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Commerce Commission
PO Box 2351
WELLINGTON

Email: regulation.branch@comcom.govt.nz

Dear Sir/Madam,

SUBMISSION ON PROPOSED COMPLIANCE REQUIREMENTS FOR THE 2015-2020 DPP FOR ELECTRICITY DISTRIBUTORS

This letter constitutes Unison's submission on the *Proposed Compliance Requirements for the 2015-2020 Default Price-Quality Paths for Electricity Distributors* ("Consultation Paper"). Unison has read and contributed to the development of the ENA's submission and supports its conclusions and recommendations. Rather than repeat the analysis in the ENA submission we focus on one key issue – incentives for price restructuring.

The Commission states that price re-structuring activities would be excluded from the scope of activities eligible for recoverable costs under the energy efficiency and demand-side management incentive mechanisms (para 7.2.1 of the Consultation Paper). The Commission does not explain why price restructuring is excluded from the mechanism, or how EDBs would otherwise be incentivised to restructure prices to promote more efficient use of their networks, but specifically seeks comments on whether the compliance arrangements facilitates price restructures (para 6.2 of the Consultation Paper).

From Unison's perspective, price restructuring potentially offers a significant means of encouraging efficient network use. By focusing charges on particular behaviours (e.g., higher prices on consumption at peak times and lower prices to reward consumption at off-peak times) there is significant potential to improve network capacity utilisation and defer future capacity upgrade investments. However, price restructuring carries with it significant revenue risks. In particular, in setting prices an EDB has to estimate the extent of consumer reaction to any new pricing structure. For example, in reaction to stronger peak-time pricing signals consumers may chose to either change the timing of their activities (pre-heat a home in off-peak periods) or substitute to alternatives (e.g., gas space heating). Either response will reduce revenues, but with no immediate benefit to the EDB from reduced costs.

In combination with the Commission's proposal that no D-factor would apply to revenue losses due to price restructuring, the proposed compliance requirements that require an EDB to use actual quantities, creates a substantial deterrent for price restructuring. For example, if an EDB moved to a peak/off-peak approach to pricing from a current flat-rate structure, in calculating compliance with the price path the EDB would have to apply the new prices to actual quantities from the t-2 period in the peak and off-peak periods. However, in the actual assessment period, it would be expected that quantities would decline in the peak period and increase in the off-peak period, such that an overall revenue reduction would occur.

The requirement to use actual rather than estimated quantities presents a clear barrier to price restructuring. The risk of revenue shortfalls from price restructuring is compounded by the fact that an EDB may only receive at best partial benefits from reducing future capex. Under the Commission's capex incentive proposals an EDB undertaking a price restructuring would only be able to retain 20% of any future avoided capex, even assuming that the avoided expenditure was represented in the EDB's capex forecast, which may have been capped under the Commission's proposals for capex forecasts.

Overall, Unison submits that the combination of the Commission's approaches to price restructuring under the proposed D-factor scheme, the compliance framework for treatment of quantities under the DPP and approach to retention factors under the capex incentive scheme create a strong barrier to price restructuring, and therefore is inconsistent with the requirements of section 54Q of the Commerce Act.

To address these barriers, Unison submits that where an EDB restructures its prices to achieve energy efficiency or demand-side management objectives, an EDB should have the opportunity to estimate the impacts of the price restructuring on quantities in each price category, and have these estimates approved by the Commission prior to setting prices. These effects are likely to need to be considered over multiple years, as long-run demand elasticities are higher than short-run demand elasticities.

At the end of each assessment period, an EDB undertaking a price restructuring should then be required to estimate the actual movements in quantities against the forecasts and implement a wash-up as a recoverable cost. This would ensure that differences between the actual and estimated consumer response do not result in undue revenue shortfalls or excesses. The precise means of carrying out this calculation might depend on the nature of the price restructuring, so rather than seek to define the calculations prescriptively in the DPP Determination, these could form part of the EDB's proposals to the Commission when seeking approval for the estimated quantities to be used in any price restructuring. The overall objective of putting in place such an arrangement would be to reduce the risk to the EDB and its consumers that a price restructuring creates shortfalls or excesses in revenues.

Unison submits that the approach outlined above would be consistent with the requirements of section 54Q, by providing a basis where an EDB would not be deterred from restructuring prices to achieve demand-side management objectives. If the Commission does not accept this proposal, (or does not put in place an alternative) that addresses the concerns raised with the proposed compliance framework, then Unison requests the Commission provide an explanation of how the Commission's current proposals promote and (do not discourage) efficient tariff restructuring.

Unison notes that even though we have introduced a time-of-use ("TOU") structure as a tariff option for residential users, the differentials between peak and off-peak rates and the corresponding flat-rates under our conventional tariff options are minimal.[1] Accordingly, there

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1 See Unison's published tariff options available at http://www.unison.co.nz/site_resources/library/PUBLICATIONS%20AND%20DISCLOSURES/Prici

has been no uptake of this option despite the availability of smart meters capable of producing TOU data. We have been reluctant to increase the differentials due to revenue risks and in this year's consultation with retailers we will be seeking comment on a proposal to remove TOU rates as a tariff option to residential consumers. Although our preference would be to strengthen the TOU differentials, because of the revenue risks we are not prepared to do so. The reason for proposing to remove the TOU option is to reduce transaction costs for retailers, given on-going criticisms of EDBs for having too many tariffs.[2]

Thank you for considering this submission.

Yours sincerely

Nathan Strong
GENERAL MANAGER BUSINESS ASSURANCE

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ng%20Information/Pricing_Information_2013/Unison_Electricity_Distribution_Line_Charges_2013_HB.pdf

2 We are having to consult with retailers on potential removal of TOU rates now due to our timeframes for finalising tariff structures in advance of setting actual tariffs.