

Via email distribution.pricing@ea.govt.nz

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Targeted Reform of Distribution Pricing (Public Submission)

Mercury welcomes the opportunity to provide feedback to the Electricity Authority (the Authority) on its paper *Targeted Reform of Distribution Pricing* (the Issues paper) published on 5 July 2023. Mercury notes that our response does not include commercially sensitive nor confidential information. We support the Electricity Retailers Association of New Zealand (ERANZ) submission in its entirety.

The energy sector faces significant complexity and transformation in the coming decade and beyond to support Aotearoa/New Zealand's decarbonisation journey. Mercury acknowledges that electricity distributors will need to manage and invest in existing assets to ensure reliability in the face of physical climate change impacts as well as the transition to a low carbon and climate resilient economy. As peak demand increases due to electrification, this will put pressure on physical network infrastructure. Clearer pricing signals will promote efficient use of the network during peak periods, ameliorating the infrastructure needed, and easing the transition.¹ Despite pricing sending a strong signal for retailers and consumers, there are times when there are inefficiencies. In our view, load control tariffs are an efficient way for networks to provide pricing signals coupled with smart control to ensure large-scale, dynamic demand response.

In this latest Issues paper, the Authority discusses their concern that progress toward more cost-reflective pricing is not occurring as consistently or as rapidly as required to transition to a low-emissions economy. The Authority is seeking to target a number of areas for possible intervention. We limit feedback in this submission to the Issues paper Section 8, which concerns itself with retailers' response to distribution price signals although we do make a few points on connection charges as well.

In the Authority's view, two factors appear to weaken retailer incentives to manage input costs and contribute to a lack of efficient retailer response to distribution prices:

- a) continued use of deemed or residual profiles for energy and network billing for ICPs with advanced meters; and
- b) overly permissive assignment policies for transitioning ICPs to non-uniform distribution tariffs.

The Authority would prefer to see:

- a) retailers billed on actual half hourly usage for energy and network costs for all ICPs with capable meters; and
- b) distributors providing very limited (or zero) grounds for opting out from non-uniform tariff options.

Mercury welcomes the Authority's proposal to support a managed and mindful transition to billing on actual data, as well as develop guidance on tariff assignment. We are supportive of the Authority continuing to provide clear guidance to EDBs to support their transition to cost-reflective, time-varying network pricing. Ultimately, we believe that it is important that EDBs send the right signals, but equally these need to be as simple and transparent as possible otherwise there is a risk of over complexity and poor consumer outcomes. The remainder of this submission illuminates some additional points, and we answer the Authority's questions to section 8 in Annex A.

¹ Boston Consulting Group (BCG), *The Future is Electric - A Decarbonisation Roadmap for New Zealand's Electricity Sector*, 2022. p. 132



Competition will result in signal from distributors being passed through over time

Consumers' preferences, as expressed through the pricing or product they choose to purchase, are important signals to the market. It is the role of retailers, who are most exposed to consumer preferences, to design different pricing and product packages to appeal to the cross section of consumers. There is robust retail competition in New Zealand electricity market, which naturally increases pressure on retailers to compete for consumers and bring offers to market that consumers want. There should be no restrictions on how a retailer designs its market offers; to apply restriction simply removes consumer choice and stifles retail innovation. We believe there has been a lot of focus from retailers on managing loads on behalf of consumers as the ability to manage flexibility has significant value for retailers. This will result in smart tariffs aimed at types of use, rather than specific times of use.

In addition, we are transitioning out of the complex reforms of Low Fixed Charged (LFC) regulations and would encourage the Authority to allow these reforms to phase out. As the Ministry for Business Innovation and Enterprise (MBIE) note in their *Measures for Transition to an Expanded and Highlight Renewable Electricity System*²

The ability of electricity retailers to introduce innovative pricing structures has, to an extent, been constrained by the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004. These regulations are currently being phased out over five years and will be fully removed from 2027. We expect that, as the constraints of the regulations lessen, more innovative tariffs will be developed, including at the retail level.

A consumer-focused pricing reform is required

We believe more attention to the consumer voice is needed in this conversation, particularly as these pricing reforms may have distributional impacts in the short-term. Some customers will be willing and able to shift some of their electricity usage to lower cost periods and transform from a price reform loser into a winner. Others who may not be able to handle more complex cost signals may instead adopt "set and forget" smart appliances that automate price response. Many, however, including the more vulnerable households, will either prefer simplicity or not be able to materially change their behaviour or have access to such appliances or a combination of either.³ While we agree efficient pricing is important, this must be balanced against the other functions the Authority has, including those to protect the interests of consumers. We echo IPAG who note that "electricity price risk management and technology innovation is not a core skill for most customers - particularly vulnerable residential customers."⁴ The Consumer Advisory Council recommended "that the Authority treats consumers as significant and active stakeholders in the industry".⁵ Thus, we encourage the Authority to consider engaging widely with consumers. This might include public communication of what changes will mean and even a consumer awareness campaign - the electricity market is already difficult for many to navigate, and targeted pricing reforms may unintentionally cause deepening scepticism if not managed appropriately.

In our view, a consumer-focussed solution to distribution pricing reform is required to ensure all consumers are willing and informed participants in the transition and to ensure that no consumers are left behind. Such a solution will recognise that load flexibility is not all of the people, all of the time, for all of their load, but rather some of the people, some of the time, for some of their load.⁶

² Ministry Business Innovation & Enterprise, *Measures for Transition to an Expanded and Highlight Renewable Electricity System*, August 2023 available from <https://www.mbie.govt.nz/dmsdocument/26909-measures-for-transition-to-an-expanded-and-highly-renewable-electricity-system-pdf>

³ Energy Consumers Australia (ECA), *Industry Perspectives on Electricity Tariffs and Retail Pricing*, November 2022, available from <https://energyconsumersaustralia.com.au/publications/industry-perspectives-on-electricity-tariffs-and-retail-pricing>

⁴ IPAG, *Pass-through of distribution price signals*, 2021, available from <https://www.ea.govt.nz/documents/1560/IPAG-DP-Practice-Note-submission-2021.pdf>

⁵ <https://www.cac.org.nz/assets/Submissions/updating-the-regulatory-settings-for-distribution-networks-28-February-2023.pdf>

⁶ ECA 2022, available from: <https://energyconsumersaustralia.com.au/wp-content/uploads/Industry-Perspectives-on-Electricity-Tariffs-and-Retail-Pricing-Final-Report.pdf>



Concerns about complexity

Ultimately, while we are supportive of pricing structures that provide strong and efficient signals, and the Authority's proposal for retailers to be billed on actual half hourly usage for energy and network costs, we would like further details as to how this would work in practice (including further discussions on the period of implementation of such changes). In our view, as distribution pricing gets more sophisticated and complex a degree of structure standardisation for all distributors would be beneficial to avoid needless cost of minor structure variation. Keeping in mind pricing is only one part of the conversation on how to manage future network congestion and peak loadings. Boston Consulting Group (BCG) report notes

*"in the 2030s, we predict that **electric vehicles will overtake hot water ripple control as the largest demand-side flexibility opportunity**. By 2050, we predict electric vehicle demand-side flexibility will be 3 times greater than hot water ripple control. As such we believe it is critical that effective EV load control tariffs emerge quickly to enable networks to efficiently manage peak demand and to avoid or defer physical network build. "*

We remain of the view that reform of distribution pricing is necessary and beneficial to the market in the long-term thus we will continue to support an EDB's decision to bill its customers (i.e retailers) on half-hourly usage and agree that all distributors should eventually offer cost-reflective tariffs. As we have said, the ability for retailers to innovate and change their products based on their input costs and consumer's preferences is a feature of an efficient market. Consumers preferences, and therefore the benefits they derive from a tariff, are likely to differ depending on factors such as when they are able to shift their load or whether they want or be able to engage with complex tariff structures.

Connection charges

Finally, we wanted to briefly comment on connection charges. It is not unexpected that there are differences in connection charges approaches given the varied nature of New Zealand's 29 distributors. The Authority notes the "growth in EV network connections will also increase in the overall load on the wider electricity network. Depending on how this charging is incentivised or managed, it could add load during times of peak demand." There is no difference to the network if an EV charger is connected behind the meter or as a separate ICP. However, the current cost structures (connection and ongoing fixed charging plus the cost of a specialist electrician) and processes (connection application) strongly incentivise behind the meter installation. This is likely to lead to inefficient to EV charging infrastructure and investment. In our view EDBs should have a zero (or low) peak usage EV connection option with minimal fixed charge and no connection charge.⁷ We believe that this connection type should strongly incentivize off-peak charging.

We answer the Authority's questions to section 8 in Annex A

Yours sincerely,
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⁷ There are also improvements to be made to the connection approval process. We would recommend a standardised and streamlined approach for an EV connection where load is agreed to be off-peak.



Annex A: Consultation Paper questions with Mercury's response

Issues Paper questions	Mercury response
<p>Q25A. Do you agree with the assessment of the current situation and context for retailer response? What if any other significant factors should the Authority be considering?</p> <p>Q25B. [for retailers]: What plans do you have for responding to distribution price signals as distributors reform their price structures? What barriers do you see to responding efficiently?</p>	<p>Mercury will continue to support an EDB's decision to bill its customers (i.e retailers) on half-hourly usage and agree that all distributors should eventually offer a cost-reflective tariff. We remain of the view that reform of distribution pricing is necessary and beneficial to the market in the long-term; but there should be no restrictions on how a retailer designs its market offers; to apply restriction simply removes consumer choice and stifles retail innovation.</p> <p>We agree that the take up of EVs is growing rapidly and there is significant potential for the consumer trend of growing EV uptake to have a growing impact on electricity retailer pricing behaviour in coming years, but we also believe EVs present the most significant opportunity for demand side flexibility – even greater than hot water ripple control.</p>
<p>Q26. Do you agree with the problem statement for retailer response?</p>	<p>The majority of EDBs are progressing with pricing reforms and retail pricing is only one of many responses from a retailer. For example, instead of passing through a peak distribution price into retail pricing, a retailer could keep its customers on a flat rate, but contract with them (potentially via a flexibility trader) to control some of their load remotely (water heating, space heating, etc). The distribution price signal could then effectively do its job (via the actions of the retailer) without the end-user needing to see any change to its retail prices. In Mercury's view distribution congestion might be managed, to an extent, by demand flexibility, utilising emerging technology and business models⁸. In any case, there is robust retail competition in the market, which naturally increases pressure on retailers to compete for consumers and bring offers to market that consumers want.</p> <p>We encourage the EA (and distributors) to focus on the desired outcome. The outcome is a load profile that better utilises information about distribution network and generation capacity as well as consumer demand, which promotes economic efficiency.</p>
<p>Q27A. Do you have any comments on the Authority's preferred pricing?</p> <p>Q27B. [for retailers]: What use do you make of deemed and residual profiles? Please explain the reasons for this. What barriers do you see to phasing out use of deemed and residual profiles?</p>	<p>We agree in principle with the Authority's recommendation however we would like further details as to how it will be managed, especially with regards to communicating vs non-communicating meters as well as the role of legacy meters who may be left on these profiles. Acknowledging that non-communicating will require constant profile management and drive cost. Phasing out will require a clear understanding how profiles will work. This is</p>

⁸ <https://www.ea.govt.nz/documents/1547/Consultation-paper-Supporting-reform-to-efficient-distribution-pricing--appendices.pdf>



	<p>especially important for charging retailers when actual data is not available as this may have the effect of being on-charged to some customers. In addition, profiles for small or remote loads where metering or comms are a significant cost barrier should be allowed to continue.</p> <p>If a regulated phase-out is to occur, the Authority should be willing to provide a period of implementation including considering three phases relating to the publication and coming into force of the regulations – a publication date, commencement date, (when the regulations, if chosen, come into force), and a date on which compliance must be achieved. This has been done by other regulators, most notably the Commerce Commission, when undertaking certain industry change.</p>
<p>Q28. Are there other options you think the Authority should consider for retailer response?</p>	<p>Please see answer to Q26</p>
<p>Q29. Which if any of the above options do you consider would best support distribution pricing reform in the area of retailer response?</p>	<p>We are supportive of the Authority</p> <ul style="list-style-type: none"> a) enabling transition to billing on actual data for network and energy purchases; b) developing guidance on tariff assignment