More efficient distribution network pricing – principles and practice

Decision paper

4 June 2019

Market Design

Executive summary

Purpose of this decision paper

This paper sets out new Distribution Pricing Principles and the approach to monitoring and promoting progress on distribution pricing reform.

These new arrangements are based on proposals the Authority consulted on over the December 2018-February 2019 period, amended to reflect feedback from submissions.

Distribution pricing reform requires urgency

Distributors run primarily fixed-cost businesses, but still recover most of their costs using flat per kWh charges (includes day/night and controlled rates options) that do not reflect the economic costs of providing network services.

This is inefficient, and creates poor outcomes – overinvestment by consumers in technologies to avoid network charges, shifting costs onto other consumers; and unnecessary network investments.

For example, it gives consumers few incentives to avoid using power-hungry appliances or charging their vehicle at times that a network gets congested; others might take steps to reduce their energy use to avoid network charges when there is plenty of capacity.

The scope for poor outcomes from inefficient price signals is growing, as technologies such as electric vehicles, solar panels and battery storage are becoming more available and affordable.

There is broad industry agreement that distribution prices need to change. Distributors have been working on pricing options and implementation issues for a number of years. Even so, the Authority is concerned that, without further facilitation, price reform efforts may not go far or fast enough, or would stop. This would mean that consumers end up paying more than they need to.

New Distribution Pricing Principles

To support distribution pricing reform, the Authority consulted on changes to the Distribution Pricing Principles. These aimed to set clear expectations for efficient distribution prices. After considering submissions, the Authority has decided to adopt updated Distribution Pricing Principles. These are set out in the box on the next page.[1]

We expect that distributors first describe the consistency of their pricing with these updated Principles as part of the disclosures that are due by 1 April 2020.

The submissions and past experience both indicate there is scope for different practical interpretations of the pricing principles. We will supplement the Principles with a Practice Note to assist with practical interpretation. We have prepared a draft version, which we will seek input on from distributors before we finalise it by the end of August 2019.

Monitoring and support

We also consulted on a proposal to publish star ratings for each distributor based on the efficiency of their pricing structures. Many submitters encouraged us to continue or expand our role in supporting effective pricing reform. But submissions raised concerns about the star ratings, and preferred a more holistic and constructive approach.

[1] The substantive changes from the principles proposed in the consultation paper are explained in Appendix A.

In response, the Authority has decided to introduce a scorecard approach. This widens the assessment to cover context, strategies, plans, and outcomes (such as the efficiency of pricing structures and uptake measures). It combines traffic lights for status reporting, charts showing trends, and commentary for a holistic picture that recognises local context.

This decision paper presents a draft Pricing Scorecard template. We will seek input from distributors to finalise the draft Pricing Scorecard template by the end of August 2019. We will then complete baseline assessments based on 2019 disclosures and roadmaps, and repeat this after each disclosure.

We will discuss the scorecards with distributors annually, to test the application of principles and price structures to fit their network's context, highlight leading practice, and identify and help with roadblocks to adopting more efficient pricing. This approach supports and reinforces the Authority's expectation that pricing reform should not stop when distributors have introduced new pricing structures in the immediate future, but should continue as circumstances and what is feasible changes.

The 2019 Distribution Pricing Principles

(a) Prices are to signal the economic costs of service provision, including by:

- (i) being subsidy free (equal to or greater than avoidable costs, and less than or equal to standalone costs);
- (ii) reflecting the impacts of network use on economic costs;
- (iii) reflecting differences in network service provided to (or by) consumers; and
- (iv) encouraging efficient network alternatives.

(b) Where prices that signal economic costs would under-recover target revenues, the shortfall should be made up by prices that least distort network use.

(c) Prices should be responsive to the requirements and circumstances of end users by allowing negotiation to:

- (i) reflect the economic value of services; and
- (ii) enable price/quality trade-offs.

(d) Development of prices should be transparent and have regard to transaction costs, consumer impacts, and uptake incentives.

Contents

Tables

Figures

1 We have decided to revise the pricing principles and approach to monitoring pricing reform

1.1 We have decided to:

(a) publish updated Distribution Pricing Principles (Principles)

(b) withdraw the Information Disclosure Guidelines (Guidelines)

(c) publish a Distribution Pricing Practice Note (Practice Note)

(d) work with distributors to finalise a revised approach to monitoring pricing reform.

Principles

1.2 We have completed consultation on proposed changes to the Principles. Submissions have helped us to refine these Principles, and we have made changes that:

(a) focus on the essential elements of efficient pricing; a Practice Note will provide more detailed guidance where required

(b) continue to recognise that distributors should have regard to transaction costs, consumer impacts and uptake incentives.

1.3 The finalised Principles can be found at page iii of this decision paper and Appendix A explains the changes.

1.4 Under existing Commerce Commission (Commission) disclosure rules distributors are required to demonstrate how their pricing methodologies are consistent with the pricing principles and explain reasons for any inconsistency.[2] We expect the first disclosures against the updated Principles will occur in early 2020.

Guidelines

1.5 We confirm our proposal to withdraw the Information Disclosure Guidelines (Guidelines) that accompanied the Principles when they were first developed.[3] The Guidelines are redundant now the Commission has implemented detailed disclosure rules.

Practice Note

1.6 Past experience and the submissions indicate scope for different practical interpretations of pricing principles. We also recognise that interpretation will evolve over time. We will therefore introduce a Practice Note to help with that.

1.7 We will update the Practice Note from time to time to ensure it reflects evolving leading practice and addresses matters raised by the sector and our monitoring activities.

Monitoring and support

1.8 We consulted on a proposal to publish star ratings for each distributor based on the efficiency of their pricing structures. Submissions supported our role in promoting

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2 Electricity Distribution Information Disclosure Determination 2012, https://comcom.govt.nz/__data/assets/pdf_file/0025/78703/Electricity-distribution-information-disclosure-determination-2012-consolidated-3-April-2018.pdf, Part 2.4.

3 Electricity Commission (2009), *Distribution Pricing Principles and Information Disclosure Guidelines*, https://www.ea.govt.nz/dmsdocument/1944-guidelines-distribution-pricing-principles-and-information-disclosure

efficient distribution network pricing but raised doubts or concerns about the star ratings. They recommended a more holistic and constructive approach.

1.9 We generally accept these comments. Further, we found on close examination that distributors' detailed revenue structure data is currently too inconsistent to be able implement the star ratings as proposed.[4] We will work to improve this source of information over time.

1.10 We do still want to put greater emphasis on accountability for progress on price reform, but we have decided to amend our assessment approach by:

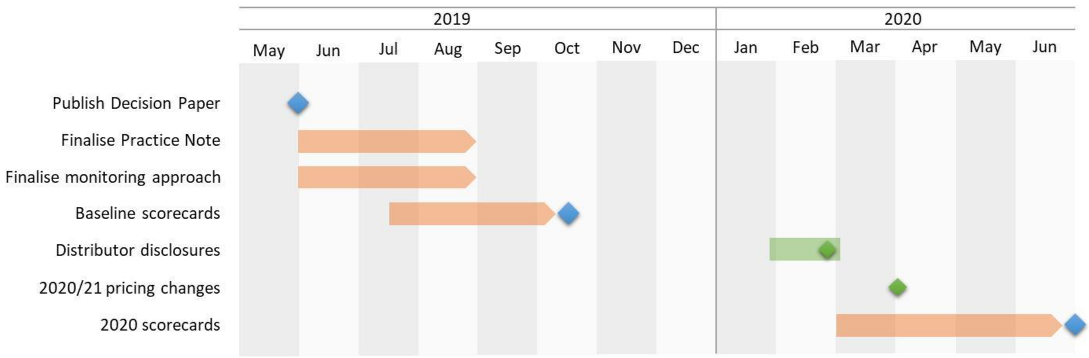
(a) widening the assessment to span input (strategies and roadmaps) and outcome (revenue structures, uptake) measures as well as pricing structures

(b) using a consumer-friendly scorecard approach

(c) regularly discussing the scorecards with distributors, to test the application of principles and price structures to fit their network's context, highlight leading practice, and identify and help with roadblocks to adopting more efficient pricing.

1.11 We have developed drafts of both the Practice Note and the Pricing Scorecard. We will work with distributors to finalise these by the end of August 2019, before we complete baseline assessments based on 2019 disclosures and roadmaps.

Figure 1: Next steps



4 Schedule 8 of the annual Information Disclosures to the Commerce Commission.

2 Background

2.1 On 11 December 2018, we published a consultation paper titled *More efficient distribution prices – What do they look like?*[5] We consulted on a proposal to:

(a) amend the Principles to clarify our expectations for efficient distribution prices

(b) monitor and rate the efficiency of distributors' prices and their reform progress.

2.2 We also sought views on how else we could help to progress pricing reform.

2.3 The design of distribution prices is important, because distribution prices recover distribution and transmission network costs, which account for 27% and 10% of an average electricity bill, respectively.[6] Efficient price signals allow sound decisions about network use and investment in networks and network alternatives.

2.4 Our proposals were targeted at encouraging an urgent transition to more efficient distribution prices. Reform is needed because the scope for poor outcomes from inefficient price signals is growing. This is a result of technologies, such as electric vehicles, solar panels and battery storage, becoming more available and affordable.

2.5 The consultation paper provided examples of the nature and likely scale of poor outcomes. These included: overinvestment by consumers in technologies to avoid network charges; shifting costs onto other consumers; unnecessary network investments; and exposing distributors to commercial risks (eg, stranded assets).

2.6 Our proposal to amend the Principles aimed to improve clarity and to set a higher target for efficient pricing. Our proposal to introduce star ratings aimed to strengthen distributors' reputational incentives for efficient pricing and provide more direction on our view of the relative efficiency of various pricing structures.

2.7 After publishing the consultation paper, we visited every distributor for a discussion on their pricing reform, local context, and practical considerations. Common points were:

- a commitment to pricing reform, but less consensus on its urgency
- many distributors are assessing (and some are introducing) new pricing structures
- low fixed charge regulations increase complexity and limit pricing reform options
- there are problems with access to data
- local context matters.

2.8 This paper sets out the Authority's decisions on the Principles, and approach to monitoring and encouraging price reform, and gives reasons for those decisions.

2.9 More information about distribution pricing is available on our website at: https://www.ea.govt.nz/development/work-programme/pricing-cost-allocation/distribution-pricing-review/.

[5] Electricity Authority, 2018. *More efficient distribution prices – What do they look like?* https://www.ea.govt.nz/dmsdocument/24425-more-efficient-distribution-prices-consultation-paper

[6] Transpower allocates transmission costs to its customers, with distributors paying the largest share. Distributors in turn recover their transmission charges from their customers.

3 Decision: revise the principles for better outcomes

3.1 Our statutory objective is to promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers.

Our approach promotes efficient network pricing

3.2 The role of prices is to signal network costs to customers. This supports efficient consumption and consumer investment decisions, which in turn supports efficient network investment.

3.3 Well-structured prices will promote competition in retail and related markets (where consumer agents may offer, for example, demand management services), support efficient investment in network alternatives and send signals that could avoid reliability problems. They help unlock the benefits of network transformation / open networks. They also keep transaction costs proportionate, for example avoiding disproportionate information or billing costs.

3.4 The scope for poor outcomes from inefficient distribution price signals is growing. Poor outcomes can arise from inaction, poor pricing design, or a reform process that is implemented without sufficient regard to implementation or customers.

3.5 We will promote the Authority's statutory objective by revising the Principles and supporting this with enhanced monitoring. These changes will:

(a) encourage more efficient distribution price structures

(b) support ongoing improvement with information on leading practice, as the feasibility of pricing option evolves

(c) enhance reputational incentives for effective distribution pricing reform.

Our approach is cost-effective

3.6 Our approach is to continue to rely on industry-led reform, supported by revised Principles and enhanced monitoring. This is cost effective compared to alternatives:

(a) Requiring all distributors to submit their proposed pricing methodologies for approval would drive price reform more directly. But it would take time to develop and would be costly to operate across dozens of network pricing areas. The urgency of reform varies by network area, as do the best-fit reform options. It could disrupt and delay progress. Given the level of attention to price reform we have seen, we do not think this option is warranted at this time.

(b) A more selective approach would be to require approval as a fall-back option that can be applied where we are not satisfied with reform efforts. This would strengthen incentives and be less likely to disrupt industry-led progress. However, a fall-back regime would be costly to develop, so we would need to be satisfied that progress will be unsatisfactory without such a regime in place. We will keep this option open for consideration as we monitor distributors' progress.

(c) We could publish new Principles with less monitoring and support, including omitting our Practice Note and/or scorecard reporting. It was clear from submissions and our visits with distributors that ongoing monitoring and additional practical guidance would be valued and can assist to sustain impetus. Our plan to work with the sector to finalise our scorecard activities will assist us to find the most cost-effective approach.

4 We considered the following matters in reaching our decision

4.1 We received 40 submissions on our December 2018 consultation paper (Table 1). Submissions, and a summary of submissions, are available on our website at:

https://www.ea.govt.nz/development/work-programme/pricing-cost-allocation/distribution-pricing-review/consultations/consultations-2/#c17905

Table 1: Summary of submitters

Category	Submissions
Distributors	16 standalone submissions Distribution Group of 15 distributors
Advocacy organisations	Electricity Networks (ENA) Energy Trusts (ETNZ) Electricity Retailers (ERANZ) Independent Electricity Generators (IEGA) Major Electricity Users (MEUG) Federated Farmers
Electricity Network Trusts	Two submissions
Retailers	Seven submissions
Other	emhTrade Solarcity Transpower Five individuals

4.2 Issues raised by submitters fell into three main categories.

(a) The urgency of distribution network pricing reform

(b) Pricing efficiency and trade-offs with other considerations

(c) Design and effectiveness of star ratings, and our wider role.

4.3 Each of these issues is discussed below.

The urgency of distribution network pricing reform

A significant majority of submitters agree reform is necessary, but submissions highlight how circumstances and urgency vary by network. Pricing reform activity is underway though it is mostly at the preparatory stage. We continue to see distribution network pricing as a priority for the sector.

We made the case that distributors need to act with ambition and urgency

4.4 We stated that distributors need to act with ambition and urgency on reforming their pricing structures, and that concrete transition plans were needed now. We cited the poor cost-signalling properties of traditional flat per kWh charges and pointed to specific examples of how poor outcomes can arise.

(a) We cited NZIER analysis[7] of the scope for solar panel investment to drive higher distribution prices and Concept Consulting analysis[8] of incentives for households to over-invest in solar panels and shift fixed costs to poorer households in the process.

(b) We cited analysis[9] of the network utilisation benefits that could be achieved by pricing arrangements that encourage smart electric vehicle charging. Traditional pricing structures do not encourage charging at off-peak times.

(c) We illustrated how clusters of electric vehicles or solar panels could cause poor power quality if there are no incentives or requirements to stagger vehicle charging times or store excess solar production.

(d) We noted that these technology-specific examples can sit alongside the more general case of poor cost signalling contributing to sub-optimal growth-driven network investment.

Submitters' views

4.5 We found good agreement with the view that it's timely for distributors to review their network pricing structures, but more mixed views on the urgency of reform. Submitters mentioned several factors that make review timely.

(a) The technology cost and availability trends we identified.

(b) Increased availability of smart metering, which expands the range of potential pricing structures.

(c) The April 2020 transition for price-controlled distributors from price to revenue cap form of control, which reduces the risk of reform for those distributors.

4.6 We heard from some distributors and many retailers that these issues warrant urgent focus on pricing reform.

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7 NZIER, 2015. *op. cit*

8 Concept Consulting, 2016. *New Technologies Study: Part 2 – Economic Impacts* and *Part 3 – Social Impacts*. http://www.concept.co.nz/publications.html

9 Concept Consulting, 2018. *Driving Change – Issues and options to maximise the opportunities from large-scale electric vehicle uptake in New Zealand*, http://www.concept.co.nz/uploads/2/5/5/4/25542442/ev_study_v1.0.pdf

4.7 Several submitters noted that solar panel uptake has been slower than projected by NZIER in 2015, thus questioning the urgency. It is true that uptake has been slower to date, but this could change. The Authority is of the view that the NZIER analysis remains a valid indication of the scale of the risk associated with poor pricing.

4.8 Distributors should take the opportunity to prepare for reform ahead of such risks crystallising. Oversees experience shows reform can become more difficult as the uptake of new technologies increases. Also, solar panels are just one of the challenges that point to the need for a shift from current pricing structures. Other challenges include:

(a) Electric vehicle charging behaviour, hosting capacity and network support potential

(b) Changes in demand driven by climate change policy

(c) Population pressures

(d) Declining average household demand.

4.9 A strong message from submissions was that, even where the drivers for reform are pressing, considerable care is required to ensure changes in pricing are developed and implemented in a careful, measured and well-coordinated way.

4.10 From some distributors we heard that pricing reform is less of a priority for them at present. Aurora Energy and Buller Electricity provide two illustrations.

(a) Aurora Energy supports reform of distribution network pricing, but sees a strong business need to defer its own reforms while it prioritises developing a customised price-quality path proposal to fund increased network renewal investment

(b) Buller Electricity has a small rural network with no growth and significant spare capacity, low average household consumption, limited smart meter coverage and expectations of relatively slow uptake of new technologies. Given these factors, Buller Electricity has focussed on rebalancing pricing towards a higher fixed component and sees value in being an industry follower for any further reform.

4.11 Other submitters pointed to industry-wide factors they see as impeding progress, including:

(a) most submitters see low fixed charge regulations as increasing complexity and limiting options, while some see the regulations as a substantial barrier to reform

(b) many submitters cited challenges accessing metering data for pricing design and impact assessment (and some pointed to limited smart meter coverage in their networks)

(c) some distributors worried that retailers would not pass new tariffs through to consumers, and cited poor uptake to date of opt-in tariffs.

4.12 Several submitters characterised pricing reform as a sector-wide process that will involve distributors, retailers, metering equipment providers and the Authority all working to identify and remove roadblocks, learn from trials, engage with end users, and develop industry standard approaches.

4.13 We have seen and heard evidence of progress on distribution pricing reform, including:

(a) collaboration – including ENA and ERANZ working groups and research

(b) strategies – 16 distributors included pricing strategies in their 2019/20 disclosures[10] and most have published roadmaps

(c) trials – some distributors have trialled or are trialling new pricing, such as Wellington Electricity's electric vehicle and battery pricing trials, and Top Energy and Northpower time-of-use trials

(d) rebalancing – some distributors have rebalanced their pricing, including Buller shifting its fixed/variable balance, Unison rebalancing structures for solar panel customers and Orion introducing fixed charges

(e) implementation – some distributors have recently implemented new pricing for mass market customers, such as The Lines Company, WEL and Powerco. More sophisticated price structures are common for large commercial customers.

Our decision

4.14 The Authority:

(a) confirms its view that distribution network price reform is urgent and a high priority

(b) acknowledges local network circumstances influence the urgency and direction of reform for each distributor

(c) acknowledges low fixed charge regulations complicate and limit price reform options.

Pricing efficiency and trade-offs with other considerations

Many submitters considered our proposed Principles favour economic theory ahead of practical considerations, and some submitters found the proposed Principles unclear. Many submitters provided constructive recommendations for improvement to the Principles. We have used this feedback to further amend and finalise the new Principles.

We proposed changes to the pricing principles to support pricing reform

4.15 We proposed changes to the Principles to better align with the Authority's developing views on network pricing, including:

(a) widening the types of economic costs that may be reflected in prices (rather than only mentioning future investment costs)

(b) introducing additional cost attribution concepts

(c) replacing mention of promoting price stability and certainty with concepts of transparent application of the Principles and predictability of prices

(d) removing mention of having regard to the impact of changes to prices.

10 Pricing strategy disclosure is required under clause 2.4.4 of the Commerce Commission's Electricity Distribution Information Disclosure Determination 2012. A pricing strategy is defined as "*…a decision made by the Directors of [a distributor] on [the distributor's] plans or strategy to amend or develop prices in the future, and recorded in writing*".

4.16 We also provided material on pricing and cost allocation methodologies, and a simple analysis of distributor cost structures. We proposed to remove Information Disclosure Guidelines that were developed alongside the original Principles and are redundant now the Commission has determined information disclosure rules.

Submitters' views

4.17 Some submitters agreed with proposed changes to the Principles, but generally did not provide detailed reasons for their support. Most submitters raised some concerns. The most common concerns included that the proposed Principles:

(a) seem to point towards impractically fine-grained variability by time and location

(b) underplay the benefits of simplicity in reducing implementation costs and of retail pass-through to drive end-user response

(c) underplay the importance of managing the impact of changes to prices, and of engaging with retailers and end users

(d) would be better to retain focus on signalling long-term investment costs.

4.18 Submitters also offered suggestions on terminology and the structure of the Principles and identified areas where they found the proposed Principles unclear.

4.19 Most submitters supported the view that rebalancing pricing over time towards a higher fixed component would be desirable, as it would better reflect cost structures. Some also suggested it would reduce household budget stress from seasonal variation in monthly bills. Some submitters offered the contrary view that higher fixed prices are undesirable in the context of energy affordability and energy conservation priorities.

4.20 Many submitters considered our analysis of accounting costs did not shed light on the balance of fixed and variable costs. Some submitters stated there were practical upper limits to rebalancing and risks of variable components becoming too small to influence consumer behaviour.

4.21 Some submitters supported the proposal to remove the Guidelines, though most did not address this part of our proposals. Several submitters suggested that guidance on application of the proposed Principles would be useful.

Our decision

4.22 The Authority has decided to:

(a) adopt the Principles, with amendments (see page 3 and Appendix A)

(b) develop a Practice Note to assist distributors with interpretation and application

(c) confirm withdrawal of the Information Disclosure Guidelines.

4.23 Overall, the changes we have made respond to submissions by:

(a) focusing the principles on the essential concepts, with other ideas moved to the Practice Note

(b) recognising trade-offs, by noting distributors should have regard to practical matters, including transaction costs, consumer impacts and uptake incentives

(c) simplifying terminology and aligning it to those of the Commerce Commission.

4.24 We considered whether a transition period would be needed before the amended Principles come into effect. Distributors are required to disclose consistency with the

Principles before 1 April each year, and industry practice is to disclose sometime after transmission prices are notified in December. As such, we think transition arrangements are not needed because distributors will have at least eight months to assess consistency with the updated Principles.

4.25 We have prepared a draft Practice Note on which we will seek targeted sector input. This will allow us to finalise the Note by the end of August 2019 so that it is available to support distributors' first disclosures against the updated Principles.

The design and effectiveness of star ratings, and our wider role

While some submitters supported star ratings in principle, almost all submitters raised doubts or concerns with how they would work in practice and whether they would achieve their objectives. We have reviewed our approach, and will introduce an annual Pricing Scorecard that gives a broader assessment of progress.

We proposed to give price structures a star rating

4.26 In order to increase reputational incentives to progress price reform, we proposed to regularly:

(a) review and rate each distributor's top three to five pricing plans (by revenue) for efficiency and alignment with their cost structure, and review progress against roadmaps and compared to the wider sector

(b) publish a distribution price structure star rating for each distributor, alongside qualitative information on the quality and ambition of roadmaps, and implementation progress

(c) engage with distributors on these assessments.

4.27 We also provided an indication of how we would translate various pricing methods into star ratings. For example, we indicated seasonal time of use would be rated two stars while dynamic critical peak would be rated five stars.

4.28 Finally, we asked for views on other things we could do to support distribution network pricing reform.

Submitters' views

4.29 Some submitters supported star ratings in principle, some opposed the idea, and most raised doubts or concerns. There were several consistent concerns expressed.

(a) Local context – the ratings as proposed took a fixed view on the best pricing methods, whereas the best-fit method will vary by network

(b) Disruption – the ratings may disrupt reform progress by consuming management attention, creating perverse incentives (to pursue higher star ratings rather than best-fit pricing), or harming consumer engagement

(c) Assessment focus – it may be better to assess pricing strategies and other evidence of engagement on reform, or outcome indicators

(d) Cost – the ratings system would add to compliance costs, including the cost of complying with existing information disclosure obligations

(e) Design –some elements, such as the assessment of cost structures, are too simplistic.

4.30 Many submitters voiced support for Time of Use pricing and considered this should attract a higher star rating.

4.31 Many submitters encouraged us to continue or expand our role in supporting effective pricing management. Distributors also welcomed the one-to-one meetings we held after releasing the consultation paper. Submitter suggestions for our role were:

(a) Address regulatory roadblocks – most submitters mentioned LFC regulations, and several other issues such as meter data access and retail uptake and pass-through incentives were mentioned

(b) Support harmonisation of pricing arrangements across distributors

(c) Provide a public engagement and education role

(d) Provide sector guidance and support, including disseminating information on best practice, and clear expectations for pricing roadmap disclosures.

Our decision

4.32 We generally accept the concerns on the star ratings and the suggestion for annual engagement with each distributor to discuss progress on price reform. Further, we found on close examination that distributors' detailed revenue structure data[11] we intended to use is currently too inconsistent to be able implement the star ratings as proposed.

4.33 We have decided to amend our assessment approach by:

(a) widening assessment to span context, strategies, plans, and outcomes (such as the efficiency of pricing structures and uptake measures)

(b) using a consumer-friendly scorecard approach

(c) regularly discussing the scorecards with distributors, to test the application of principles and price structures to fit their network's context, highlight leading practice, and identify and help with roadblocks to adopting more efficient pricing.

4.34 This broader focus reflects that effective strategy formation and change management should drive good pricing structures and outcomes:

- assessing inputs provides richer and earlier indication of progress, while assessing outcomes provides insight over time into the effectiveness of reform efforts
- if the quality of pricing strategy disclosures is lifted, they will provide a suitable dataset for assessing progress and identifying performance outliers
- a scorecard approach that combines a variety of assessment methods, such as traffic lights (for status reporting), trends, and commentary for a holistic picture.

4.35 This revised assessment approach will be more reflective of local context and what price structures are currently feasible. It is intended to distinguish good and leading practice in strategy, implementation, and outcomes.

4.36 We have also identified a need to work with the Commission to lift the quality of pricing information disclosed by distributors, similar to that which the Commission has completed for distributor asset management plans and other data disclosures. Formally changing the information disclosure requirements would be a longer-term improvement

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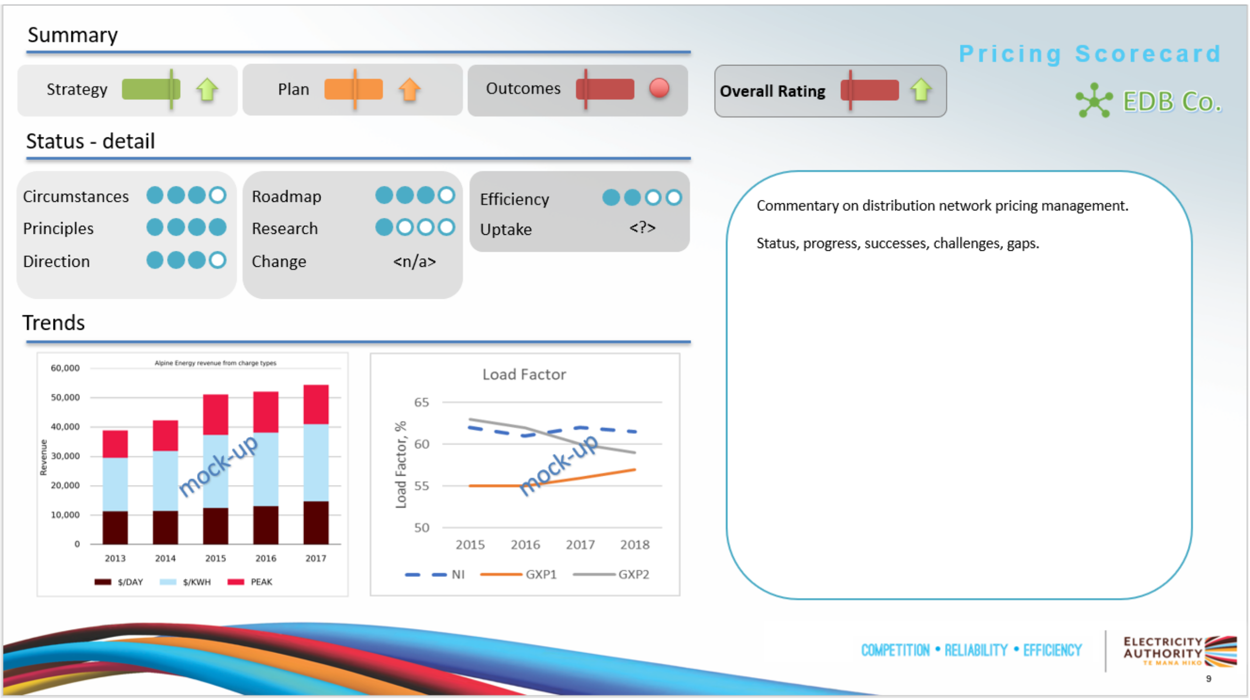
11 Schedule 8 of the annual Information Disclosures to the Commerce Commission.

that the Commission may consider. In the meantime we can work with distributors and the Commission on voluntary approaches to improve the information disclosures (eg common terminology and pricing types).

4.37 We have prepared a draft Pricing Scorecard (see mock-up below), and we will work with distributors to further test its workability and finalise this by the end of August. This will allow us to complete baseline assessments by October.



4.38 We note the views expressed about the merits of Time of Use pricing and a concern that the Authority rated it relatively low. This low rating is because of the risk that Time of Use is not a good signal of economic cost. For example, a network peak does not necessarily mean that the network is hitting its capacity. As such, a peak price may not be needed, and a peak signal may act to inefficiently dampen demand.

4.39 We do however agree that Time of Use pricing can be a good next step for many distributors. But we expect distributors will need to move beyond Time of Use in future, to price structures that better signal the economic cost of distribution service provision.

5 Other matters considered

5.1 The Authority notes distributors' ongoing concern that retailers may not pass through reformed distribution pricing structures. The Authority remains of the view that distributors are responsible for presenting efficient, cost-reflective prices to their customers. It is the retailers' role to determine how the costs of distribution (and energy) are passed to their customers. Competition in the retail market means that retailers should have good incentives to offer plans that consumers want and value.

5.2 We also heard feedback that the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 (LFC regulations) are in practice increasing difficulty and limiting options for reform. We acknowledge this feedback. The Electricity Price Review (EPR) Panel has consulted on recommending phasing out these regulations and we have a role in advising the Minister should such a recommendation proceed.[12]

5.3 We also note the EPR Panel consulted on three other options directly relevant to our work on the Principles.

(a) E2 (panel favours) – *Government Policy Statement on distribution pricing (GPS)* – we may need to review the Principles if a GPS introduces a policy direction that is not accommodated by the Principles, although the Practice Note could be used to provide guidance on how the Principles apply to be consistent with a GPS.

(b) E3 (panel undecided) – *Regulate cost allocation principles* – this option would involve cost allocation regulations, and a role for the Authority to monitor compliance. We expect this option would be compatible with the Principles.

(c) E4 (panel undecided) – *Limit price shocks* – this option would expand the Authority's role to include approval of pricing structures and annual pricing changes. This option may require us to develop more prescriptive Principles and incorporate them into the Code. This would take time.

5.4 Given this assessment, we conclude our decision and implementation steps are prudent.

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[12] Electricity Price Review Panel (2018), *Electricity Price Review: Options Paper*, https://www.mbie.govt.nz/dmsdocument/4578-electricity-price-review-options-paper

Appendix A Rationale for changes to Principles

A.1 The following table provides rationale for changes to the Principles relative to the consultation version.

A.2 These changes reflect feedback from submissions, as well as some presentational improvements.

A.3 Please note: the purpose of the tracking marks in this table is to highlight how the substance of the principles has been refined. It is not a full mark-up.

Table 2: Rationale for changes to the Principles

Change	**Rationale**
(a) Prices are to signal the economic costs of service provision, <u>including</u> by:	Recognition that the items identified may not be an exhaustive list.
(i) being subsidy free (equal to or greater than <u>avoidable</u> ~~incremental~~ costs, and less than or equal to standalone costs)~~, except where subsidies arise from compliance with legislation~~;	While the terms are generally interchangeable, *avoidable* replaces *incremental* in this line as it is more clearly consistent with the practical application of this part of the principle, which should be to compare consumer group revenue with the standalone and avoidable costs of serving that consumer group. Applying the test in this way helps guide the allocation of residual costs. The compliance exception is redundant. Distributors' assessments should identify where and why prices are not consistent with any of the principles, including due to compliance with legislation or regulations.
(ii) ~~signalling the effect that~~ <u>reflecting the impacts of</u> network use on <u>economic</u> costs~~ including losses, opportunity costs of capacity constraints and other avoidable costs~~; ~~(iii) being time and location specific;~~	Pulling back to the principle, with the Practice Note providing guidance on the types of economic costs that may be relevant. The principle is still intended to be broader in scope than the original Principles (which focussed on long-term investment costs only). Use of plural (*impacts*) supports the idea that multiple cost-usage relationships should be considered. However, the level of granularity about what are economic costs fits better in the Practice Note. The same applies to 'being time and location specific', which is thus also better expanded in the Practice Note.

Change	**Rationale**
~~(iv) charging costs to a specific user or group of users where those costs can be attributed to that specific user or group of users.~~	Submitters found the attribution principle unclear. Attribution is implied by 'being subsidy free' and 'reflecting economic cost of network use'. Further guidance on attribution fits better in Practice Note material on residual cost allocation, as a complement to the main principle of allocating residual costs in a way that least distorts network use.
(iii) reflecting differences in network service provided to (or by) consumers; and	Reinstates service-based pricing idea from the original Principles but broadens its scope beyond service capacity. Broader scope can encompass differences such as whether a connection has interruptible demand, controllable generation or storage, enhanced or reduced resilience, priority restoration, etc. As per consultation version, wording explicitly recognises consumers may provide services that support the network.
(iv) ~~where network economics warrant,~~ encouraging efficient network alternatives ~~investment in transmission and distribution alternatives (eg, distributed generation or demand response) and technology innovation.~~	Edited to focus on the core principle. The Practice Note can provide guidance on the types of network alternatives or the mechanisms. Mention of technology innovation deleted because it does not add anything to the principle. Brought up in the list because designing prices to signal value to providers of network alternatives should be a core part of economic cost signalling. The complementary task of negotiating prices for specific network alternatives still fits within the new principle (c)(i).
(b) Where prices ~~based on efficient incremental costs~~ that signal economic costs would under-recover ~~allowed~~ target revenues, the shortfall should be made up by prices that least distort network use ~~and reflect the value that users derive from the network~~.	Reflects the logic of first establishing cost-signalling prices and then allocating residual costs. Target revenue terminology works for exempt distributors and for scenarios where distributors aim to recover less than their allowable revenue. Focus on the main *non-distortion* principle, with Practice Note to provide information on relevant attribution methods that can further guide allocation of residual costs

Change	**Rationale**
(c) Prices should be responsive to the requirements and circumstances of consumers~~,~~ ~~including by reflecting services provided by users and to users~~ by allowing negotiation to:	Principle of reflecting differences in the services provided shifted to (a)(iii).
(i) reflect the economic value of services; and (ii) enable ~~stakeholders to make~~ price-quality trade-offs ~~or non-standard arrangements for services~~.	Redundant material removed.
(d) ~~The application of these principles~~ <u>Development of prices</u> should be transparent ~~and predictable~~ <u>and have regard to</u> transaction costs, <u>consumer impacts, and uptake incentives</u>.	Transparency of the *application* of the Principles is achieved through the information disclosure rules. Information Disclosure rules, including pricing strategy, support transparency and predictability of changes in prices. Practical matters are grouped together with *have regard* formulation. *Consumer* includes end users *and* acquirers (such as retailers, other consumer agents and distributed generators). Consumer impacts are included in recognition of submissions. This also encompasses pricing predictability as it relates to the operation of prices. Uptake incentives added to recognise onus on distributors to consider how pricing design and implementation will influence uptake by retailers, and to use appropriate assignment or eligibility methods.