Submission on the consultation paper

'Distribution Pricing Methodology'

30 October 2009

To

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Electricity Commission

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EXECUTIVE SUMMARY

- Eastland Network does not support the proposed guiding principles. The development of the pricing methodology needs to be aligned with the purpose statement of the Commerce Act 1986 (the "Act") in order to form a consistent regulatory framework for distribution businesses.
- Eastland Network believes that pricing methodology can only be a principles based approach, in a way that it provides voluntary guidance for EDBs.
- A certain level of cross subsidisation is induced by the legislative framework while some cross subsidisation is due to morale conscience. Electricity services into remote areas are generally at a level that does not signal the true costs of supply due to the relation of length of line and consumers on that line. Even though we agree that subsidisation is not desirable, for the example of remote consumers, we consider a low level of cross subsidisation as acceptable. We also recommend that the Commission is mindful of the differences between EDBs in their sizes, geographic locations and demographic of their consumer bases.
- Eastland Network recommends the standardisation of terms and definitions and coordination of tariff structures.
- We do not support the proposal that distributors should provide sufficient detail to be clear as to why their methodology varies from the proposed model approach in form of a Statement of Variations. This process would only add unnecessarily to compliance costs. While the methodological requirements may be useful as guidelines, we do not believe that they should be reported on nor used as measure in compliance reporting. In fact, we argue that these are not required in the context of distribution businesses as they stand in contradiction to the principles based approach. We also note, that a very high level of detail has been added to the original requirements from the gas determination.
- We believe that current disclosure requirements of pricing methodologies in combination with threshold compliance statements and information disclosure schedules provide ample information for the regulator and interested parties. The regulatory control regime is an effective mechanism to limit the risk of abusing market power by applying excessive pricing. Thus, the benefits to gain from a standard pricing methodology do not exceed the regulatory compliance costs for EDBs, nor does it provide greater benefits to the end consumers.

1.0 INTRODUCTION

1.1 Introduction to Eastland Network Ltd

Eastland Network Ltd owns and operates the lines for the upper East Coast of the North Island. Eastland Network 100% owned by the Eastland Community Trust with the Gisborne District Council as the capital beneficiary of the Trust.

Eastland Network distributes approximately 302 GWh of electricity to approximately 26,000 consumers, of which almost two thirds are in Gisborne City and Wairoa Township. The remaining connections are spread out widely, across two isolated distribution networks covering 11,952km^2, resulting in an overall line density of less than seven connections per kilometre of line.

1.2 Structure of this Submission

Our views are aligned with the views taken by the Electricity Network Association (ENA) and PricewaterhouseCoopers (PWC) in their respective submission on this matter. Eastland Network fully endorses both submissions and recommends the Electricity Commission gives these submissions, representing a large number of lines businesses, full recognition.
Eastland Network's responses to the questions raised by the Electricity Commission in their consultation paper will be provided in the third section of this submission.

We do not wish to be heard in support of our submission.

2.0 BACKGROUND

Under Part 4 of the Commerce Act 1986 a distributor's prices and revenue are subject to regulatory constraints. A distributor that is not exempt due to its owner-ship status must adjust its prices according to the default/ customised price path set by the Commerce Commission. As part of the information disclosure requirements, all distribution businesses disclose annually their pricing methodologies.
Currently, there is no uniform pricing methodology. In order to address this issue, the Electricity Commission (the "Commission") released a consultation paper in a first consultation round, which proposed a voluntary model approach to distribution pricing methodology.

The proposed model aims to

- Improve the transparency of cost allocation;
- Facilitate efficient pricing;
- Encourage efficient use of lines businesses;
- Provide incentives to invest; and
- Establish greater consistency of distribution pricing.

Ultimately, the use of a uniformed model is expected to enhance competition for retailers. The proposed methodology is based on the recommendations provided by the Pricing Approaches Working Group (PAWG) in 2005. The consultative group was formed for the purpose of developing voluntary model approaches to distribution pricing.

The first consultation round was followed by a second consultation paper, released on the 30th September 2009, and a workshop held on the 12th October 2009.

3.0 COMMENTS

3.1 Proposed Principles

Eastland Network supports the Commission's preliminary preference to adopt 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. Flexible pricing provides an efficient reward for innovation and investment, which would be restricted under a standardised model. Non-exempt EDBs are limited in their ability to extract excessive profits under the regulatory regime of the Commerce Act 1986. Thus, as there is already an effective mechanism in place to protect consumers from the abuse of market power, the need for a standardised model is arguably fairly small.

The Commission proposes the following pricing principles which, where appropriate, reflect:
(a) additional objectives set out in the Electricity Act 1992;
(b) relevant objectives in:
  (i) the transmission pricing methodology; and
  (ii) the Electricity Governance (Connection of Distributed Generation) Regulations 2007; and
(c) feedback from submissions on the Consultation Paper.

While we support these principles should be used for guidance purposes in the design of pricing methodologies, we note that caution must be taken if they are used for actual assessment of pricing methodologies.

Particularly principle a[1]. is problematic in its implications. A certain level of cross subsidisation is induced by the legislative framework while some cross subsidisation is due to historic pricing considerations. Electricity services into remote areas are generally at a level that does not signal the true costs of supply due to the relation of length of line and consumers on that line. Even though we agree that excessive subsidisation is not desirable, for the example of remote consumers, we consider a reasonable of cross subsidisation as

[1] (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.

acceptable. We also recommend that the Commission is mindful of the differences between EDBs in their sizes, geographic locations and demographic of their consumer bases.

3.2 Proposed Methodological Requirements

The Commission proposes to adopt a set of methodological requirements (table below), 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. In fact, we argue that these are not required in the context of distribution businesses as they stand in contradiction to the principles based approach. We also note, that a very high level of detail has been added to the original requirements from the gas determination.

The requirements as proposed, 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 distributor's pricing.

3.3 Define Terminology

Eastland Network supports industry wide common terminologies and definitions for aspects of distribution tariffs; however we would not go as far as supporting 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 the 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 true cost of supply.

Furthermore, Eastland Network opposes to 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 correct pricing signals and generating the appropriate level of revenue for the 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 networks. Potentially, common tariffs could result in increased levels of cross subsidisation and send the wrong pricing signals.

3.4 Compliance Costs

The Commission proposes adopting compliance reporting whereby EDBs would submit information at the same time as the Information Disclosure Schedules. The Commission is suggesting 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. This will be an extremely resource and costs intensive process. EDBs would be required to gain intimate knowledge of the Commission's model to be able to apply the model to their own tariff structures, assuming these are compatible with the Commission's model.

We believe that current disclosure requirements of pricing methodologies in combination with threshold compliance statements and information disclosure schedules provide ample information for the regulator and interested parties. The regulatory control regime is an effective mechanism to limit the risk of abusing market power by applying excessive pricing. Thus, the benefits to gain from a standard pricing methodology do not exceed the regulatory compliance costs for EDBs, nor does it provide greater benefits to the end consumers.

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.

Yours sincerely

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