Vector Limited
110 Carlton Gore Road
PO Box 99882
Newmarket
Auckland 1149
+64 9 978 7788 / vector.co.nz

30 August 2023

Tim Sparks
Director, Network Pricing
Electricity Authority
PO Box 10041
Wellington 6143
By email: distribution.pricing@ea.govt.nz

Vector cross-submission on the Targeted Reform of Distribution Pricing consultation

1. This is Vector's ('our,' 'we,' 'us') cross-submission on the Electricity Authority's (Authority) Issues Paper on Targeted Reform of Distribution Pricing. No parts of this submission are confidential, and it can be published on the Authority's website.

Timeframes and regulatory options

2. Vector was not alone in raising concerns with the process timeframes and the regulatory options put forward by the Authority to address the issues raised in the paper.

3. WEL Networks is worried that the Authority is rushing into Code amendments that could lead to unforeseen issues:

   "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."

4. Horizon Energy has made a similar recommendation:

   "When the Electricity Authority issues updated feedback and identifies new issues, sufficient time is provided to allow stakeholders (such as EDBs) to act on the feedback and issues. Any concerns regarding the timeliness of actions should be addressed through collaborative engagement with stakeholders so realistic timeframes and expectations can be set."

5. Vector agrees with WEL, that the paper covers a wide range of complex issues, and that the Authority should prioritise these issues based on consumer feedback, a step which is currently missing from their process to date (see section below on consumer engagement).

6. We also concur with FirstGas Group around the continuation option whereby:

> *"Timing of the release of the pricing scorecards is important to make timely changes for the next pricing round."*

7. EDBs are due to receive finalised scorecards in September 2023. In order for EDBs to take account of wholesale changes to their pricing it would be much more valuable to receive finalised scores and feedback by August at the latest. As we described in our submission, EDBs need long lead times to implement recommendations on pricing reform into their annual setting of prices.

8. We also note that Wellington Electricity has provided similar feedback to us on the feedback we are given in the scorecard process:

> *"The scorecard process provides an opportunity for the EA to provide targeted advice on how a network's prices are not cost-reflective and improvements they could make. The current scorecard process provides high-level guidance but is often light on specific changes that should be made."*

9. Vector reiterates that if the Authority wants reform in a certain way, it should be more prescriptive and recommend their preferred option(s) in their draft scorecards. EDBs then have the opportunity to consider the directive or give a reason why the option will not or cannot be adopted.

10. Orion and Horizon Energy have offered a fourth regulatory option for the Authority to consider. Orion explains:

> *"A fourth option to consider is "Collaboration", that looks for the Authority to engage at a technical level to understand "how" EDB's are quantifying and signalling avoidable costs in their pricing. Collaboration should also be extended to retailers and aggregators (as part of the pricing supply chain), with the goal of developing a consistent approach to pricing that is focussed on positive consumer outcomes."*

11. This fourth option is a good one and needs to involve the Authority and other stakeholders, rather than an EDB-only collaboration (noting that we must be cautious around collaboration involving parties that operate in competitive markets). Other stakeholders have supported further engagement on these issues. SolarZero suggests:

> *"[…] a set of workshops for the industry to discuss and debate further with the aim of getting to a stronger shared view across the entire sector."*

12. And PowerNet favours:

"[…] the Authority working more closely with EDBs and the EEA to allow iteratively exploring and understanding options that best balance needs of stakeholders and ultimately customers."

13. Vector believes that in order for this fourth option to work the Authority needs to streamline their work program and focus on only one or two issues at a time. A workshop on 'retailer response' for example would benefit all parties:

    a. EDBs would benefit from a better understanding of all the components retailers need to factor into their end-user billing;

    b. Retailers would benefit from *understanding* the pressures from both regulatory regimes on how we price; and

    c. The Authority would benefit from understanding the best balance on how to ensure the benefits to consumers anticipated from distribution pricing reform have the greatest chance of being realised.

Connection pricing

14. Drive Electric shares their view on mandating connection pricing:

"*In our view, EDBs need to be mandated to:*
i. provide connections based on efficient costs and be made to disclose that they are doing so.
ii. price connections as a separate 'Public EV Charging' customer class and not a subset of 'non-residential' or such like class of customer, as at present.
iii. allow provisioning and installation services to be contestable.
iv. price connections in a consistent manner – that is, the pricing structures are consistent and predictable across EDBs, but the price levels reflect each EDBs costs and local network circumstances.
v. have consistent policies for capital contributions to connection costs for public charging.
vi. provide flexibility - that is, one size may not fit all."

15. On point 2 above, there cannot be a customer class for every new type of distributed energy resource (DER) wanting to connect to an EDB's network. We note that while Drive Electric wants special treatment for Public EV Charging, Ecotricity would like to see incentivisation for battery storage:

"For example, simply moving from gas / coal boilers to electricity can create material challenges to the network. If those customers added battery storage, then this could be used to offset peak period issues and result in better outcomes for everyone. Our view is that these should be incentivised through lower connection charges at a level of materiality that allows businesses to develop a robust business case for including a storage solution."

16. We support the view of EA Networks to counter the above:

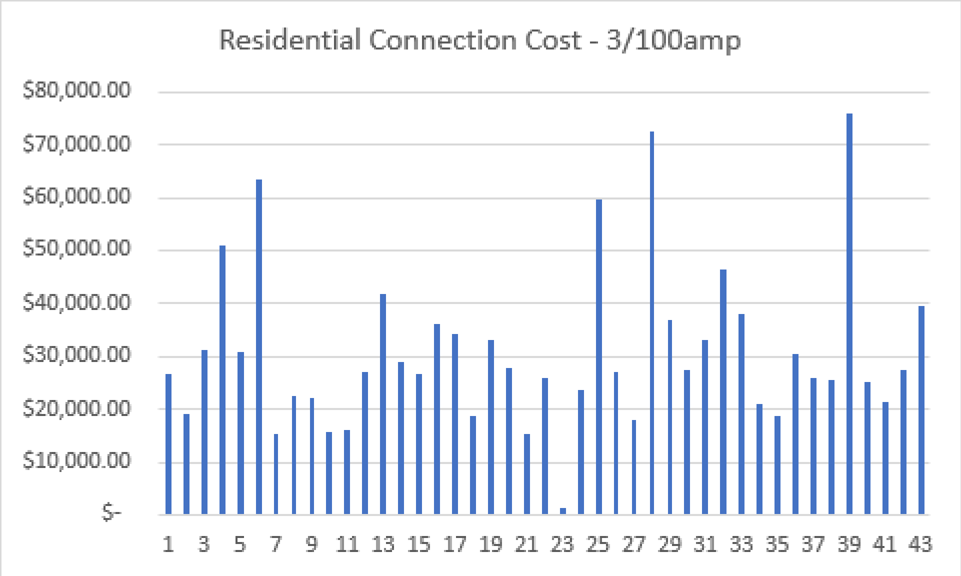
> *"We are concerned that the Authority has included this area of focus in response to a small subset of our new connections – electric vehicle fast chargers. We accept that this customer group would like to pay less to connect, but we are not in a position to support one commercial initiative over another, or one decarbonisation technology over another. Where capital contributions are consistently applied they lead to lower ongoing charges for customers. The interests of those that have "bought in" through a capital contribution would be undermined if subsequent customers do not pay. Those subsequent customers would enjoy a lower entry fee as well as lower ongoing charges due to the pre-funding by prior customers. The Authority's call for standardisation would evoke these inequitable outcomes."*

17. It appears that Drive Electric is contradicting themselves in point 4 above. EDBs cannot price connections in a consistent manner due to:

    a. Cost reflectivity: It is in fact the diverging costs and local network characteristics that are the primary driver of an EDB's pricing. Drive Electric should instead be concerned if the tariffs were *not* cost-reflective, and there was a risk they were subsidising others' connections; and

    b. Access to capital: We note that the Commission does not undertake a financeablity test when it sets the DPP, therefore it should not be assumed that EDBs will always be able fund investments in its network. To fund investment an EDB needs to obtaining funding. If cashflows under the DPP are insufficient to support credit metrics or returns and cashflows are insufficient to attract equity then required investments may not be able to be made. Access charges are a source of funding for EDBs any changes to access charging made through regulation may have unintended consequences, especially given lack of financeability testing in the Commission's current DPP setting process.

18. Drive Electric provided a graph of the differences in quotes for a 100 Amp connection for a charging point operator (CPO) in Auckland (example CPO B). To illustrate that we are not treating CPOs any differently than other connection requests, we have produced a similar graph below of the costs of non-complex residential 3/100 Amp connections from 1 January 2022 to 31 July 2023.



19. The graph shows the diversity in costs across this connection size, demonstrating that rather than it being an issue related to CPO charging, it has everything to do with the cost-reflective approach we take to our pricing. Rather than this level of variability being an indictment on our pricing approach, we think it positions us as an exemplar of cost-reflective connection charging.

20. Further, Drive Electric's members should be concerned if there were *less* variability in these connection charges, as this would imply that some of their members were subsidising (and being subsidised by) other members, which would penalise those who are actively seeking out the most efficient locations to connect. Equally, our other connecting parties (e.g. residential subdivisions, data centres, bus-charging depots, commercial users) would be concerned if they were subsidising the costs of CPO connections. The costs lie where they fall, and we do not believe the Authority would consider it our role to pick winners between different groups of consumers.

21. We would also suggest that such variability has been part and parcel of connecting generation developments to the transmission network, for decades. A wind farm located 50km away from the nearest transmission line would certainly not expect to pay the same cost to connect as one located right next to an unconstrained substation.

22. We sympathise with Network Waitaki's experience and agree with their stance on subsidisation shared below:

> *"Electricity demand in the Network Waitaki supply area has doubled over the last two decades due to dairy and irrigation conversion necessitating investment in distribution assets to ensure a reliable supply. Existing customers in the Network Waitaki supply area who connected new load through that time have all contributed in terms of the provisions of the capital contributions policy in place. To now abolish connection levies and increase line charges to fund growth investment would result in these customers paying twice.*

Network Waitaki follows a load agnostic principle and perceives any notion to benefit a certain type of customer as discriminatory and not in the interest of the overall consumer base. For example, we would ask the question as to why must existing network users subsidise EV charging stations getting connected without connection levies?"

23. We also agree with Northpower and Top Energy who explain that the Authority is paying particular attention to one group of customers EV charging providers and ignoring its statutory objective to protect domestic consumers:

"Commercial EV charging providers are seeking to reduce the costs of connection. However, who pays instead is a question moving forward if distributors were to fully adopt the Authority's recommendations? It's unfair to make smaller consumers subsidise new commercial EV charging providers, just like it is unfair to make them subsidise the new connection costs of property developers, supermarkets, and other commercial interests. Further to this, it hardly aligns with the Authority's new statutory objective to protect the interests of domestic consumers and small business consumers in relation to the supply of electricity to those consumers. The approach suggested makes small consumers pay more than their fair share."

24. Finally, the Electricity Networks Aotearoa (ENA) summarises the issue succinctly for EDBs:

"ENA notes the Authority has no definite preference for a single approach to connection prices. ENA is deeply concerned that the Authority is proposing to ban some types of connection charges without first demonstrating that they are not cost-reflective or efficient. Any change in approach to connection pricing requires EDBs to be extremely mindful of intergenerational equity issues. For existing customers who have paid upfront for their connections, a change in approach risks new consumers benefiting from the contributions of existing consumers without making a contribution of their own. ENA is concerned that the Authority appears to suggest that EDBs should explicitly subsidise access seekers at the expense of existing customers."

25. In terms of solutions that could assist the issues raised by stakeholders on connection charging, Ecotricity refer to incentives:

"We would add that we believe an additional incentive layer should be considered i.e. given the anticipated rapid electrification, particularly of large industrial load, connection incentives should be provided to those who specifically include flexibility assets in their capital plans."

26. If we understand this excerpt correctly, Ecotricity is suggesting that EDBs are incentivised to include more flexibility (or non-traditional solutions) into their capex forecasts. If that is the case we would lend support to this idea, noting that the audience for this type of request should be the Commerce Commission and not the Electricity Authority. We have successfully implemented such a flexible connection at Auckland Transport's e-bus-charging depot in Panmure.

27. Meanwhile, the major electricity users' group (MEUG) has referred to another solution proposed by the Commission in their recent Input Methodologies draft decision, which Vector also supports.

> *"As noted in our submissions to the Commerce Commission, we support a new LCC mechanism that can 'provide a timelier option and process for customers looking to enter into large contracts with EDBs'."*

28. We encourage the Authority to engage with the Commission to understand the benefits of this new proposals and how it fits into the Authority's workstream on connection pricing.

Load control

29. Contact has shared its concern around load control:

> *"Where load control tariffs are offered EDBs retain direct control over the load assets. This precludes other parties from managing that asset which is likely to create unintended consequences where the asset is not being used for its most efficient purpose. For example, EDBs are not incentivised to provide this load control to the energy market. We also have a long-standing concern that the EDBs are using this capacity to generate non-regulated revenue in the reserves market, and are not sufficiently incentivised to pass these benefits on to consumers. Because of this arrangement, the EA had to mandate EDBs to offer in their load control to the system operator through differencing bids at the real time pricing scarcity price. We believe there should be requirements on EDBs to ensure that the conditions of access to the load control tariff is open to any party and does not require approval and/or control from the EDB."*

30. In response to these allegations we set out the following points for Contact to consider:

    a. The default distributor agreement (DDA) permits any party to take over load control, so it is incorrect to say that EDBs can somehow lock others out. In fact, it is an easy process under the DDA for others to enter into the load control market, as many retailers already are;

    b. The Authority's mandate for EDBs to enter difference bids was implemented to increase visibility of controllable load to manage grid emergencies (particularly through winter), not due to the practice Contact describes; and

    c. Under the Commerce Commission's regime EDBs are allowed to generate non-regulated revenue through related parties as long as we allocate costs according to the methodologies prescribed by the Commission, and disclose in our annual information disclosures (which are subject to audit). Under this regime however we cannot generate up- or down-stream benefits despite our repeated advocacy for our regulators to look at the energy system as a whole via a whole of energy system cost

(WESC). Instead the only gains we can generate are efficiency gains under the Commission's building block's model.

Retailer response: pass-through

31. The question of how retailers respond to distributors' pricing (or not) generated much debate within submissions. To that end, the Authority must recognise this being a critical issue with divergent views, and prioritise response accordingly.

32. It is clear that, despite the Authority's efforts to explicitly clarify its views on retailer pass-through, this issue is still far from settled within the sector:

    a. ENA noted that some parties believe the overarching objective of distribution pricing reform is for consumers to see price signals and shift their load in response, to reduce peak demand and minimise network investment.

    b. Other parties, including the Authority, we suspect, view its purpose to be informing choices, by retailers, consumers and/or other agents in the system. The choice by a retailer not to respond to a distributor's price signals in any way (except to increase its prices to pay for more network investment), is a perfectly valid outcome under that perspective. If a consumer elects not to switch away from that retailer, and to pay for the cost of network upgrades, that is their right.

33. It is worth reiterating again that these two perspectives will send EDBs down very different development and design routes for their pricing. In the former, the EDB must understand consumer preferences, elasticities and other factors to work out how to engineer the desired response from consumers. With that intent, simplicity and understandability for consumers is a highly valid consideration. This kind of development is a significant undertaking for EDBs, requiring material investment in research to understand consumers' preferences.

34. Under the latter world view, EDBs are simply signalling costs to retailers. The role of consumer engagement (or not) is left entirely to the retailer. Simplicity need not be a consideration in that world, as retailers are (in general) far more sophisticated than most consumers – those same retailers already have to manage spot prices that vary by node and by half-hour. These energy price signals are not expected to be passed through to end consumers either – again, the retailer works out whether and how to engage consumers in respect of energy price signals.

35. We note that this latter approach is at odds with the Commission's intentions with regards to consumer engagement for the DPP reset, where they have signalled that EDBs must engage with end consumers on their proposed investment plans and report on those interactions and learnings from those engagements within their asset management plans. Noting, however, the irony that the party that is effectively billed for those plans are electricity retailers. So perversely, even though an end user has had input into an EDB's investment programme

they may or may not be charged for those investments in the way described to them by the EDB.

36. As we noted in our initial submission, retailers themselves have mixed views on their role in the system and whether there should be any sector expectation of pass-through. This played out in submissions, as we had expected. For some retailers, it may be the case that they do not have a choice – they may be forced to pass through distributors' pricing exactly, as they cannot manage the financial risk associated with any form of re-bundling.

37. From where we are standing, it feels like until there is a reconciliation of these bipolar views (EDBs price to end consumers to elicit demand response versus EDBs price to retailers to inform choices), the sector will struggle to make progress towards pricing reform.

38. Overall, therefore, to help align expectations, we consider it would be helpful for the Authority to clarify explicitly what it expects retailers to do with evolved distributing pricing, and what it does *not* expect them to do. This will help EDBs focus their design efforts in the right places.

39. While we and other EDBs may find its perspective uncomfortable, a statement from the Authority along the lines of the following (which aligns with its views, as best we can infer them) could provide real clarity for the sector – distributors, retailers and other stakeholders:

> ***The Authority's expectations of retailer response***
>
> When designing their pricing for their retail customers, the Authority does not necessarily want, nor expect retailers to directly reflect to consumers the structure of, or signals within, distribution prices. Equally, the Authority does not expect retailers to reflect the dynamism of energy spot price signals in their retail pricing, or any of their other input costs, such as metering or billing.
>
> The Authority does not see retailer pass-through of price signals (either distribution or energy) as a necessary precondition for cost-reflective pricing to deliver long-term benefits to consumers.
>
> Instead, the Authority expects retailers to respond to evolution in distribution pricing in a variety of ways, recognising the heterogeneity of consumers and the multiplicity of their preferences.
>
> Retailers' responses could include (but will not be limited to):
> - Providing information to consumers on the benefits to the system of shifting load; and/or
> - Managing consumers' loads (for example their water-heating or EV charging), directly or via a third party, in response to upstream price signals, to minimise their purchase costs; and/or
> - Evolving their retail prices in some way, including potentially incorporating incentives for consumers to alter the timing of their consumption.
>
> Evolved distribution pricing will create the incentive for retailers to respond in one or more of these ways. Thus, distribution pricing reform is a necessary pre-condition for retailer response.
>
> The Authority will focus its retail market monitoring on providing transparency on retailer response, and giving confidence to the sector (and EDBs in particular) that the 'thriving competition' it relies upon is driving change in these areas, and delivering the long-term benefits to consumers anticipated.

40. Given that this statement would appear to be at odds with the revealed philosophies of a sizable proportion of EDBs, and even some retailers who advocate transparent pass-through, we would require evidence from the Authority that:

   a. This position is aligned with the objectives of and mechanisms within Commission's regulatory framework, which includes EDB pricing, and aims to promote the long-term benefits of consumers, and that the Commission is 100% aligned with, and approves, the Authority's position. This is essential for EDB confidence.

b. This position is consistent with the Authority's statutory objective, including its new, additional objective. It appears not to have ever been analysed and tested through this lens.

Consumer engagement

41. It was apparent at the Authority's initial meeting to discuss the Distribution Pricing Issues Paper on 25 July 2023, that the regulator had not conducted any form of consumer engagement in its process thus far. Related to the points above, there is concern across a number of stakeholders (including EDBs, transmission, and retailers) that this critical process step has been skipped.

42. Counties Energy explains that:

"Counties is increasingly concerned at the Authority's apparent reluctance to engage with and seek input from the end consumer."

43. Meanwhile, Transpower asserts:

"We consider it important potential consumer concerns about pricing changes are understood and addressed, including through strong stakeholder and consumer engagement. The reasons for the changes and what they can be expected to mean for consumers (including how they can expect to benefit) should be clearly explained."

44. Finally, Nova Energy recommends that:

"Detailed customer research is undertaken to inform the Authority's proposed changes (prior to any changes being implemented). For example, Time of Use pricing could aggravate the impact of 'energy use avoidance' - where customers deliberately avoid using power during peak times to their detriment, if peak periods are priced too high."

45. The Consumer Advocacy Council (CAC) submitted that it is doing its own consumer research, in lieu of any from the Authority:

"The Council is currently carrying out survey research to assess consumers' capacity to shift electricity use to off-peak times. When the findings of this research are available, we would be happy to discuss them with the Authority."

46. All these submissions appear to rest upon the expectation that distribution price structures and signals must, and will, find their way into end-consumers' retail packages. As noted above, and in our initial submission, that does not appear to be the Authority's assumption – it stated that retailers have a range of response options available, just one of which involved

changing their own pricing in some way (and again, even then not necessarily to pass through the signal).

47. It would follow that if distribution prices are simply one input into retailers' proposition development, such consumer research on preferences for *distribution* pricing would be both misplaced and irrelevant. The Authority appears to be firmly of the view that distribution prices are primarily for retailers to respond to, not consumers.

48. Equally, it would follow that understanding consumers' preferences, and designing prices for them, is seen as the realm of the retailers, who already spend millions of dollars per year on this research. Retailers compete with each other and, as a result, the results of their investment in research are not published, but can be inferred in how their propositions evolve over time and consumer take-up rates change.

49. Again, the submissions highlight the clear dichotomy of views, and that questions fundamental to the design and development of distribution pricing are not settled within the sector.

50. Therefore, it seems clear to us that the Authority must either:

    a. make a concerted effort to convince stakeholders that it makes no assumption about pass-through of distribution prices (as noted in our inferred position statement above), and that this is either not necessary, or will only happen in ways that are aligned with consumers' preferences – which does not appear aligned with the view of a material proportion of stakeholders; or

    b. undertake its own research specific to distribution pricing, ensuring it has also well understood the impact of its proposed changes on end consumers.

51. Whilst there is a strong desire among EDBs to engage with consumers on pricing, in the past Vector has faced challenges from retailers who hold the direct relationship with the end consumer.

52. Relatedly, we would like to understand more about MEUG's concerns around pricing:

    "MEUG's biggest concerns with EDBs and pricing relates to a lack of transparency around the pricing process and a lack of consistency in EDBs practices and information provision. These issues are particularly apparent for MEUG members who have operations across the country (for example, Fonterra and Countdown), and it highlights the variation in both the performance and customer-focus of EDBs."

53. All end consumers will have a retailer to provide the transparency in pricing, with the distribution element of the end user's bill being on average less than a third of the total. If a consumer is on a non-standard contract with Vector, they will have a customer care manager looking after the relationship.

Retailer response: accommodation and implementation

54. As with pass-through, there is inconsistency between the retailers' submissions on the issue of implementation and accommodation of evolved distribution prices. Some warn of the "lack of technology and systems" and that "certain non-uniform price structures from distributors are challenging for retailers to adopt" (Mercury), whereas others are embracing the opportunities enabled through more complex and innovative pricing evolutions – such as Ecotricity:

> *"We are currently responding to EDB pricing signals through our VPP programme, particularly within the Vector network, where a zero-rated off-peak component was recently added. We are in a position to respond immediately on any network that introduces effective peak / off-peak pricing signals."*

55. The Authority highlighting these kinds of examples as part of its retail monitoring will go a long way to reassuring sector stakeholders that the retailer response it expects and relies on is occurring.

56. This conundrum between retailers makes it very challenging to scope out the best ways to elicit a retailer response – e.g. complex vs simple pricing. In any case, it would be even more challenging to provide both options for each of our tariffs just to appease all retailers.

57. A fundamental design question for EDBs is whether it is *our* role to provide a*ny form of averaging* of cost-reflectivity in our pricing (e.g. should we average a critical peak signal into standard TOU pricing, just because that is the preferred structure for some retailers), or whether averaging is purely something the Authority feels *should be left to retailers*. Any averaging we undertake at the behest of less sophisticated retailers (for example turning a dynamic, critical peak signal into fixed-profile TOU) not only risks foreclosing opportunities to those more sophisticated and wanting to innovate and deliver great outcomes to consumers, but it will lead to over-management of consumers' resources (i.e. they will be controlled for far more periods than is necessary). Clarity would be helpful.

58. To that end, Vector endorses the ENA's overall position on retailer response:

> *"It would be extremely helpful to EDBs and the industry more broadly, for the Authority to clarify its position on retailer pricing, and whether it desires to ensure incentives for retailers to manage and respond to EDB pricing are as strong as possible. This will create the greatest chance of those EDB prices influencing end consumers' decision-making."*

Link to the default price-quality path

59. To conclude, we urge the Authority to engage thoroughly and continuously with the Commerce Commission on the outcomes of the IMs review and the ongoing DPP reset process. Vector has already raised this, but we are not alone in voicing our concern.

60. Wellington Electricity warns:

> *"A network's customer capital contribution policy must align with a network's allowances. Any change to how a network calculates capital contributions must also be reflected in their available allowances. EDBs have already submitted their capex schedules that will inform the network price reset and they have one more chance to adjust these schedules for any significant changes in December 2023. After December, networks will not be able to change their capital contribution approach without either reprioritising other capital projects, incurring regulatory penalties (networks will be penalised 25-35% of any overspend of their regulatory allowances) or the Commerce Commission allowing networks to reopen their price paths."*

61. And ENA outlines:

> *"The Commerce Commission's (Commission) Input Methodologies review and Default Price-quality Path (DPP) reset are underway. From a practical perspective, any control options from the Authority will come too late to be reflected in price paths and revenue allowances determined by Commission for the 2025-2030 regulatory period. ENA would like to have visibility of the ongoing dialogue between the Authority and the Commission to ensure the overlaps between the DPP and this workstream on distribution pricing are understood (see 53V of Commerce Act). The outcomes of this engagement should be clearly documented in both parties' consultation papers."*

62. The Authority must grasp the knock-on effects of some of the sweeping changes that could come out of this pricing reform workstream. To reiterate the point made by Wellington Electricity above: capital contributions reduce EDBs' financing requirements. Without those contributions from connecting customers, EDBs would need to finance those works themselves (for recovery via price-quality paths). That additional burden could come at a time when EDBs are already facing profound financing challenges from the substantial investments required to enable electrification.

Yours Sincerely
For and On Behalf of Vector Limited,

Richard Sharp
GM Economic Regulation and Pricing