

CONSUMER COALITION ON ENERGY (CC93)

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David Caygill
Chair
Electricity Commission
PO Box
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via email: bronwyn.christie@electricitycommission.govt.nz

Dear David

Distribution Pricing Methodology

The Consumer Coalition on Energy (CC93) welcomes the opportunity to provide a submission to the Electricity Commission on its consultation paper entitled 'Distribution Pricing Methodology' dated 5 June 2009. Our comments are set out below.

CC93's Interest in this Issue

CC93 has a strong interest in the regulation of lines businesses. This interest is underpinned by a desire to ensure that the:

- a. regulation of lines businesses is effective, and in the best long-term interests of end-consumers; and
- b. practical implementation of the regulatory framework is, as a whole, cost effective and does not impose any undue or unexpected transaction costs on third parties.

Therefore it is important that the Electricity Commission does not, in its focus on lines businesses and their relationship with retailers, overlook the interests of end-consumers

in the electricity supply-chain. This is particularly relevant where changes to lines businesses' prices impact on retail tariffs.

A Clear Case for Regulatory Action Exists

CC93 considers the case for greater regulation of distribution companies to be clear with the market failure associated with natural monopolies being reasonably well understood. Competition is limited (if not non-existent) and the incentives to act as if competition existed must be mimicked by regulation. Regulation, on this basis alone, would be to the long-term benefit of end-users. However, regulation in this area is also likely to extend to the retail market. By eliminating inefficient pricing and access arrangements, transaction costs can be reduced and entry costs lowered.

As is invariably the case, a number of key questions arise when considering the case for greater regulation - these being:

- a. the type of regulation (e.g. principles or 'fixed' methods);
- b. the nature of the regulations (e.g. voluntary or mandatory); and
- c. which entity should develop and be responsible for them (e.g. the Electricity Commission or the Commerce Commission, or both).

Fundamental to these questions is how to establish the point at which the trade-off between economic efficiency and innovation produces a net public benefit. That is, to find the right point on the spectrum between standardisation (mandatory or not) and flexibility.

CC93's Proposed Way Forward

CC93 has the following views on these matters:

1. While there are certain obvious attractions to the use of a standard methodology, the hard-learned lessons of Vector should not be lost on the Electricity Commission. It is clearly possible to use a principles-based approach to develop a robust and durable pricing methodology. Vector, in its presentation to a recent Electricity Commission workshop dated 17 June 2009 set out some principles. These were:
 - a. no cross-subsidies;
 - b. discourage uneconomic bypass;
 - c. cost-reflective;
 - d. signal costs of new investment;
 - e. signal price-quality trade-offs;
 - f. Ramsey compliant;

- g. price stability and impact on customers is considered; and
- h. tariffs should not place undue transaction costs on retailers and consumers

While the Electricity Commission’s proposed principles are a sound start, the Electricity Commission should ensure that the principles set out in paragraph 5.5.1 of the consultation paper are of a broader nature;

2. The use of a principles-based approach does not exclude the use of a standard methodology. A principles-based approach implies the retention of a significant degree of flexibility by the distribution companies. But CC93 considers that this should be tempered by the adoption of a standard methodology. However, rather than reporting on variations to a standard, the onus should be on the distribution companies to first justify its unique circumstances for use of the non-standard approach. The fundamental basis for any deviation must be the delivery of long-term benefits to end-consumers and so the views of retailers and consumers should form a part of this justification. The presence of an Administrative Settlement with the Commerce Commission should, for example, be sufficient justification. This approach could be expected to drive positive change for end-consumers and achieve it quicker;
3. CC93 considers that a strong case exists for the standard methodology to be applied as a default. The standard methodology should, subject to the discretion set out above, be mandatory and be required to be used where insufficient justification for a bespoke method is provided by the distribution company. This approach places an important discipline on the Electricity Commission – essentially regulators should have the courage of their convictions. Either a sound public policy case to regulate a default standard approach exists, or not. A voluntary standard is a regulatory ‘soft’ option which:
 - a. enables the Electricity Commission to ‘tick’ the Government Policy Statement ‘box’ while having to neither provide clear evidence of a net public benefit of a mandatory standard (default or otherwise), nor describe the actual conditions or timeframe under which the voluntary standard would become a mandatory standard; and
 - b. creates regulatory uncertainty for distribution companies. The risk remains of further regulatory intervention in the form of a mandatory methodology whose final shape may, or may not mirror the proposed voluntary methodology.

CC93 also fails to see how the difficulties set out in paragraph 2.2.2 of the consultation paper (the key paragraph that sets out the main reasons for the choice of a voluntary over a mandatory model) such as:

“many complexities with distribution pricing,geographical differences, historical pricing and cross-subsidies”

can be avoided unless the voluntary model is not widely adopted (thereby diminishing its usefulness); and

4. Finally, CC93 questions whether the Electricity Commission should take this work any further forward. While the obligation arising for the Electricity Commission from the Government Policy Statement is clear, addressing regulatory problems associated with natural monopolies (market access and pricing) would ordinarily lie with the Commerce Commission as New Zealand's specialist economic regulator. The presence of two regulatory agencies, broadly responsible for undertaking similar work – despite the existence of a memorandum of understanding – is neither desirable nor good regulatory practice. The Commerce Commission has a broader mandate, is able to develop pricing methodologies for the purposes of both price control and information disclosure, and has the requisite skills to do so. In light of this, CC93 considers that the Electricity Commission should look to the Ministerial Review for guidance on how aggressively it should continue to pursue this workstream.

Summary

The existence of well-known market failures associated with natural monopolies warrants action greater than use of the Electricity Commission's powers of persuasion and promotion, and the provision of information, guidelines and model arrangements.

CC93 considers that the approach outlined above is consistent with the Electricity Commission's objectives, proportionate, and likely to retain the desired flexibility for innovation. We urge the Electricity Commission to give it serious consideration.

Yours sincerely



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