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Targeted Reform of Distribution Pricing – Issues Paper

Network Tasman welcomes the opportunity to submit on this important paper. As the Authority notes, distribution networks have a critical role to play in the electrification of New Zealand's economy. Efficient distribution pricing can support an affordable transition to a low-emissions economy – by providing appropriate signals to consumers as they consider their own power use and respond. It is important for the industry to work together to ensure this transition is as smooth an efficient as possible.

In addition to this submission, Network Tasman endorses the ENA's submission.

The basic premise of the Authority's paper is that based on the evidence gathered from scorecards since they were introduced, the Authority is concerned progress to cost-reflective pricing is occurring consistently or as rapidly as required.

Network Tasman encourages the Authority to examine the reasons for the slow reform before proposing solutions.

On this front, Network Tasman submits the Authority should consider not just what efficient prices look like but how it can provide distributors with regulatory consistency and prioritisation of the actions it wants distributors to take that will give distributors the platform required to undertake these reforms with greater confidence.

Consistency

A key responsibility of the Authority is to communicate clearly and effectively with the industry on distribution pricing.

The Authority's views on distribution pricing have evolved over time and by its own admission continue to evolve. The Authority implicitly acknowledges this in the Issues Paper when it states

"Some of the areas covered in this paper (such as time-of-use, TOU pricing) have been discussed before – although in some of these areas the Authority's thinking **has evolved**. Other issues (such as connection costs) are relatively new focus areas for the Authority. For all these matters, this paper is an opportunity to test with stakeholders our **current thinking** on the issues and on the identified regulatory reform options " (**emphasis added**)

The Authority has had a dedicated distribution pricing team since at least 2016. That the Authority's views on many of the issues central to distribution pricing have evolved and the Authority still refers to its "current thinking" creates uncertainty about how robust the Authority's (current) views are.

Similarly, by referencing its "current" thinking, the Authority acknowledges that its views are not firm and open to change.

It is worth noting that the Authority's views on distribution pricing have evolved considerably. In late 2018 the Authority was advocating dynamic critical peak (congestion) demand charges as the best method for pricing congestion and losses associated with the use of the network. It stated that peak charges would apply on a dynamic basis – typically set in advance on a daily or half-hourly basis, as is currently the case in the wholesale market.

Then in early 2019 it published an expert report on the practicality of introducing locational marginal pricing at a distribution level in NZ.[1]

Since early 2019, the Authority has gradually softened its views on what it considers an appropriately efficient distribution price.

This is reflected in the current Issues Paper when it states "In this context, it can also be practical, efficient, and effective for distributors facing demand growth to use TOU pricing for small users, rather than more dynamic or targeted price signals."

This is not to criticise the Authority.

It is natural, given the significant uncertainty about how the evolution to a low carbon economy will develop for views and expectations to change for all stakeholders, including the Authority.

These circumstances make it difficult for EDBs to deliver reforms that align with the EA's expectations if these expectations are evolving and guidance is based on current views. Network Tasman recommends that the Authority consider how it can give EDBs greater certainty about the robustness of its views and be clear about the areas where it has firm views and those where its views are developing.

Prioritisation

Despite being termed as a targeted reform of distribution pricing; the Issues Paper covers a lot of ground. It effectively encompasses the full spectrum of the distribution pricing process, from how to allocate costs to consumer groups, to what the most appropriate price structures are and to how setting price level should be set.

The Issues Paper does not consider the magnitude of the issues identified and what sort of benefits the Authority considers would be gained from addressing them.

In order to direct attention to the issues that will create the most benefit to consumers, Network Tasman submits that the Authority should assess each of the actions it considers warrants further attention and rank them in order of priority.

Currently the only explicit guidance about where EDB's should direct attention is provided by the Distribution Pricing Scorecards.

[1] Sapere Research Group, *An exploration of locational marginal pricing at the distribution level in the New Zealand context*, 29 June 2017.

Although the scoring framework is somewhat opaque, the scorecards have six categories against which EDBs prices are scored against. Until this year, each category has had equal weighting.

Although the Authority expresses disappointment about the speed of progress of EDBs price reform programmes, the scorecards offer a picture of steady and consistent improvement and demonstrate that EDBs have been responding to the Authority's guidance.

Average scores have improved from 2.7/5 in 2020 (min 1.5 and max of 3.7) to 3.0/5 in 2021 (min of 1.7 and max of 4). Conversations with Authority staff suggest EDBs have again made material improvements again in the 2023 scorecards. Similarly, conversations with Authority staff are generally positive about progress being made and somewhat at odds with the tone of the Issues Paper.

It may be that the incentives provided by the scorecards don't align with the Authority's internal priorities. However, without making these priorities public and unambiguous, the scorecards are the only explicit measure the Authority has provided to distributors to assess their reform progress against the Authority's expectations.

If the Authority is proposing to make code amendments, it is obligated to undertake a cost/benefit analysis. However, it is not obligated to undertake a comparative analysis of parallel reforms.

Undertaking a comparative analysis of the relative benefits of each measure the Authority intends to progress once it has assessed submissions on this issues paper should be the first step the Authority undertakes, irrespective of whether or not the Authority intends to introduce a Code amendment for the measure.

Progressing reforms on the basis of individual cost/benefit analysis, without a comparative analysis will not enable the Authority to progress reforms that will bring the greatest benefits to consumers.

A comparative analysis would firstly require the Authority to quantify the benefits of each of its proposed actions. To date, the Authority's analysis has focused on theoretical concepts of efficiency rather than outcomes achieved from any reforms. It is clear that a dynamic network peak demand signal sends a theoretically more efficient price signal than a standard time-of-use tariff, but it is unclear whether the incremental benefits of a dynamic peak demand signal outweigh the incremental costs. That is, whether they result in more efficient outcomes.

It is outcomes the Authority should be focused on. For example, the potential for higher prices during peak demand periods to exacerbate hardship within communities is an issue distributors have regularly raised as a concern with the Authority.

This issue was recognised by the Authority in its 2017 review of pricing and load control by The Lines Company. In this review, the Authority noted that when consumers are unable understand their prices they are more likely to make investments that are unlikely to have any effect on their charges (or will only reduce their charges in the short-term).

There is a real risk with sharper peak price signals of creating exacerbating economic hardship for those least able to afford electricity as they have no option but to respond to price signals and have limited ability to invest in technologies that can assist with this.

Again, this was highlighted in the Authority's review of The Lines Companies prices. In a survey of TLC consumers, a UMR survey found that of those surveyed who felt they had been adversely affected, 25% stated their standard of living has been affected.

Similarly, 23% of respondents who took ongoing action to minimise their lines charges did so by always cooking at a different time. Similarly, 41% of these respondents stated they always turned off heating to minimise lines charges.

These are considerable societal costs that are not generally captured by a standard cost/benefit assessment. Network Tasman commends the Authority for further considering the effect of sharper peak price signals on hardship across the community.

Communication

Distributors are limited by their DDAs to changing their prices once a year. Price changes are significant undertakings that often have a 10-12month timeframe from beginning to end. Regulatory obligations to consult with retailers about changes and notify them of upcoming prices mean final decisions on new prices must be made in December/January each year.

To allow for consultation with retailers and time to address submissions, an (internal) draft decision on a new price structure generally needs to be made by no later than August/September in a given year[2] if it is to be implemented in April the following year.

This means that EDBs have limited ability to take into account feedback or comments provided by the Authority after June or July in a given year.

For example, the Authority published an open letter to distributors on 19 September 2022 highlighting its main areas of focus for distribution pricing in 2022. The Authority stated it expected to see specific changes to EDB's pricing methodologies and roadmaps for three of the five focus areas.

Three days prior to that, on 16 September 2022, Network Tasman circulated to retailers its consultation paper on reforms it was proposing to implement from 1 April 2023.

Given this timing, our ability to incorporate this guidance into our price changes is severely limited.

The pace at which EDBs can change their prices is constrained by (valid) regulatory obligations set by the Authority. If the Authority wants to maximise the impact of its regulatory guidance, it needs to be more aware of the limitations that EDBs face when setting their prices and provide its guidance in the first half of the calendar year, when EDBs can incorporate it into their pricing plans at an early stage.

[2] September/October for consultation with retailers, October/November to review feedback and develop final recommendation, November/December for a final decision on the price structure.

The later the EA communicates, the less effective it is in influencing EDBs' plans.

Use of anytime maximum demand (AMD) to recover fixed costs

The Authority states that it continues to see some distributors using an individual customer's AMD as a charging metric to recover residual costs and that some distributors have argued this charging metric is less distortionary than using a measure of capacity as a basis for fixed charges.

The Authority states that distributors should not use consumer AMD as a charging metric to recover residual costs. The Authority states that it considers the use of customer AMD, particularly when the chargeable quantity is a single annual peak updated each year, provides a strong incentive for customers to reduce their peak load, and potentially invest in technology that lops off their peaks.

It concludes that it would be interested in any data that sheds light on the question of which allocation metric is more or less distortionary.

The Authority is forthright in its view that AMD is more distortionary than a capacity charge but offers no explanation or evidence for that view.

Network Tasman currently uses AMD to recover fixed charges for consumers with connections with a capacity of 150kVA+.

We considered the option of a capacity charge in our 2023/24 pricing methodology, to the extent we could following the Authority's September letter and concluded that both capacity and AMD charges provide incentives for consumers to alter their behaviour.

For those on a capacity charge, those incentives are strongest for consumers at the ends of their capacity band because a small increase/decrease in their AMD would require them to change their capacity and experience a step change in their charges. By comparison, the incentives for a consumer subject to an AMD charge are uniform, irrespective of their characteristics.

Network Tasman concluded that it is not clear which of these charges provides stronger incentives, on aggregate, for consumers to alter their behaviour and on that basis maintained the status quo of using an AMD, whilst noting that a review of prices for these consumer groups was planned to be undertaken in 2023 (which is currently underway).

Network Tasman had hoped that this analysis would prompt the Authority consider our analysis and offer a view on which of the two options offers a stronger incentive for consumers to alter their behaviour and the materiality of these differences.

This issue is an issue that Network Tasman would like the Authority to consider further and explain why it considers AMD to be more distortionary than a capacity charge.