



**TRANSPOWER**

*Keeping the energy flowing*

Waikoukou  
22 Boulcott Street  
PO Box 1021  
Wellington 6140  
New Zealand  
P 64 4 495 7000  
F 64 4 495 6968  
[www.transpower.co.nz](http://www.transpower.co.nz)

Tim Sparks  
Director  
Network Pricing  
Electricity Authority Te Mana Hiko

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By email: [distribution.pricing@ea.govt.nz](mailto:distribution.pricing@ea.govt.nz)

## Targeted Reform of Distribution Pricing

1. Transpower welcomes the opportunity to cross-submit in relation to the Electricity Authority's (Authority's) Issues Paper, Targeted Reform of Distribution Pricing, published on 5 July 2023.
2. We continue to support inclusion of cross-submissions as part of consultation processes, and the prompt publication of submissions.

## New section 15(2)-(3) of the Electricity Industry Act

3. Our views on the new consumer protection provisions are consistent with various other submissions which either explicitly commented that the objective is applicable to distribution pricing (2degrees and Electric Kiwi (joint submission), the Consumer Advocacy Council and Mercury) and/or raised concerns about how distribution pricing could harm consumers (e.g. ERANZ, Genesis and Vector).
4. For example, Mercury commented that *"more vulnerable households, will either prefer simplicity or not be able to materially change their behaviour"* and *"While ... efficient pricing is important, this must be balanced against the other functions the Authority has, including those to protect the interests of consumers"*. ERANZ similarly raised concern about the *"adverse social consequences (including to human health) of having a tariff that gives rise to some consumers (generally the most vulnerable) being afraid to turn their heating on"*. We share these concerns.
5. The inclusion of the new consumer protection objective means that the current interpretation document is now out-of-date. We consider that the Authority should now review and update its interpretation. As part of this, it would be useful for the Authority to clarify its interpretation of what *"dealings ... with domestic consumers and small consumers"* means, and what it does and does not include. We consider the

explanatory note for the additional consumer objective<sup>1</sup> does not preclude distribution pricing being relevant the consumer protection function.

## The approach to determining LRMIC pricing

6. A number of submissions noted this was the first time the Authority has overtly supported use of LRMIC pricing for distribution (2degrees and Electric Kiwi (joint submission), EA Networks, ENA and WEL Networks).
7. For example, ENA submitted *"The Authority has historically provided no guidance nor publicly stated a preference for the use of short-run or long-run marginal cost pricing. The issues paper implies that the Authority has a preference for the use of LRMIC pricing. ENA encourages the Authority to explicitly communicate this preference publicly and give EDBs an appropriate amount of time for pricing methodologies to reflect the advice"*.<sup>2</sup>
8. We support the view that the Authority should provide guidance on LRMIC pricing, and when it is appropriate to use SRMC or LRMIC pricing, in the Distribution Pricing Practice Note.
9. There also appears to be broad consensus amongst submitters that a standard approach should be developed for determining how to set LRMIC pricing (and subsidy-free pricing). We support this view and agree a collaborative approach would be beneficial. We reiterate the report we commissioned from Dr Batstone on how LRMIC pricing could be implemented would be a useful starting point for this work.<sup>3</sup>

## Different approaches have been taken for distribution and transmission pricing

10. We agree with Vector that it would be useful for *"the Authority to clearly explain to stakeholders how they consider distribution pricing should differ from transmission pricing, if in fact there are any differences"* and to explain how the *"TPM principles translate into distribution pricing"*. We also agree *"A reconciliation of principles across the distribution pricing and transmission pricing, in our view is fundamental to giving confidence on consistency of approach and application"*.
11. Our submission highlighted that *"The difference in approach the Authority has taken to distribution and transmission pricing goes much further and deeper than a "targeted approach to distribution pricing" versus "the more comprehensive framework for transmission pricing"*. The Authority's explicit support for LRMIC pricing at the distribution level means that the divergence between distribution and transmission pricing has now widened. At a global level, the differences include:
  - i. Prescriptive mandatory Guidelines (transmission) v voluntary pricing principles (distribution)

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<sup>1</sup> Refer to the Authority's [Q&A](#) on the Consumer protection objective

<sup>2</sup> The fact ENA and some of the EDBs are raising questions about whether the Authority intends cost-reflective pricing to signal LRMIC or to elicit a particular (demand reduction) outcome, which may necessitate prices in excess of LRMIC also highlights the benefit of the Authority being clearer about its position on peak/congestion pricing.

<sup>3</sup> We commissioned Dr Stephen Batstone of Sapere Research Group to research and consider practical design aspects of an LRMIC charge for New Zealand's TPM. The literature search analysis has been peer reviewed by Dr E Grant Read (Consultant and Adjunct Professor, University of Canterbury): Sapere, Issues to consider in designing an LRMIC pricing regime, August 2017, available [here](#).

- ii. Benefit-based charging (transmission) v cost-reflective pricing (distribution)
- iii. An allocative efficiency approach to pricing (transmission) v a dynamically efficient approach or an approach that permits both allocative and dynamically efficient pricing (distribution)
- iv. Exclusion of LRMC pricing (transmission) v support for use of LRMC (distribution)<sup>4</sup>
- v. Mandatory use of AMD (transmission) v expectation AMD won't be used (distribution) - see below.

## Use of AMD for transmission pricing versus distribution

12. Based on EDB submissions (EA Networks, ENA, Network Tasman, Network Waitaki Powerco, and Vector), the question of whether AMD should be used warrants further consideration and discussion.
13. We consider the EDB submissions supporting the use of AMD are consistent with the Authority's reasoning in relation to transmission pricing and raise valid reasons why EDBs should be able to consider AMD charging.
14. ENA submitted, for example, that *"historical AMD is an appropriate measurement of the proportion of network capacity needed to service a customer. EDBs must design and deliver networks to meet their customers' peak demands no matter how often this occurs"*.
15. Vector provided a useful example where both EV owners charging their cars during peak and off-peak can drive the need for additional capacity.<sup>5</sup> Vector essentially argues use of AMD (which captures EV owner's non-peak contribution to capacity requirements) in conjunction with peak-pricing (which captures the capacity needs to due peak-usage) helps ensure consumers who do not own EVs/can't afford EVs don't end-up subsidising EV owners for additional capacity requirements.
16. We share the questions ENA has raised about the consistency of approach between distribution and transmission pricing: *"ENA does not understand how the Authority can view historical AMD as an appropriate tool for setting fixed charges in the transmission network but not for distribution networks."*

## Concluding remarks

17. Transpower welcomes that the Authority has been upfront that its *"thinking has evolved"* and it is dealing with some issues that *"are relatively new focus areas for the Authority"*. This evolution highlights how new technologies and the energy transition represent a major change for the electricity industry and network pricing.

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<sup>4</sup> MEUG, for example, submitted: *"We note that with the move to the new TPM and the removal of the Regional Coincident Peak Demand (RCPD), there is actually less of a focus on peak demand, which seems counter to what the Authority is seeking through distribution pricing."*

<sup>5</sup> Capacity requirements can be driven by peak-usage AND anytime maximum demand. An effective way to think about Vector's point is to consider what a network's capacity needs would be absent EVs, what the capacity needs are with EVs (but absent peak-demand spikes) and what the capacity needs are with peak-usage and who should pay for each component of this.

18. One of the clear implications of these changes is that dynamic efficiency and use of peak-demand/LRMC pricing is becoming increasingly important. While a number of submissions pointed out this consultation was the first time the Authority articulated LRMC can be efficient for distribution pricing, there was no pushback or opposition from submitters against dynamically efficient or LRMC-based pricing.<sup>6</sup>
19. It appears the main area where there is disagreement between submitters and the Authority is in relation to how the TPM and distribution pricing interact with issues raised about pass-through of transmission charges and the efficacy of AMD pricing.
20. We consider it would be useful for the Authority to adopt a collaborative, industry-wide approach for dealing with these kinds of issues with the objective of achieving a wide level of agreement (if not consensus).
21. There is widespread agreement that developing a common approach to LRMC (and subsidy-free) pricing would be beneficial. As 2degrees and Electric Kiwi noted *"There is further opportunity for electricity distributors to work collaboratively with stakeholders, either through the ENA and/or the Authority, to develop uniform approaches to matters such as how to calculate LRMC pricing and subsidy-free pricing. The electricity industry doesn't need each electricity distributor to reinvent the wheel"*.

Please contact me at [joel.cook@transpower.co.nz](mailto:joel.cook@transpower.co.nz).

Kind regards,

Joel Cook  
Head of Regulation

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<sup>6</sup> The main comment from EDBs was that they need to be given time to adjust their pricing to reflect the Authority's latest thinking, and needed clarity about what LRMC pricing should look like before the Authority considers regulation.