



Orion Delivery Pricing

Discussion paper

2019

3 September 2019



1. Introduction

This paper follows on from our consultation in 2017 and 2018 which resulted in some initial changes to our pricing along the path of our wider pricing reform. We have now received the Electricity Authority's (EA) pricing "practice note" and we are yet to fully consider its content, and pending the EA's distributor ratings, and the release of the government's pricing review, we are not proposing any substantive changes for next year's update.

However, in this discussion paper we take the opportunity to provide further feedback on the questions we asked and responses from our previous round of consultation. While this is not formal consultation, we wish to continue the conversation to help shape our future reform and we would be happy to receive any comments you might have.

2. Feedback on previous consultation

In our 2017 consultation we set out a wide range of component pricing approaches together with the benefits and challenges of each.

Responses to our 2017 consultation expressed strong support for a volume based time-of-use (TOU) pricing approach, and in our 2018 consultation we focussed in on the issues and challenges that come with TOU pricing. In response to both consultations, we also received strong support for us to move away from our current dynamic peak pricing, or at least reduce the price for this component. Our peak pricing has also attracted similar unfavourable comments in wider industry consultations.

We respond in relation to these two component pricing approaches in the following sections.

Time of use pricing

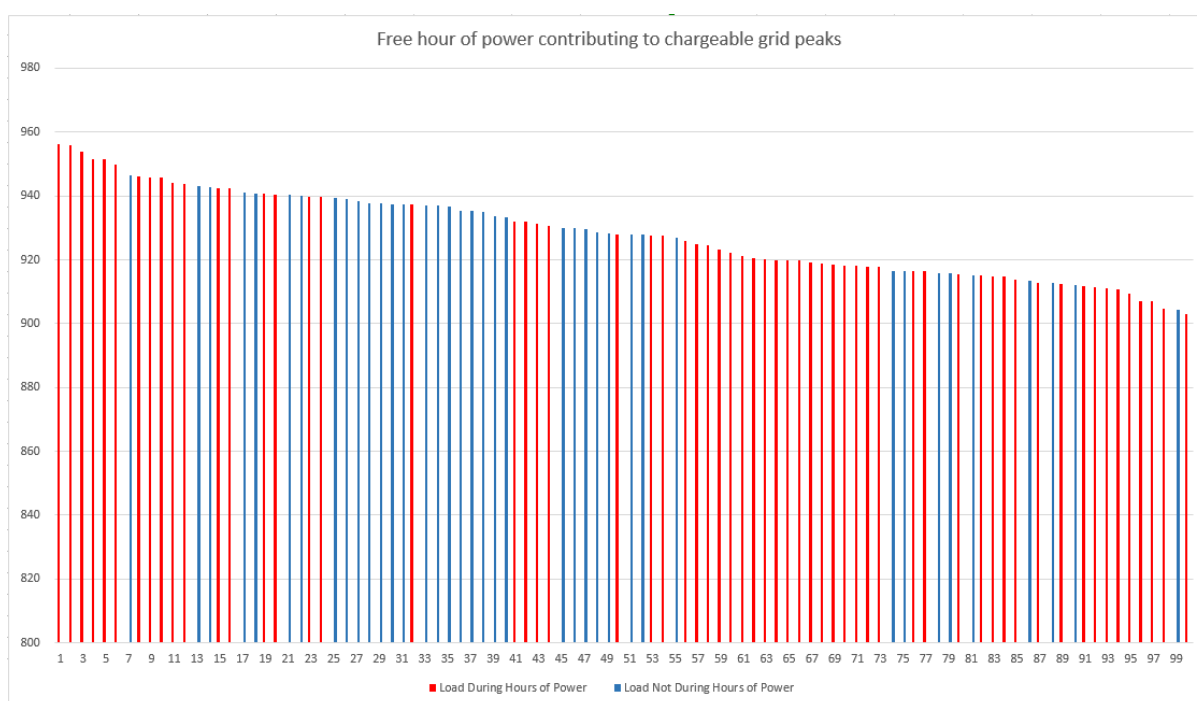
The issues and challenges that we sought to address with TOU pricing can be summarised (very briefly) as:

- There is a conflict between static TOU pricing and progressive (dynamic) water heating management.
- TOU pricing has an adverse impact on load diversity for discretionary load.
- TOU pricing provides an artificial reward for customers with solar PV and/or batteries and this is not addressed with seasonal TOU pricing.
- Many of our weather dependent peaks occur during times identified as shoulder or off-peak TOU times, and traditional peak times often have relatively low loading levels during mild weather.

In 2017 and again in 2018, we did not receive any feedback that would help us address these issues and challenges. Electricity retailers that responded place the emphasis on approaches that are easy to implement, simple and standardised. These are relevant concerns, but they are difficult to achieve without compromising the efficiency benefits of cost reflective pricing.

For example, Electric Kiwi responded telling us that their customers are keen to shift usage in response to the free hour-of-power that it provides. We found this interesting. Looking at the times they allow their customers to select free power we observed that they align with the traditional off-peak times. Looking *more closely*, we observed that 61% of the regional grid peak demands last year, the highest loads for the whole year, also aligned with these “off peak” times!

Free power has an attribute that it not only encourages customers to shift energy usage, it also encourages more usage than might otherwise be the case. **In 61 of the top 100 half hour loading periods for the local grid, Electric Kiwi was encouraging its customers to use more power.** This additional usage comes at considerable cost, a cost that is shared across our customer base. To paint this picture a bit more clearly, the “load duration” graph below shows last year’s peaks on the upper South Island transmission grid, and the peaks where Electric Kiwi was encouraging additional usage with free power (including the 6 highest loadings for the whole year) are shown in red.



We accept that customers might like Electric Kiwi’s pricing approach, but it comes with real costs, and is the opposite of what cost reflective pricing aims to achieve. Electric Kiwi submitted that its sharp price signal smooths out network peaks as customers are incentivised to use electricity at off-peak times. Unfortunately the evidence shows the opposite is true, and Electric Kiwi’s pricing (a form of TOU pricing) is contributing to peaks.

We are also aware that Genesis has been providing its customers with periods of free power, and in its offer there has been no attempt to avoid peak loading periods. The flexibility for customers to choose when they take their free “power shout” means that load diversity is preserved, but the extent to which customers use additional power (that they wouldn’t otherwise use) will have contributed to the peaks. Specifically, we are aware that Genesis offered free “power shouts” in July 2018, when a number of the upper South Island grid peaks shown above were set.

Genesis suggested that multiple steps in price leading in and out of a peak time would help address the step changes in load that might occur if customers respond to a single change in price. While we agree, we do not agree with their suggestion that this would also help align higher prices with when the peaks actually occur.

The Electric Kiwi and Genesis 'free' offerings confirm our concerns that fixed period TOU pricing can cause and shift peaks. For us to underpin such offers with our pricing would only compound the problem as we might find more and more retailers offering zero prices during periods they think are 'off-peak' times.

Powershop suggested that TOU pricing should only apply to discretionary load, and not to controlled load. We went to some length to point out that, in our situation, it is not possible for us to separate the two – the vast majority of the housing stock in Christchurch is not wired that way. We also noted that it would not work for new storage loads (batteries and EVs), and that the controlled load price is effectively constrained by the lowest off-peak price.

We appreciate the feedback that was provided, but we did not find any suggestions that appropriately address the challenges we set out, and (understandably) we did not receive support for the solutions that we proposed. In general, we received support for TOU pricing on the basis that it is simple and easy to implement, can be understood by customers, and is a stepping stone to more cost reflective pricing in future.

From our perspective, we already have an element of TOU pricing (with a working weekday vs night and weekend differential) as well as dynamic peak demand pricing. While for some distribution businesses, TOU pricing might be a step toward cost reflectivity, for us, replacing the peak pricing with TOU would be a step away.

We remain of the view that TOU pricing does not address the issues we are facing and would not result in good outcomes for customers. We are aware that this differs from the direction that is being taken by other distributors, but we can't ignore the facts – our weather driven peak loads do not align with fixed time periods, no matter how much we want them to.

From an economic perspective, with new technologies, any form of volume pricing for delivery will incentivise inefficient investment and / or inefficient usage.

Peak pricing

Responses to our consultation in 2017 and 2018 showed strong support for us to move away from our current dynamic peak pricing, or at least reduce the price for this component.

Our peak price is the main cost reflective component in our pricing, and it is set to match our estimate of the long run average incremental cost of building and maintaining peak capacity. This works in two ways:

- In areas where load is approaching capacity and upgrades might be required, customers are faced with a price that reflects the cost of the upgrade (in the long run), and will make efficient decisions about if and when to use electricity or select alternatives.

- In areas where upgrades are not currently needed, the peak charge provides an appropriate trading price between one customer that elects to reduce their peak load (they will pay less) and another customer that elects to increase their peak load (and pay more).

We acknowledge the points made in submissions, and we recognise the complexity that comes with this price component. And it is appropriate for us to consider and possibly adjust our position in the trade-off between this more-complex and cost-reflective approach and simpler, more understandable alternatives.

However, there are some additional considerations:

- The Electricity Authority, as regulator, is encouraging us to move in the other direction, toward more cost reflective (and more complex) pricing arrangements, and has even suggested locational marginal pricing (which would imply some form of dynamic peak pricing that differs by location).
- If we were to reduce the peak price we would need to instead recover that revenue through other price components. With the LFC constraint on fixed daily pricing – and we note that the government has yet to release or respond to the electricity price review’s final report - the only option for us would be to increase volume based prices, which would compound the issues with volume pricing noted above.

With these additional considerations, we don’t think that we can adjust our peak pricing approach at the current time. We do encourage retailers to voice their concerns to the regulator in relation to its call for more cost reflective pricing and in relation to the restrictive LFC regulations. Changes in these areas will provide more options for us to consider as alternatives to peak pricing.

In the meantime we are:

- heavily involved with the ENA price reform process,
- considering the implications of the latest TPM proposal for the structure of our pricing, and
- considering, given the (disappointing) apparent lack of change with respect to the low fixed charge regulations arising out of the electricity price review, the impact that high volume prices have on commercial customers at the upper end of the general connection category, and how this might be addressed within our pricing framework.

3. Our next pricing update

Our next annual pricing update will apply from 1 April 2020 and will be subject to a default price path (DPP) reset and new regulatory framework (due to be issued on 27 November 2019). To ensure our updates appropriately comply with the new requirements, and comply with the notice requirement in our delivery services agreements, we expect to issue the update by 3 February 2020.

Within this update, we note:

- Following on from our price reduction in April this year, we expect the DPP reset will result in a further reduction in the distribution part of our prices.
- The transmission part of our prices is likely to increase as we return to a higher winter focused RCPD result, which more than offsets the reduction in Transpower's overall HVAC revenue requirement as its RCP3 begins.
- The overall effect on delivery prices of these two movements is not yet known with any certainty.
- We are considering some minor changes to the fixed daily charges for major customers to make them more fit-for-purpose.

Please feel free to contact the pricing team at Orion (pricing@oriongroup.co.nz) to provide any further feedback or clarification on the issues discussed here.