ELECTRICITY PRICE REVIEW

SUBMISSION FORM

Electricity Price Review
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Other Information

Marlborough Lines welcomes the opportunity to respond to the First Report of the Electricity Price Review, (the Report).

Marlborough Lines supports the submission prepared by the Electricity Networks Association. This submission does not aim to restate all the points made by the ENA and its membership. The purpose of this submission is to focus on a small number of key areas which are particular pertinent to us.

This submission does not contain confidential information.

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Summary of questions

Part three: Consumers and prices

Consumer interests

1. *What are your views on the assessment of consumers' priorities?*
Not answered

2. *What are your views on whether consumers have an effective voice in the electricity sector?*
Not answered

3. *What are your views on whether consumers trust the electricity sector to look after their interests?*
Not answered

Prices

4. *What are your views on the assessment of the make-up of recent price changes?*
The Report presents an analysis of the composition of residential prices in 1990, 2004 and 2018. The conclusion is that the distribution component has increased 548% between 1990 and 2018 and that the shifting of distribution charges from business to residential consumers has been a key factor driving the increase in costs for residential consumers. We are concerned by this analysis and consider it to be flawed. 1990 is not an appropriate starting point for an analysis of price components of residential prices. In 1990 the separation of distribution business from generation and retailing had not occurred. Any analysis that tries to split the distribution component from the generation and retail component at that time will be significantly compromised by inadequate data and assumptions.

From 1994 onwards the distribution component of prices were indicated through Information Disclosure. However at that time Marlborough Lines still had multiple roles in the electricity industry with substantial local generation, and providing distribution and retail services.

A more appropriate starting point for the analysis would be either 1994 with some caution, or post 1999. After the separation of the lines and supply businesses in 1999, the costs of providing distribution services on their own became apparent and would have been reflected in the prices charged by the distributors.

With respect to the rate of change of the various price components of residential prices, unsurprisingly, the results of this type of analysis depend on the starting point selected.

If the analysis is undertaken to look at the change in components between 1994 and 2018, our understanding is that distribution charges will be found to be approximately in line with the change in the total retail price. If a starting point of 2004 is used, coinciding with the start of the current data set, then distribution prices have increased at a lesser rate than the overall rate of price increase.

In the absence of complete and consistent data sets we are truly surprised that such a definitive conclusion appears to have been drawn. This finding is then further examined with the analysis on the allocation of distribution costs between residential and business consumers in the technical paper.

Figure 8 contains an estimated breakdown of charges by consumer type and highlights that distribution charges on a c/kWh are least for industrial consumers and highest for residential consumers.

There has been a drive by the regulators in the electricity industry to ensure that distribution charges are cost reflective/service based. Although there are clearly aspects of current distribution costs that are not cost reflective, the variance in distribution charges across the groups portrayed in figure 8, reflect some of the key differences in the costs of providing distribution services to customers within these groups.

We consider figure 8 generally reflects distribution charges based on the Pricing Principles for Distribution and ideologies of the electricity industry regulators.

5. *What are your views on the assessment of how electricity prices compare internationally?*
Clearly the rate of change in residential prices is a key concern. However we consider it is important to ensure a balanced message is provided to generate informed debate. The Minister's message on the very first page of the report states *"We know that in recent years household electricity prices in New Zealand have risen much faster than in countries to which we compare ourselves. We also know that our industrial prices are below average in those same countries."* It is only in the body of the report that it is revealed that even with the recent increases, NZ's residential electricity prices are still well below average in the OECD.

6. *What are your views on the outlook for electricity prices?*
Not answered

Affordability

7. *What are your views on the assessment of the size of the affordability problem?*
Not answered

8. *What are your views of the assessment of the causes of the affordability problem?*
We consider that the low fixed charge tariff regulations are poorly targeted and exacerbating the affordability problem. The impact of these regulations have steadily increased since they were first introduced. The 8,000kWh threshold is higher than the average and median residential consumption level. Marlborough Lines has a dual residential pricing structure i.e. a standard plan and a low fixed charge plan. As more consumers take up the low fixed charge pricing option, distribution prices are increased to recover the resulting loss of revenue. Consequently low-income, high use households face increasing costs to a greater degree that they would otherwise. Currently 70% of residential consumers on the Marlborough network use less than 8,000kWh per annum. 46% of eligible consumers are on a low fixed charge plan. The households with higher incomes who have already adopted new technology avoid distribution charges. These costs get transferred to other households including low-income, high use households. Figure 12 could include solar panels and batteries as factors affecting consumption and price especially in the future.

9. *What are your views of the assessment of the outlook for the affordability problem?*
We agree that it is important to avoid a scenario where some households, likely more affluent ones, can lower their costs by making use of new technologies such as PV resulting in increased charges for other users. We are concerned that any change in prices cause winners and losers and therefore needs to be managed carefully. We are concerned that cost reflective pricing may not benefit low-income consumers and the affordability challenges will require other solutions.

Summary of feedback on Part three

10. *Please summarise your key points on Part three.*
The Report incorrectly attributes a large proportion of the increase in costs for residential consumers to distribution charges. The distribution proportion of charges in Figure 8 reflects the general pattern of the costs distributors incur to provide services to the three consumer groups. We consider that the low fixed charge tariff regulations are not fit for purpose, they are poorly targeted and do not provide assistance to low-income high use households. They are inconsistent with objectives for distribution pricing to be service based/cost reflective and are arbitrary rather than fair.

Solutions to issues and concerns raised in Part three

11. *Please* briefly describe any potential solutions to the issues and concerns raised in Part three.
Remove the low fixed charge tariff regulations and replace them with targeted measures to address the needs of those in energy hardship.

Part four: Industry

Generation

12. *What are your views on the assessment of generation sector performance?*
Not Answered

13. *What are your views of the assessment of barriers to competition in the generation sector?*
Not Answered

14. *What are your views on whether current arrangements will ensure sufficient new generation to meet demand?*
Not Answered

Retailing

15. *What are your views on the assessment of retail sector performance?*
Not Answered

16. *What are your views on the assessment of barriers to competition in retailing?*
Not Answered

Vertical integration

17. *What are your views on the assessment of vertical integration and the contract market?*
Not Answered

18. *What are your views on the assessment of generators' and retailers' profits?*
Not Answered

Transmission

19. *What are your views on the process, timing and fairness aspects of the transmission pricing methodology?*
Not Answered

Distribution

20. *What are your views on the assessment of distributors' profits?*
In Figure 22 and 23 returns are calculated net of posted discounts. Marlborough Lines, (ML), pays a substantial posted discount. Therefore ML's stated return in these graphs appears very low when compared with other distributors. Analysis such as this can be misleading when comparing individual companies.

21. *What are your views on the assessment of barriers to greater efficiency for distributors?*
We agree that there are barriers to the introduction of more cost-reflective pricing structures. Significant barriers are; smart meter infrastructure, workable access to smart meter half hourly data, the low fixed charge tariff regulations and the impact of uneconomic customers. Currently only 51% of residential and small business customers in Marlborough have AMI metering installed. We remain concerned that an increase in the cost-reflectiveness of price structures may do little to help with the affordability of electricity charges for some residential consumers. As a community based, trust owned distribution company we strive to work in the best interests of our consumers. All Trustees are elected by the consumers of Marlborough. ML is exempt from price-quality regulation. We consider the reasons for exempt status are still valid. As shown in figure 22 and 23 EDBs exempt from price-quality regulation do not generally make higher profits. With additional regulation comes additional compliance costs. As well as the Electricity Authority and Commerce Commission costs that we pay through levies, there is also management time and training, the support of external experts, audit requirements and additional governance costs. Ensuring that

regulation is only used when absolutely required would support efficient operation of distribution companies.

Included in the overview of the report is a statement that the panel

"*found factors that may hold back efficiency, including… the quality of governance*."

The report reiterates comments by the OAG and the IEA regarding risks around investing in areas outside of distributor's normal field of expertise. We consider that managing risk is unrelated to the efficiency of operations. We also note there is no evidence or authoritative support provided for this assertion. It seems inconsistent that there are no similar comments made in regards to other parts of the sector which are also facing significant change e.g. Gentailers manage both generation and retail businesses and are embarking on multi-utility strategies.

ML has also leveraged its operating capability through its shared ownership and management of Nelson Electricity.

ML has always undertaken prudent operating and capital expenditure. The AMP shows there is no requirement to escalate capital or maintenance expenditure from current levels.

It is important to note that the investment made by ML outside of the distribution sector has not been made at the expense of investment in the Marlborough network.

ML's investment in Yealands Wine Group has achieved an IRR of 26% over the last three years.

ML's reliability statistics are very good. A graph of recent reliability is included in the additional information. The reliability of the Marlborough network is often only exceeded by those networks that are substantially urban or very small.

We consider Marlborough consumers benefit from retaining community ownership of ML in numerous ways. Most consumers receive a significant annual discount, ($226 per typical residential consumer). Proceeds from investments made, other than in the Marlborough Network, are distributed to consumers annually by the Marlborough Electric Power Trust (MEPT). This year consumers will receive a payment of $200 per consumer as a result of the company's successful investment strategy.

ML also undertakes an independent customer survey annually. Customer satisfaction levels remain high with 95% of consumers satisfied or very satisfied with the Company's overall performance.

22. *What are your views on the assessment of the allocation of distribution costs?*
We consider that the Report's assessment of the increase in prices since 1990 between residential and commercial/industrial consumers is flawed and misleading. The analysis provided in the Report regarding the allocation of distribution costs between business and residential consumers is also misleading. The Report states that "*businesses on affected networks are paying on average less than a proportionate share of distribution costs, and residential consumers are paying more.*" The report refers to an estimated reduction of $90 dollar per year in residential prices should costs be proportionately shared. The analysis including in the supporting technical paper, though interesting, needs further consideration. Our concerns include: 1) The authors qualify their analysis by referring to the model as being "simple"; 2) The results are based on the pricing of only 17 out of 29 EDBs; 3) Key assumptions are based on statements made by a single EDB and metrics from another EDB. Consumption measured in kWh, is not a significant driver of costs. Concluding with an estimate of potential savings that can be achieved by reallocating distribution costs appears to be beyond the scope of this report. The analysis presented looks somewhat like a proposed solution to the affordability concerns. Distribution businesses demonstrate extensive analysis of their costs in their pricing methodologies which are publicly available. ML shares the costs of providing services to uneconomic areas across all consumer groups. The Electricity Authority rightly points out in their letter to the panel that their focus has been on cost reflectivity not fairness. We consider that price reform will only be successful if a broader perspective is taken. The key to successful pricing reform will be: • Simplicity • Customer acceptability • Fairness and equity • Ability to achieve sufficient revenue for safe, reliable operation of the network. The Report notes that many distributors' prices don't differentiate between rural and urban consumers. We consider that in some instances this is because there is a Government policy for equal rates of line charge increases for urban and rural consumers. Section 113 of the Electricity Industry Act 2010 provides for regulation to be introduced to limit prices increasing at a greater rate for rural consumers than for those consumers in urban areas.

The Reports considers the issue of rural urban cross subsidy;

"*Some in the industry argue this amounts to urban consumers subsidising rural consumers. But this does not stand up to scrutiny when revenues and costs are assessed and compared using the incremental-to-standalone measure – except in the case of extremely remote rural consumers*."

We consider this dismissal of an urban to rural subsidy disappointing. Uneconomic lines were constructed in accord with government legislation to facilitate development. They have always been uneconomic and required cross subsidies from other users. We invite those considering the issue to visit the Marlborough network to gain a better understanding of the challenges in this area.

Remote-rural consumers require more distribution network assets to supply their service. The maintenance of these lines is more expensive than for centrally located assets. Some parts of the Marlborough network are only able to be accessed by boat, helicopter or on foot.

The cost of vegetation management in these areas is also high. ML spends more on a vegetation management on a $/customer/km basis than any other New Zealand network.

We conclude vast areas of our network are uneconomic to supply (meaning the revenues received from those customers are not enough to cover the costs of maintaining the network that supplies them) and we do have a cross subsidy between our urban and rural remote customers.

We agree there are issues with complexity of prices, possibilities of consumers disconnecting from the network, fairness and affordability.

However if ML were able to differentiate pricing between urban and rural remote consumers and were not subject to the continuance of supply provisions then the prices charged to our urban consumers would reduce.

23. *What are your views on the assessment of challenges facing electricity distribution?*

Not answered

Summary of feedback on Part four

24. *Please summarise your key points on Part four.*
We consider the analysis on the allocation of distribution cost between business and residential prices is simplistic, not necessarily representative of the industry and therefore question whether the conclusions drawn are valid. Although dismissed in the report, ML's network experiences extreme differences in the costs to provide services to urban compared with remote-rural customers. A discussion on cost reflective pricing is not complete without adequately addressing this issue. It is important that options are provided to distributors to ensure they can take appropriate steps to addresses these issues where required. We consider that the current Government policy regarding the differential pricing between urban and rural consumers' needs to be reexamined. We also consider the continuance of supply obligations force ML to supply uneconomic consumers increasing the prices faced by most of our consumers.

Solutions to issues and concerns raised in Part four

25. Please briefly describe any potential solutions to the issues and concerns raised in Part four.
Allowing EDBs more flexibility with respect to pricing differentials between urban and rural consumers so those consumers face appropriate costs. . The Government consider the provision of support to EDBs to fulfill their continuance of supply obligations in uneconomic areas.

Part five: Technology and regulation

Technology

26. *What are your views on the assessment of the impact of technology on consumers and the electricity industry?*
Not answered

27. *What are you views on the assessment of the impact of technology on pricing mechanisms and the fairness of prices?*
Not answered

28. *What are your views on how emerging technology will affect security of supply, resilience and prices?*
Not answered

Regulation

29. *What are your views on the assessment of the place of environmental sustainability and fairness in the regulatory system?*
Not answered

30. *What are your views on the assessment of low fixed charge tariff regulations?*
The low fixed charge tariff regulations had two objectives when introduced; to support people in hardship and encourage energy efficiency, in terms of a reduction in kWh. There is a general consensus that they are a poorly targeted means of assisting those in hardship. With respect to the other objective of encouraging energy efficiency, the focus has changed from reducing the consumption of grid supplied electricity to de-carbonisation. We consider that these regulations are no longer fit for purpose and should be replaced by more targeted mechanisms particularly for low-income high use households.

Our experience is that the LFC regulations add complexity to distribution pricing and that reform of distribution pricing structures would be easier to achieve if the LFC Regs were revoked.

31. *What are your views on the assessment of gaps or overlaps between the regulators?*

We are concerned that some aspects of the Electricity Authority's work programme may cross over with that of the Commerce Commissions, a recent example is the Distribution Sector Review.

32. *What are your views on the assessment of whether the regulatory framework and regulators' workplans enable new technologies and business models to emerge?*

Not answered

33. *What are your views on the assessment of other matters for the regulatory framework?*

The regulation by the EA and Commerce Commission places significant costs on the industry. The scope of work undertaken by the EA grew significantly since its inception. We welcome the Authority's recent indication that their work programme will be refocused to target key issues and ensure progress is made in a timely manner.

The Tree Regulations are inadequate and impose unnecessary costs and risks on network operators and the public. The Tree Regulations need to be revised to ensure fire, public safety and reliability concerns are able to be effectively addressed.

Summary of feedback on Part five

34. *Please summarise your key points on Part five*.

Solutions to issues and concerns raised in Part five

35. *Please briefly describe any potential solutions to the issues and concerns raised in Part five.*

Additional information

36. *Please briefly provide any additional information or comment you would like to include in your submission.*
See graph below.