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Tēnā koutou

Targeted Reform of Distribution Pricing - Issues Paper

WEL Networks (WEL) appreciates the opportunity to provide feedback on the Electricity Authority's (the Authority) Issues Paper – Targeted Reform of Distribution Pricing (the Issues Paper).

WEL is New Zealand's sixth largest electricity distribution company and is 100% owned by our community through our sole shareholder WEL Energy Trust. Our guiding purpose is to enable our communities to thrive, and we work to ensure that our customers have access to reliable, affordable and environmentally sustainable energy.

WEL supports the Authority's focus on distribution pricing being cost reflective. However, the Issues Paper presents the Authority's views for the first time on a number of aspects of distribution pricing. To date the Authority's expectations have been outlined in the Distribution Pricing: Practice Note (the Practice Note). These expectations have focused on what cost reflective pricing means and further detail in areas such as TOU pricing and non-uniform variable pricing. This is the first time the Authority has laid out its preferred approach to target revenue allocation and capital contributions in new connection pricing.

WEL submits that the Authority's analysis of the current state, and problem definition, in these areas lacks much of an evidential basis and a level of understanding of the issues that should be expected by good regulatory practice. Further, the Issues Paper gives the impression that the Authority's concerns about pricing approaches apply in equal measure to all distributors (the lowest common denominator) – that is, we are all tarred with the same brush. By creating this impression, the public's perception of our sector, and the work many have undertaken towards cost-reflective pricing, is diminished. We understand that the outcomes of the Authority's most scorecard assessments will show (once published) that all but three EDBs, improved compared to their previous assessments.

We understand that the Authority plans to propose Code amendments in late 2023. We are very concerned that this timeline does not allow for a robust assessment of these complex and important issues, and the extensive cross-industry collaboration that will be needed to generate enduring solutions. We believe it is prudent that the Authority take a step back and work with the industry to conclusively determine if problems exist (supported by evidence), before proposing hurried regulatory changes which may lead to unintended consequences.

Key Themes

Our key messages regarding the proposed targeted distribution pricing reforms from this Issues Paper are:

- any proposed changes should take into account that each distributor is at a different point in their cost-reflective pricing journey. And that, changes to EDB input price signals happened only very recently (i.e. the changes to RCPD-based transmission interconnection charges and transitioning out of low fixed charges).
- we have found that, while it could be refined and improved, the Practice Note is a helpful guide to interpret the Authority's expectations. Our strong preference is to use this approach for all the topics raised in the Issues Paper. At no point does the Issues Paper provide evidence or prove that more intrusive regulatory intervention is warranted at this time.
- a principles-based approach to distribution pricing is always preferable over prescriptive approaches or methodologies determined by the Authority.
- any expansion of the Practice Note must be prepared collaboratively with the sector (networks and stakeholders) to ensure the guidance reflects an understanding of the practicalities and realities of operating a distribution network (and not a pure economic theory pricing approach) – this includes allowing sufficient time to implement changes before including them as part of the scorecard assessment.
- the benefit from amending distribution prices must exceed the cost – we suggest the cost of moving closer and closer to pure economically efficient cost-reflective prices will far outweigh any incremental benefits to consumers.
- in addition to clear Practice Notes, the Authority always has the option (without regulatory intervention) to 'call-out' any individual distributors – that is, to pick up the phone to discuss in more detail their approach and the Authority's expectations. WEL strongly encourages the Authority to adopt this approach.
- acknowledging the stakeholder engagement improvements made by the Authority over the past couple of years. And expressing our hope for even greater collaboration with the Authority going forward.

Overall, our strong preference is for the Authority to:

- continue as-is while roadblocks to reform are phased out, or while distributors implement the Authority's expectations;
- refine and/or expand the guidance in the Practice Note;
- collaborate with distributors by adopting a 'call-out' approach to address particular issues with particular distributors; and
- refrain from implementing heavy-handed Control or Call-in options.

WEL's Approach to Distribution Pricing

In preparation for determining 2023/24 prices, WEL undertook a major review of our pricing methodology and structure. We determined that parts of our methodology and pricing structure did not align well with the Authority's Pricing Principles and Practice Note. This helped us to understand where we were recovering revenue rather than signalling the economic costs of network use.

We engaged constructively with the Authority on our focus areas. We now consider that the Authority has a good understanding of WEL's current approach and future areas of improvement. We understand that this work has resulted in a significant increase to our Pricing Scorecard assessment (unpublished at the time of writing) compared to the previous assessment.

WEL supports the submission provided by Electricity Networks Aotearoa (ENA).

We have provided more fulsome answers to the questions raised in the Issues Paper in Appendix G of this submission.

Should you require clarification on any part of this submission please do not hesitate to contact me.

Otherwise, we look forward to continuing to work collaboratively with the Authority, and other stakeholders, toward more efficient and cost-reflective distribution pricing.

Ngā mihi nui

David Wiles

Revenue and Regulatory Manager

Appendix G Format for Submissions

Submitter	WEL NETWORKS LTD

Questions
Q1. Are there other options that you think the Authority should consider?
Instead of a call-in approach, WEL recommends a 'call-out' approach be adopted. Based on information in pricing methodologies and pricing scorecards, the Authority could 'call-out' individual EDBs – that is, pick up the phone and initiate a discussion about aspects of those EDBs pricing, where that EDBs approach is materially different from the Practice Note expectations. A call-out approach would mean the Authority uses evidence to identify and work with specific EDBs where the benefit for consumers is maximised. This approach does not require any Code amendments. As the Authority acknowledges, EDBs are at different points along a journey to cost-reflective pricing. The Authority must allow EDBs a fair period of time (necessary to change approaches and direction and to phase-in prices to mitigate prices shocks) to implement the guidance in the Practice Note. Distribution pricing had been (and largely continues to be) structured around, what the Authority has described as a strong pricing signal, provided for a significant period of time by the previous Transmission Pricing Methodology (RCPD price signals). Confirmation that this price signal was no longer relevant only happened very recently. WEL agrees with the Authority that it is appropriate[1] to have a different approach to distribution pricing compared with transmission pricing.
Q2. Do you have any comments on the options outlined?
The description in the options section of the Issues Paper is a good description of what the Authority might do and how it might perform its role. WEL submits that the Issues Paper does not provide sufficient evidence to support the regulatory option(s) the Authority prefers for each topic. The Issues Paper is also relatively silent on the impact of these approaches on individual EDBs (for example, initial implementation costs and ongoing compliance). The Issues Paper also does not look beyond what it considers to be efficient distribution pricing to the impact of implementing these efficient pricing approaches on EDB's customers. For example, if the Authority mandates a particular pricing approach does this eliminate any flexibility the EDB has to manage price shocks for its customers?

[1] Paragraph 3.11. This is particularly relevant when transmission pricing has a locational (nodal) price signal. Extending locational marginal pricing into distribution pricing is exceedingly complicated.

It's unclear if the Authority has considered its most recently added statutory objective while preparing the various regulatory and pricing options:

> c. 15(2) of the Electricity Industry Act: "The additional objective of the Authority is to protect the interests of domestic consumers and small business consumers in relation to the supply of electricity to those consumers."

Q3A. Do you agree that a combination of TOU tariffs and load control (appliance) tariffs would be useful for the smart management of peak demand?

The Authority has not been specific about whether the discussion on peak pricing relates only to residential customers or to all customers. As stated in the Issues Paper, WEL has already *"assigned the majority of its residential customers to TOU plans and able to use consumers' TOU usage for billing of distribution services"*[2].

WEL agrees that a combination of TOU prices and load control (appliance) prices for residential customers is useful for the management of peak demand. This approach allows for a good balance of dependable outcomes (load control) and customer choice (TOU pricing).

However, we note the difference between the certainty of outcomes from load control and TOU prices. Load control prices – where customers benefit from lower network charges when the EDB is responsible for the customer's level of demand at a particular time period (a firm response) – versus a peak TOU prices – where the customer faces a higher charges in the same time period but has the discretion to decide whether to change their consumption behaviour (non-firm response). EDBs rely on consumers responding to TOU price signals but have no guarantee of the behaviour the price signal will elicit in that time period or if the peak signal will result in the same behaviour in the next period.

Q3B. Do you consider that TOU pricing could have unintended consequences for congestion on the LV network?

No, after five years of mandatory residential TOU pricing, we have seen no evidence of TOU pricing causing unintended consequences for congestion on the LV network. However, we have seen unrestricted retailer offerings of free power during certain periods create unintended consequences on LV networks.

Fortunately, we currently have access to smart meter data for over 70% of our over 100k connections. Visibility of 5-minute consumption data allows our Asset Management team to better identify and remedy LV congestion.

Managing congestion is lower cost than network investment to the point where an incremental step change in network capacity is required. Currently, our view is that a defined period for peak pricing is sufficient.

Q3C.Do you consider that use of shoulder pricing as part of the TOU price structure could be an effective way to mitigate this risk? What other ways could be effective?

The Authority supports TOU pricing as a "*first stepping stone in pricing reform for distributors facing future congestion, proving it can be implemented in a way that is cost reflective*"[3]. It also states it "*has been comfortable with distributors facing demand growth transitioning to TOU structures as a starting point for improving cost reflectivity*"[4].

[2] Footnote 25

[3] Paragraph 4.15

[4] Paragraph 4.12

WEL submits that the Authority must allow EDBs sufficient time to implement TOU pricing that suits their network circumstances and to test the effectiveness of this charging structure at influencing demand behaviour on their networks. The Authority may view this as a satisfactory 'first-step' but we suggest it will take several years before EDBs and end consumers value anything more complicated.

Q4. Do you agree with the assessment of the current situation and context for peak period pricing signals? What if any other significant factors should the Authority be considering?

WEL suggests that the description of the current situation fails to recognise that until very recently all EDBs faced a strong signal to manage peak demand to reduce transmission charges – the RCPD methodology for interconnection charges. This was based on regional peak demand and not necessarily correlated with an individual EDB's periods of peak demand or network congestion[5].

Due to RCPD, it was not possible to also structure distribution prices to reflect the EDB's demand and capacity utilisation profile. Now that the RCPD signal does not exist, EDBs are evolving their charges to reflect activity on their own networks, but this process has only just begun.

Additionally, we feel that the Authority's assessment of EDBs non-residential pricing structures is incorrect. WEL and many other EDBs have well-developed peak pricing regimes for non-residential customers.

Q6. Do you have any comments on the Authority's preferred pricing for peak periods?

WEL queries what the Authority means by "rapid phasing out of uniform tariffs"? WEL's approach was to design pricing using our own meter data and calculate charges so that most customers would initially pay a similar amount on the mandated TOU pricing, compared with prior uniform charges, to limit any initial price shock.

We have refined the level of each TOU rate over time to achieve more efficient distribution pricing while continuing to manage price shocks. It is unclear how the Authority proposes other EDBs to achieve "rapid phasing out of uniform tariffs". Further, what is the evidence EDBs that are experiencing congestion are still charging uniform tariffs – how many EDBs are in this category?

WEL agrees with a rapid phase out of deemed profiles in favour of the use of actual meter data. We believe that a ban on profiling if a smart meter is installed, could increase the likelihood that distributor cost-reflective pricing is seen by the end consumer.

The current limitation, as we understand it, is retailers' willingness and/or ability to pay for the meter data and/or be able to process the data in their billing systems.

WEL also suggests the Authority review the role of Meter Equipment Providers. This is essentially a monopoly part of the supply chain and the cost of acquiring data from MEPs is uncontrolled. Further, WEL would support the development of a central depository for meter data so that the data is readily available to any appropriate participant, at a standard and reasonable cost.

[5] For example, Electricity Ashburton as part of the Upper South Island region

We agree with the principle that the differential between peak and off-peak rates is "clearly linked to estimated cost consequences of usage", but this will take time to implement. WEL is making best endeavours to implement cost reflective pricing, and is mindful of coherent and internally consistent pricing, but, in our view, incremental changes can achieve benefits without imposing high costs on consumers. We also query whether it will ever be possible to have perfect consistency given the position EDBs are coming from. Regardless, implementation requires some flexibility and time – both of which are influenced by the position the distributor is starting from. The Authority's new additional statutory objective is a relevant consideration here.
Q7. Are there other options you think the Authority should consider for improving peak period pricing? WEL's views on the options the Authority is considering (detailed in para 4.31) are: (a) The option to do nothing is valid until the LFC regulations are fully phased out. As discussed above, EDBs are starting from different points on the journey to cost reflective pricing. Change is happening and it will take time. The scorecard assessment approach has value as does WEL's proposed 'call-out' approach. (b) WEL supports the Authority developing a revision to the practice note and consulting on the draft. Most importantly, the practice note must be a clear articulation of the Authority's expectations and the purpose of the scorecard assessment is to form the basis of a discussion between the Authority and a distributor. (c) WEL does not support the Authority mandating or prohibiting any of the specific approaches outlined. (d) WEL does not support the Authority calling-in peak pricing for review and approval.
Q8. Which if any of the above options do you consider would best support distribution pricing reform around peak pricing signals and why? WEL believes that option (a) will suffice until LFC regulations are phased out. EDBs should be aligning with the expectations in the practice note, and where they are not, the Authority has the option to address issues with individual EDBs using a call-out approach.
Q9. Do you agree with the assessment of the current situation and context for off-peak pricing signals? What if any other significant factors should the Authority be considering? It is not clear what the Authority means in para 5.10 that distributors are setting 'material' off-peak charges. As discussed on our cover letter, we are in a period of transition moving from a strong 'off-peak / controlled load signal from the TPM to higher fixed charges. In addition, the approach to revenue recovery has to change gradually given the five-year phase out of the LFC. We note that the Authority is suggesting that distributors could solve the impact of LFC transition by allocating less revenue to residential consumers. WEL submits that this approach would only be appropriate if the resulting charges were cost-reflective and cross subsidy free. For reference, WEL is forecasting that the largest impact on our network (by a significant margin), over the next couple of decades, will be from residential EV charging. With this in mind, allocating less revenue recovery from residential customers seems like it would be counter to the Authority's Pricing Principles.

Q10. Do you agree with the problem statement for off-peak pricing signals? The problem statement seems to have little to no allowance for the transition and journey distributors are on (particularly with respect to the LFC), discussed elsewhere in this submission. There is also little quantitative evidence provided in the Issues Paper to justify this problem statement.
Q11. Do you have any comments on the Authority's preferred pricing for off-peak usage? WEL supports very low or zero off-peak prices (para 5.17) at such time we have fully balanced the fixed versus variable components of its charges. WEL disagrees that using historic AMD is not appropriate (para 5.19) as a mechanism for EDBs setting fixed/residual charges, when this was the Authority's choice for setting TPM residual charges.
Q12. Are there other options you think the Authority should consider for improving off-peak pricing? WEL's views on the options the Authority is considering (detailed in para 5.22) are: (a) The option to do nothing is valid until the LFC regulations are fully phased out. As discussed above, off-peak pricing is largely driven by LFC limitations, so until they are removed, further intervention is unnecessary. Additionally, WEL's proposed 'call-out' approach could be adopted. (b) WEL supports the Authority developing a revision to the practice note and consulting on the draft. Clearer, more defined expectations are always helpful. (c) WEL does not support the Authority mandating or prohibiting any of the specific approaches outlined. (d) WEL does not support the Authority calling-in peak pricing for review and approval.
Q13. Which if any of the above options do you consider would best support distribution pricing reform around off-peak pricing signals and why? Again, WEL believes that option (a) will suffice until LFC regulations are phased out. EDBs should be aligning with the expectations in the practice note, and where they are not, the Authority has the option to address issues with individual EDBs using a call-out approach.
Q14. Do you agree with the assessment of the current situation and context for target revenue allocation? What if any other significant factors should the Authority be considering? The Authority has not previously provided much in the way of guidance on SRMC or LRMC cost pricing. We understand from the Issues Paper that the Authority prefers the use of LRMC pricing. Long before intervention is proposed, the Authority must publicly notify that LRMC is preferred and allow time for EDBs to adopt and implement this approach. Additionally, while cost allocation models are an important factor in setting prices, it is not simply a mechanical exercise of applying the model annually as this could lead to volatility in prices. Other factors that influence our approach to pricing include: • acknowledging that networks are dynamic. Customer behaviours and resulting impacts differ from one year to the next (and often, from one day to the next) • ensuring customers do not experience excessive price shocks; • ensuring revenue adequacy; and • maintaining logical relationships between price categories.

We explain in our 2023/24 Pricing Methodology that "the level of target revenue that is actually collected from a customer group will not necessarily be identical to the level of costs the model attributes to that group. It is WEL's intention that through the pricing revision each year WEL's prices and pricing structure will approximate the modelled revenue allocation, overtime, in a way that is consistent with the pricing principles".[6]
Q15. Do you agree with the problem statement for target revenue allocation? No, there is no quantitative evidence provided in the Issues Paper to justify this problem statement. If the Authority would like to see different outcomes in this area, we suggest the first step must be providing actionable guidance with worked examples.
Q16. Do you have any comments on the Authority's preferred pricing? WEL supports the Authority first showing (on an evidential basis) the need for change. If it is required, the Authority should then collaboratively work with distributors to provide guidance and allow time for implementation.
Q17. Are there other options you think the Authority should consider for improving target revenue allocation? WEL's views on the options the Authority is considering (detailed in para 6.23) are: (a) The option to do nothing is valid if there is no evidential basis found for change. (b) WEL supports the Authority expanding the practice note and consulting on the draft if an evidential need for change is found. Distributors will need to be given ample time to implement this guidance before it is assessed as part of the pricing scorecards. (c) WEL does not support the Authority mandating or prohibiting any of the specific approaches outlined. (d) WEL does not support the Authority calling-in peak allocations for review and approval.
Q18. Which if any of the above options do you consider would best support distribution pricing reform around targeted revenue allocation? WEL's preference is option (a) and/or (b), depending on whether the Authority can demonstrate an evidential need for change. If the pricing practice note is extended there needs to be a clear benefit from this approach and we suggest a workshop format for developing draft changes to the practice note so that the capability across the regulator and sector is best utilised.
Q19. Do you agree with the assessment of the current situation and context for connection pricing? What if any other significant factors should the Authority be considering? No, WEL submits that as this is the first time the Authority has provided commentary on connection pricing, much of the nuance and complexity of this area appears to be missing from its interpretation, as is evidence for many of the claims made.

[6] Page 9 https://www.wel.co.nz/media/t4xdvkx3/pricing-methodology-1-april-2023-nc.pdf

Q20. Do you agree with the problem statement for connection pricing? No, WEL suggests the problem statement is overstated and lacks an evidential basis. This Issues Paper is the first time the Authority has raised any concerns about distributors' approaches to connection charges. We suggest a workshop discussion with distributors and connecting parties on this topic would provide a more balanced understanding.
Q21. Do you agree with the Authority's preferred pricing approach for connection charges? Consistent with our answer to Q20, WEL submits that considerably more work is required from the Authority to gain an understanding of complexities and interdependencies relating to connection pricing before a preferred pricing approach should be arrived at. We believe a workshop discussion with distributors and connecting parties on this topic would provide a more balanced view and more durable solution to this important and complicated aspect of distribution pricing. There are a set of assertions in the Issues Paper but the financial impact from balancing these different views (to get to a preferred pricing position) must be identified and discussed. The 'monopoly' aspect of EDBs activities are regulated by Part 4 of the Commerce Act – maybe some of the discourse relates to that regime rather than recovering the cost of assets. The option to standardise some connection pricing is important. Flexibility to balance reflective costs against the volume of new connections must always be accounted for. WEL notes the discussion does not extend to addressing investment in anticipatory capacity or addressing first mover disadvantage – both of which are relevant for connections of load customers.
Q22. Do you have any thoughts on the complementary measures mentioned above and to what extent work on these issues could lead to more efficient outcomes for access seekers? WEL does not agree with the assessment of the complementary measures the Authority proposes in para 7.28. Asset and capacity information is evolving but the accessibility of it to access seekers must be balanced against the cost and other resource priorities. WEL does not agree that there is any evidence to justify 7.28(b), at least in our network area. We have two very large tier one contractors that competitive tender for contracts, and numerous other tier two and network approved contractors.
Q23. Are there other options you think the Authority should consider for connection pricing? The Authority's understanding of the complexities and interdependencies of connection pricing is in its infancy. We believe that the Authority should seek to develop its own understanding of this area before progressing any further.

Q24. Which if any of the above options do you consider would best support distribution pricing reform in the area of connection pricing? WEL supports option (a), doing nothing. This Issues Paper is the first time the Authority has raised any concerns about distributors' approaches to connection charges. It is the first time the Authority has provided any detail about the issues it has with current approaches to capital contributions. If the Authority adopts option (b) and extends the practice note, we recommend a separate practice note specifically for capital contributions which has a clear statement of the Authority's expectations and direction for recovering capital contributions. Consultation and a workshop discussion, again, is our preferred approach to developing this practice note. Distributors must then be given the opportunity and time to implement the Authority's expectations. This would be a multi-year timeframe so distributors can plan and implement new charges and mitigate any consequent impacts. Again, we do not support the control or call-in approaches.
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? As with connection pricing, this is the first time the Authority has provided much commentary on retailer response, it seems that some of the nuance and complexity of this area appears to be missing from its interpretation. 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? Not applicable. Q25C. *[for **distributors**]*: What plans do you have to increase the proportion of your customers that face time-varying charges (for example, making TOU plans mandatory for retailers whose end-users have an AMI meter installed)? WEL has mandated TOU pricing for all capable mass market connections since 2018.
Q26. Do you agree with the problem statement for retailer response? We suggest that the two factors the Authority raises are only a small part of the problem and in general the problem definition is weak.
Q27A. Do you have any comments on the Authority's preferred pricing? WEL supports the Authority's preferred pricing approaches but believe they will have limited impact as they are not part of the core issues at play when it comes to retailer response.

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? Not applicable.
Q28. Are there other options you think the Authority should consider for retailer response? The Authority is the only party with the mandate to decide whether distributors' cost reflective price signals are able to be responded to by end-consumers (or their agents). At some point the Authority will have to decide whether it truly wants distribution price signals to influence end-consumer behaviour or not.
Q29. Which if any of the above options do you consider would best support distribution pricing reform in the area of retailer response? WEL supports billing on actual data, guidance for tariff assignment, and the increased monitoring of retailer pricing. However, we remain unconvinced that any of these actions will result in end-consumers (or their agents) being exposed to cost-reflective signals from distribution pricing reform.