, Authorisation pursuant to the Commerce Act 1986 in the matter of controlled services supplied by: Powerco Limited.

³ Schedule 3 Pricing Principles and Methodological Requirements, Part 1: Pricing Principles No. 4, p. 18, of Commerce Commission Decision No, 656, Authorisation pursuant to the Commerce Act 1986 in the matter of controlled services supplied by: Powerco Limited.

distribution alternatives and technology innovation.

Wellington Electricity does not support this principle.

Firstly, Wellington Electricity supports the promotion of the efficient usage of electricity within commercial bounds. However, this should not be at the expense of network efficiency which is a primary economic driver for network owners. Further, Section 54Q of the Commerce Act 1986 (“the Act”) requires the Commerce Commission to promote incentives, and avoid imposing disincentives, for EDBs to invest in energy efficiency and demand side management, and to reduce energy losses, when it applies Part 4 of the Act. This makes promotion of the efficient use of electricity unnecessary in this principle.

Secondly, the EC already has regulations in place to promote distributed generation and it is not required.

Given the above reasons we recommend that principle (f) is superfluous and should be deleted entirely.