Submission on Proposed Model Approach to Distribution Pricing Methodology – Consultation paper

From

Contact Energy Limited
(“Contact”)

13 July 2009

General Comments

Contact welcomes the opportunity to provide feedback on the EC's consultation on Submission on Proposed Model Approach to Distribution Pricing Methodology – Consultation paper. Our detailed comments follow using the EC's suggested submission template.

Submission information

Topic	**Submission on Proposed Model Approach to Distribution Pricing Methodology – Consultation paper"**
Submission on behalf of:	**Contact Energy Limited**
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Are there any parts of your submission that are provided on a confidential basis, that you want withheld from publication?	NO

Distribution Pricing Methodology

Question	General comments and response
Q1. Do you agree with the content of these proposed guiding principles? Are there alternative or additional guiding principles that should be considered?	In Contact's view the proposed guiding principles do not adequately cover the guiding principles that of most concern to retailers (the reason that the model approaches to network pricing work was initiated) - pricing structure and prices. Pricing methodology which is more about the allocation of costs and setting of prices to ensure revenue targets are met is of less concern to retailers. Contact considers the model use of system agreement/PAWG set of guiding principles were reasonably well crafted, and does not see the need to amend them apart from some relatively minor tweaking. For example, 5.3.2 (f) should be split such that the important words "transparent, predictable and readily verifiable" are covered in their own "prices" principle while also ensuring the issues raised below are covered (such as avoiding unnecessary complexity, billable, effective prices must equate to published prices). Alternatively, if the pricing methodology/pricing splits in the proposed guiding principles are to be adopted then they need to be modified to ensure the pricing principles cover pricing structure and prices more adequately. With respect to proposed guiding principle (a)(i) Contact considers "avoiding cross subsidization" goes with overly complex pricing. A certain level of cross subsidy should be acceptable within a network region unless there are material differences in costs. For example, a number of distributors have an urban/rural split, yet we note and agree with Orion's comment made at the recent workshop that the increase in price for urban customers to enable a single pricing zone is minimal compared to the much higher pricing that is necessary for rural customers to achieve purity in cost-reflective pricing. In addition pricing categories should not be created for small numbers of customers unless the alternative resultant cross-subsidy is material and unacceptable. As mentioned above the key principles Retailers want captured are largely related to pricing structure, in particular: ▪ Pricing structure should be stable and sustainable, not changing year on year; ▪ Pricing structure should be appropriate to the various customer categories and metering widely deployed, while providing signals for efficient use of the network. For example: ❖ There is little point in having summer/winter pricing or loss factors for domestic customers who cannot shift load from winter to summer, but if a distributor has summer/winter pricing or loss factors then retailers are either forced to repackage (cross subsidise) or pass through transparently with the added complexity of changing prices to customers twice a year.

	❖ It is inappropriate to have critical peak pricing for domestic customers when it is not supported by the metering infrastructure widely deployed, and even then critical peak pricing for domestic consumers will likely be counter productive for most customers as the amount of load shifted at peak periods via consumer demand response will likely be less than the amount of load able to be shifted at peak periods by involuntary control of hot water load by distributors. ▪ Prices must be predictable and billable, and not pass on network pricing risk to retailers who in turn are forced build additional risk into retail prices. The key requirement is that there should be certainty of cost at ICP level in published prices. For example, the following circumstances leave the retailer with unpredictable line charges and having to deal with network pricing risk, and an inability to provide transparency to those customers who request transparency. ❖ Prices that include a scaling element when billing line charges, where metered volumes are scaled to allow for losses such that the effective price to the retailer is not the published price. Retailers can only implicitly or explicitly bill customers for line charges based on the customer's metered volume and published prices, so any scaling results in unpredictable costs and transparency issues; ❖ Prices that are not directly recoverable without repackaging; ❖ Prices that are not billable using standard billing systems in the industry; ❖ Bulk charges for line services not included in published prices (e.g. transmission administration charges); ▪ Prices must be practicable to implement and not unnecessarily complex when simpler pricing would achieve essentially the same customer behaviour, same demand profile on the network, and same revenue for the distributor. ▪ All fixed prices should be daily rather than annual, reflecting a competitive market (daily switching) and not exposing retailers to revenue risk should the customer close its business or shift location. Several distributors set annual charges/prices - some expect to recover the annual costs off the retailer if the customer closes its business or shifts location to another network area, while others accept this circumstance as the distributor's risk.
Q2. Do you agree that the RDM should be the preferred approach?	Contact strongly supports the RDM being the preferred approach. WDM fails to reflect the fact that delivery service is to the ICP and not the GXP, transfers network pricing risk to retailers and retail pricing risk as actual input costs by ICP are unpredictable, causes administrative issues with respect to the application of transparent and predictable pricing to customers, and also adds cost with multiple reconciliation and invoice reprocessing for each month due to

	the need to align invoicing with the reconciliation cycle.
Q3. Do you agree with the proposed approach to the allocation of costs (as set out in figure 4 and table 2)? Please provide specific comments on: - load dependent costs - load independent costs, including: - Geographic zones - Asset groups - load group classifications - AMD and CPD to allocate the network asset group costs to load groups -transmission costs	Contact does not have any particular views on how the costs should be allocated to asset groups and load groups, however we are very interested in the load group and associated pricing structure chosen to recover the required revenue. The consultation paper figure 4 appears to provide a good load group structure, and basis for allocating costs, so then the key remaining issue is pricing structure. Contact agrees in figure 4 that for General Connections domestic consumers should be classed separately from non-domestic consumers, however the key point that may not be obvious is that capacity charges for domestic consumers must be avoided as they create issues for compliance with the low fixed charge regulations. Contact does not object to capacity bands as a definition for load groups, provided that the domestic/non-domestic split is made first. Furthermore distributors should avoid distinguishing between domestic and non-domestic variable rates with the same capacity.
Q4. Do you agree with the proposed approach to allocating the net benefits of deferred network augmentation?	Contact believes that the approach outlined provides a reasonable basis for rewarding deferred network augmentation.
Q5. Do you agree with the proposed approach to signaling critical peak periods and shoulder periods via distribution prices?	Contact agrees that this is appropriate for large customers with half hour metering, however it is not at present appropriate for mass market/profile customers as there would be no way to accurately bill critical peak/shoulder and off peak rates until AMI infrastructure is deployed widely and retailers have put in place billing systems that have capability to use the more complex data. If distributors were to price in this manner in the absence of the AMI infrastructure and supporting systems, retailers would be forced to repackage the rates based on their own profiling assumptions and this would cause additional unwarranted complexity, administrative burden and pricing/revenue risk. Furthermore it would be impossible to provide transparency to customers who requested distribution and energy splits. In the meantime, profile customers should be sent price signals with respect to the available hours of control on their tariff, e.g. uncontrolled (no ripple) rates should be higher than controlled (ripple) rates and be based on available hours of control. When in future AMI is widely deployed across all retailers and in all network areas, and billing systems are able to

	support this type of pricing for mass market customers, and the trade-off between distributor driven peak load management and consumer demand response is fully understood, this approach could have real value as it will incentivise demand side response through clearer price signalling.
Q6. Do you agree with the approach to structuring distribution prices?	It is not clear whether this question relates to price signalling only (and discussion on critical peak pricing), but if so then our response to Q5 already covers it. Critical peak/off peak/shoulder pricing proposed for General Connections is simply not appropriate at the current time but it is accepted that when AMI is deployed widely along with the supporting data management and billing infrastructure this approach may have real value as a pricing option as it should incentivise demand side response through clearer price signalling.
Q7. Do you agree with the model structure? Are there reasonably practicable alternatives?	Contact largely agrees with the model structure in the PAWG report, subject to • The necessary modifications to support only the RDM; and • Recognition that for General Connections the model pricing structure should reflect the impracticality of having critical peak period pricing in the absence of wide deployment of smart metering across all retailers together with billing system capability to enable the pricing to be implemented. Accordingly for General Connections Contact notes: ▪ Distribution pricing structures should be practical to implement for retailers, avoid unnecessary complexity, and accept that a level of cross subsidisation is not counter productive where additional complexity or zone pricing adds little if any value to improving network utilization and investment. ▪ Regulated low fixed charge pricing already distorts cost-reflective pricing and adds significant complexity. ▪ Prices should be predictable and billable using current metering infrastructure, be practical to implement, and enable transparency where demanded by customers. ▪ Where appropriate pricing should encourage future innovation in demand side response. ▪ While it may be administratively simpler for retailers if distributors all adopted the same structure, Contact believes there may be a risk of stifling innovation. However in some network areas the current pricing structures (and loss factor structures which also influence pricing) are overly complex and/or are inconsistent with the pricing principles of most importance to retailers, so some changes are necessary to reduce pricing risk passed through to retailers and lower the barrier to competition for new entrant retailers. ▪ There should be a universal definition of “domestic” consistent with the low fixed charge regulations.

	▪ General Connection domestic consumers should be classed separately from non-domestic consumers, and capacity charges for domestic consumers must be avoided as they create issues for compliance with the low fixed charge regulations. Contact does not object to capacity bands as a definition for load groups, provided that the domestic/non-domestic split is made first. Furthermore distributors should avoid distinguishing between domestic and non-domestic variable rates with the same capacity.
Q8. Do you agree that the proposed model approach meets the guiding principles appropriately?	Subject to modifications to the guiding principles to accommodate the issues raised in our response to Q1 above, Contact agrees that the proposed model approach meets the guiding principles. Furthermore the proposed approach needs to take into account the current limited deployment of AMI infrastructure and supporting billing systems. Contact notes that the principles-based approach with an intermediate level of detail specified in the input methodology, as per the Commerce Commission's Gas Authorisation for Powerco and Vector, appears to be leading to positive results for retailers given the rationalization in pricing structures.
Q9. Do you agree this is an effective and practicable approach to monitoring uptake? Are there alternatives that are more effective and practicable to implement?	Contact considers that this would appear to be a reasonable approach in the event of the model being adopted, or guiding principles mandated. However Contact would also recommend that an industry review occur one year after finalization of the model to see whether it is driving the desired changes. In this context Contact notes there has been very little uptake of the model use of system agreement, due in part to the delay in completing the alignment work.