



27 September 2022

Electricity Authority
Level 7, AON Centre
1 Willis Street
Wellington 6011

To whom it may concern,

Re: Settlement Residual Allocation Methodology

Thank you for the opportunity to provide a submission regarding the proposed changes to the settlement residual allocation methodology (SRAM).

Contact Energy broadly supports the proposal put forward by the Authority. It is important that there are clear incentives for the efficient use of the grid, and investment in transmission and generation assets.

However, the proposed light-touch approach to enforcing distributor pass-through is unlikely to meet the Authority's objectives. We recommend that the Authority adopts the full pass-through obligation, with an appropriate phase-in period to minimise the compliance cost.

Rebates should ultimately reach end-users

We agree that the SRAM should be designed so that it achieves lower electricity prices for end consumers. The best way to achieve this is for distributors to pass the rebates directly on to their customers.

For the avoidance of doubt the Code should make it clear that the settlement residual rebates must go to *distribution customers*, specifically: retailers, direct generation, and direct load customers. As currently drafted, there is a risk that distributors will attempt to circumvent retailers or influence how they pass the rebates on to end customers.

As noted by the Authority, retailers operate in a highly competitive market, which will ensure that these costs and savings will ultimately be passed on to end-customers. Retailers will ensure that the pass-through is done in a way that is most attractive to customers.

We do not consider it appropriate for distributors to provide these rebates to trust beneficiaries, as is the common practice for the largest distributor – Vector. In many cases the trust beneficiaries do not accurately reflect the full retail customer base, and there may be perverse incentives to provide a greater proportion of the rebate to trust beneficiaries, rather than other customers, which would undermine the principle of reducing overpayment of transmission charges.

Some distributors have also attempted to influence how retail pass-through occurs by communicating directly with end-customers about how retailers will pass through the settlement residual rebates. How retail pass-through occurs should not be dictated by the distributors. Competitive market forces will lead to a more efficient outcome. Ultimately, these communications are confusing for end-customers and exceed the role of the distributors.

A limited pass-through obligation would not meet the Authority's objectives

A limited pass-through obligation is not sufficient to ensure that each distribution customer type is allocated the settlement residual rebate in proportion to transmission charges paid by that customer type.

The scepticism from some distributors such as Network Tasman about retailer's incentives suggests that they may not implement distributor pass-through as intended. If they do not consider that retailers will pass through the rebate to end-customers, they may attempt to circumvent retailers. As noted by the Authority, this would likely result in a less efficient outcome for consumers.

Many distributors have also shown that where they are provided discretion, they may not act in accordance with the Authority's intentions. For example, distributors continue to lag in implementing the distribution pricing principles, with the Authority finding in 2021 that "most distributors are still not looking hard enough at their own cost drivers, nor properly considering how to design more efficient pricing"¹

The compliance costs of the full pass-through option can be managed

We recognise that the full pass-through option may impose some cost on distributors. However, we do not consider this to be unreasonable, given the significant benefits of improving the SRAM, and avoiding the risks of a limited pass-through obligation, as covered above.

It may be appropriate for the Authority to consider ways to mitigate this cost by allowing flexibility in the implementation date, or by considering different requirements for smaller distributors, such as those exempt from price-quality regulation under Part 4 of the Commerce Act.

Kind Regards



Brett Woods, Head of Regulatory and Government Relations

¹ <https://www.ea.govt.nz/assets/dms-assets/28/Distribution-pricing-scorecards-2021-summary-of-findings-and-key-themes.pdf>