

Orion delivery pricing

Response to consultation and progress update

7 November 2017

1. Background

On 28 August 2017 Orion issued a consultation paper targeted at retailers and consultants seeking feedback on the future direction of its electricity delivery pricing, including several initial proposals for implementation from 1 April 2018.

We received feedback from seven electricity retailers, and feedback from a solar supplier, an industry consultant and a customer group representative. Our thanks to those that responded.

This paper summarises the feedback, responds to some of the specific points made, and sets out our intended direction for this year's pricing update. We have not yet reached firm decisions on the changes we will make as we have additional customer and stakeholder interaction and feedback to consider. Any changes will be confirmed in a decisions paper closer to the end of this year.

2. Direction for next year

As a summary of the discussion in the following sections, for our pricing next year we intend to:

- Continue to consider and develop a basis to implement a 15 cents per day fixed charge for all general connections. We acknowledge the feedback requesting that the adjustment be used to reduce the peak period price, and that the charge only be applied for connections where the power is on.
- Progress our changes to major customer pricing, extending the loading range where customers can elect to be in the category, increasing the base daily fixed charge and applying a minimum 300kVA to the metered maximum demand charge.

3. Summary of feedback

This section sets out the main themes and points that we took from the feedback provided, and includes our response in some areas. We are not specifically seeking further feedback on this, but we think it is useful to develop our thinking in an open and transparent way, and we expect further discussion and consideration will occur in most areas.

3.1 Identifying the problem and applying pricing principles

We asked if we had captured the issues with peak pricing and how we should weight these issues. We received a range of responses. In general, the larger retailers agreed that we had captured the issues and reinforced how these affect them. Smaller retailers elaborated, pointing out additional issues including the need to add a retail margin to reflect the risk faced, and the ability to game through seasonal switching and post-winter customer acquisition.

Two of responders did not agree that we had captured all the issues, citing other factors such as return on investment, reliability and fairness and, in one case, suggesting that we need to embrace solar PV. These responses are either addressing wider regulatory issues, or appear to be at odds with the majority, our regulators and the direction of the industry in general.

In terms of the weighting of the issues, we also received a range of responses. Most suggested that the most important aspects are simplicity, being billable by the retailer and actionable by the customer. However, compared to previous responses on this issue, several larger retailers have moved to being more tolerant of complexity, suggesting that the role of the retailer is to deal with risk and complexity, and to rebundle in a suitable retail package, with the option to innovate using smart metering information.

While diverse, this feedback provides useful input into the future direction we take with our peak pricing.

3.2 Pricing options for the future

We provided pricing alternatives that we might consider developing and sought feedback on these. Again, we received a diverse response. However, most responders preferred a static TOU price structure, with many citing the move in this direction by other distributors. Unfortunately, the feedback did not address the incompatibility with peak load control, the inefficient signal and response that static TOU pricing provides on non-peak days, or the over-reward of PV mentioned in the consultation paper.

The incompatibility with peak load management is not an issue that we can overlook. Price signalling of any significance at fixed times will simply encourage customers to respond at those times – creating an undiversified load reduction when the price increases, and an undiversified load increase when the price drops. Peaks would occur on otherwise mild, low load days, and peaks would not be mitigated on cold, high load days. In fact on such days peaks might both shift and be higher

Although our concern does not appear to be shared, our view is based on actual experience. In the 1980s and 1990s, Southpower (the energy supplier at the time) successfully promoted night rate water and night store heating to the extent that several electrical districts peaked at 11pm when the low night price applied. To address these peaks it introduced three price tiers, with a progressively lower price for customers that elected for night rates beginning at 12am or 1am. The load response grew, and in the 2000s peaks again appeared – and in 2003 Orion moved to extend the night rate to a 10 hour period beginning at 9pm. This longer flat-price period provided the opportunity for the coordinated switching of night load over many hours, where the customer is indifferent to the switching time (so long as a full reheat is provided).

Static TOU pricing during the day is the antithesis of the position reached with night load management. Customers will not be indifferent to the coordinated switching times, and will seek for their controlled load to be turned off during the high price periods (even if there is no peak), and turned on during lower price periods (even if load is peaking). The problems with static TOU are likely to become even more of an issue with increased uptake of EVs and batteries.

Despite feedback, we would be reluctant to move to a pricing basis where we know that the outcome would ultimately be higher costs and higher charges for customers.

We are also concerned that static TOU pricing would represent a step away from cost reflective pricing compared to our current approach, and most responders included comments supporting cost-reflective and service-based pricing.

Separately and of note, a number of responders suggested a move to ICP based pricing (or options that would require a move to ICP based pricing), where differential volume pricing can be applied for customers with controllable load (a technology specific approach which might become difficult as the range of appliances and control options grows).

One responder (a retailer) voiced an objection to mandatory load control, suggesting that customers should be free to offer it to whichever party they wish. This issue wasn't covered in our consultation paper but is a consideration in our development. Orion's current approach allows customers to elect the level of load control that they offer, and they are free to select the "emergency only" option, where load control is limited to very rare capacity emergencies, leaving customers free to offer controllable load to others – as far as we are aware, none have. Nevertheless, the issue having been raised allows us to re-state our requirements and the options available. Full details are available on our website at: <http://www.oriongroup.co.nz/assets/Customers/RippleControl-OptionSum.pdf>

We would need to upgrade and reinforce our network if customers elected to remove their controllable load from our program and use it for other purposes (and of course our charges would increase). Alternatively, if customers elect to move to a third party aggregator that provided an equivalent peak load management service for a greater reward, then we may need to increase charges to cover that additional cost (as well as the margin collected by the aggregator), and this would need to be balanced against the value of the additional services the aggregator might be able to offer the wider industry with the controllable load.

However, a specific issue for us would occur if a significant number of customers elect to make any such change quickly, and/or if the alternative control approach used by the aggregator led to higher loading levels (which would be very difficult for an independent aggregator to avoid). In these situations we might be forced to augment our network with little advance notice, which can be expensive. Also, once any augmentation has occurred, the additional capacity remains available, and the savings from a managed approach are no longer available in the short to medium term.

In this regard, one retailer suggested that we had not provided in our paper any analysis of the value / relative cost of our service with and without our current approach to load management. We note this point and will seek to address it as our thinking develops.

So, we are very mindful of these additional costs and note that customers provide the sole source of funding to cover such costs. There is nowhere else that money comes from. We are also mindful that we do not have any long-term assurance of access to controllable load, and we note the challenge expressed in the retailer's submission. This uncertainty is one of the reasons we are contemplating an approach where we more explicitly provide a reward for customers that choose to allow us to manage elements of their load.

One retailer questioned why we had not specifically considered the "booked capacity" option. We did not mean to exclude consideration of it, but we believe that the issues we raised with installed capacity and customer peak demand apply also to booked capacity. We will however keep this option in mind and discuss it more specifically in future work. We also note that fixed charges are likely, at least to some extent, to vary according to the level of capacity provided, which we suspect ends up being pretty close to booked capacity.

Again, this (and the more detailed comments) provides useful input into our future direction.

3.3 Introducing a daily fixed charge

As a specific change, and a step toward addressing some of the issues identified, we proposed to introduce a universal 15 c/day fixed charge for general connections. Almost all submissions either supported or did not object to this change. One suggested taking the additional step of classifying customers and applying higher fixed charges where allowable under the low user fixed charge regulations. However, a large retailer objected on the basis that the low user fixed charge regulations look likely to change and we should wait – in response to this specific point, we consider that we need to progressively introduce the fixed charge to avoid price shock, and the near universal 15c/day level is an appropriate first step.

Several submitters suggested that the introduction of the fixed charge should be used to offset and reduce the peak price, as this, to an extent, will reduce the undesirable features of the peak price.

One submitter requested that the charge only be applied for connections in the “Active” (002) status on the Electricity Authority’s registry, and it is certainly our intention to apply the charge only when the power is on.

The feedback has been useful and we intend to progress this proposal further, considering internal system changes and additional feedback from stakeholders.

3.4 Broadening the major customer category

We also proposed some incremental changes to our major customer pricing: widening the range where customers can elect to be in the category, and increasing the minimum capacity assessment and fixed prices (with a corresponding reduction in other components). We did not receive feedback for or against these changes, but submitters commented that we should mitigate the impact for adversely affected customers, proactively assess the best category for customers in the elective range, and consider the issue of seasonal arbitrage (switching in and out of the category).

We intend to progress this proposal further, better defining the pricing framework and considering how we can incorporate any wider stakeholder feedback. We are looking at options to stagger the introduction in order to better manage the impact on customers.

3.5 Cost reflective vs simple pricing

We asked about the trade-off between more cost reflective and service based pricing (which tends to involve more complexity) and our perception that there is a call for simpler and standardised approaches.

This question evoked the most diverse response. Some stated there is no trade-off (believing their own solution satisfies both), others stated that network peak congestion is not cost reflective (which undermines the basis of the question itself), one stated that complexity is not an issue and retailers can deal with this. However, the most common response acknowledged the trade-off and called for greater consideration of simple and pragmatic approaches, rather than complex more cost reflective approaches.

Of particular note, several submitters suggested that a pricing basis is only cost reflective if customers can understand and respond, so complexity itself can undermine cost reflectivity.

Interestingly, one retailer's response called for more simplicity, despite its response to an earlier question, where it accepted the complexity associated with our peak pricing and saw it as the retailer's role to repackage this.

Clearly we have more work to do in this area to reconcile the regulator's call for cost reflective (but more standardised) pricing, and the diverse views of other stakeholders. We cannot start to define a long term direction until we can reach some sort of conclusion on what we are trying to achieve.

3.6 Progressive change vs all in one go

We asked if we should implement changes progressively or all in one go. Responses were reasonably evenly split between the two. Those favouring progressive change cited the mitigation of impacts on customers, whereas a single change will minimise system and admin costs for retailers.

Submitters provided some comments about specific changes that can be implemented in a single step. Several also suggested that a structural change can be implemented in a single step, with pricing then being adjusted progressively phase in the impact of the changes (this suggestion appears to assume that the structural change itself can be implemented without cost impact).

While progressing some initial changes for next year, we will further consider how we apply subsequent changes, which will include consideration of the actual structure that we settle on to implement.

3.7 Is spot pricing for distribution services in our future?

We asked about views on fully dynamic and geographic delivery pricing, and how this could sit alongside the spot pricing for the energy market. On this question respondents agreed – while each expressed its view differently, all said it was not feasible. Some also suggested that it was not wanted by customers and pointed out the possible adverse outcomes that it would bring.

The Electricity Authority appears to be looking in this direction and we will use the consultation responses to help define and direct the regulatory path as it is developed.

3.8 ICP vs GXP pricing

Separate from our specific questions, within responses and as a separate suggestion, several submitters suggested that we should move away from GXP based pricing to ICP based pricing. This would be a significant move that would likely involve significant system developments and process changes for Orion, but it would provide more options for reflecting costs, and also provide better alignment with the majority of distributors in NZ. To a small extent, our inclusion of a daily fixed charge is a step in this direction. We will consider this change further for our future development.