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Electricity Authority

WELLINGTON

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Supplementary Consultation of the 2019 Issues Paper proposing new Transmission Pricing Methodology (TPM) Guidelines

Introduction

This is the TPM group's[1] submission on the Electricity Authority's TPM consultation paper dated 11 February 2020 (**Consultation paper**) which presents four refinements to the proposals set out in the Electricity Authority's 2019 Issues Paper.

As you know, the TPM Group is an informal coalition of energy consumer trusts, large consumers, electricity network companies, electricity generator-retailers and stakeholder groups, who have concerns about the direction of the Electricity Authority's TPM reform. These concerns relate to both the process and substance of this reform.

The TPM Group has previously made both a submission and a cross-submission on the Electricity Authority 2019 Issues Paper.

Parallel consultation on strategy reset

The TPM Group notes that in parallel with the current TPM consultation, the Electricity Authority is also consulting on a strategy reset which sets out how it intends to deliver on its statutory objective and what success looks like for it as a regulator. One of the desirable outcomes referred to in this strategy reset is that of "consumer centricity". This is a recognition that consumers need to be at the heart of the Authority's decision-making. As a group we could not agree more.

However, we are not sure that a consumer centric focus has been applied in the priority afforded to this current consultation.

[1] The TPM group consists of Counties Power, EMA Northern, Entrust, Federated Farmers (Northland and Auckland), Horizon Networks, Northpower, Norske Skog Tasman Ltd, Oji Fibre Solutions, Top Energy, Trustpower and Vector

One of the most important matters which we, and other stakeholders, have raised in our prior submissions on the Electricity Authority's 2019 Issues Paper is a concern that the Electricity Authority had not yet robustly established that this reform is in the interests of consumers.

Indeed, we are not even sure that its benefits exceed its costs.

Our expert adviser, The Lantau Group said:

> "*It really is not possible to be strong enough in criticizing the whole way the CBA [in the 2019 Issues paper] has been structured and communicated. The CBA makes points that are clearly contentious or unexpected. It also reaches conclusions that materially differ from all prior work. Clearly the CBA is a lightning rod for concern about "transfers" vs "value creation". And yet, the CBA is presented in just about the most obtuse manner conceivable….*
>
> *When doing this type of work, in. which it is well known long in advance just what the most contentious issues will be, it is imperative to clearly explain and demonstrate in the simplest terms just what is the reason why certain results can be accepted. The CBA utterly fails in this respect.*

Other experts had similar views.

The Electricity Authority must clearly believe that it is able to robustly demonstrate that the benefits of this reform exceed costs, and that it is in the long-term interests of consumers, else it would not need to 'refine' its 2019 Issues Paper proposal.

However, in the context where the Electricity Authority has received submissions from experts outlining the strong prospects that its proposal may result in greater costs than benefits, we think its **first priority** should be to satisfy consumers, and other stakeholders, that its analysis is robust and reliable.

The best way to do this is via a world class cost benefit analysis. However as noted by our expert adviser this has not yet been done.

Instead the Electricity Authority appears to be merely interested in 'ticking the consultation box' before amending four elements of its original design.

Focus of current consultation

These four elements are the focus of the current consultation and relate to:

1) the time profile that applies to the recovery of the benefits based (**BB**) charge;
2) the nature of the BB payment obligations in the case of plant closures;
3) an amendment to the residual charge allocator; and
4) the inclusion of a new prudent discount proposal which has been described in the media as "a lifeline" for the Tiwai Point smelter.

While our members have differing views on elements 2 and 3 of the current consultation, we are united in the view that the constant changes and 'tweaks' to the Electricity Authority's proposal highlight one of the major flaws with the overall methodology- that it is impossible to forecast with any precision who will be the beneficiaries of a transmission asset over its long lifetime. The Electricity Authority and

Transpower will be faced with a constant tension between fixing charges up front to provide certainty and reduce opportunities for 'gaming' and allowing for adjustments to the charge as beneficiaries shift over time.

The groups views on issues 1 and 4 follow.

Issue 1: Proposal to use depreciated historic cost (DHC) instead of indexed historic costs (IHC) when determining the annual amount to be recovered from assessed beneficiaries under the BB charge

The TPM Group <u>does not support this change</u>.

We note the same amount of BB charges will be recovered under either DHC or IHC method, the choice merely relates to the time profile of cost recovery (i.e. is it early/front loaded or late/back-loaded). We think a back-loaded charges are more consistent with a BB approach.

One of the Electricity Authority's reasons for making the change is because of the heightened risk of future disputes over allocations under IHC. This is because there could be a weaker match between the allocation of charges and assessed beneficiaries in the later years of an asset's life and thus less disputes if more of the costs are recovered earlier. The challenges with a greater level of disputes arising under the proposed methodology has been an issue that the TPM Group has raised in the past, however the Authority's proposed solution appears to be a pretty cynical way to protect the durability of a flawed charge.

Transmission assets are typically sized to achieve scale economies. This means that there are likely to be more benefits and beneficiaries of a transmission asset in the later years of a transmission asset's life. All other things being equal, (which of course they won't be) we think a back-loaded cost recovery profile under IHC will result in a better matching of benefits with cost allocation than DHC.

Issue 4: Proposal to allow transmission customers to receive discounted charges where the charges established by the TPM are greater than their standalone costs

The Electricity Authority would like to extend the current prudent discount arrangements, which provide for transmission charges to be abated where an applicant can establish that it can bypass the grid, to a situation where a discount can also be granted if a party can establish to the decision-maker's satisfaction that its standalone costs of transmission supply are lower than the charges assessed under the proposed TPM.

These are two different propositions. In the first case grid **exit is an actual possibility** and the discount can be justified by the fact that if exit occurred, the remaining grid users will have to pay more. However, in the second case the issue is not one of potential exit but of **assessed fairness**. In proposing this change, the Authority is really asking: is the level of charges obtained by applying our TPM Guidelines to this particular applicant **too high**?

In answering this question by reference to standalone costs of supply, the Authority is attempting to find a more objective criteria than its previous "material risk of closure" test. However, this objectivity is illusionary.

This is because the Authority does not propose that the actual costs of standalone supply would be considered, instead it proposes to make assumptions around what the costs would be if certain "inconvenient truths" could be ignored (including, but not limited to, the costs of access to a world heritage site, where access would never be granted). It is not clear from the Consultation Paper what else the Authority intends to include under the term “other considerations”?

The grant of a discount of this kind is not costless; it will result in an increase of costs to all other users.

It also involves a number of contentious and subjective assumptions around what services an applicant receives from the transmission system including in relation to grid reliability, energy security and price considerations.

Against this context there is no guarantee the decision-maker (whether it is Transpower or the Electricity Authority) will get the assessment of the standalone costs right.

If it is too high, consumers will pay excessive costs (potentially triggering further disconnections) and if it is too low, exit will probably occur anyway so nothing will be gained. Consumers will also pay the costs of the debate of trying to establish whether a discount should be offered and what the level should be.

Implicit within this amended proposal are a number of difficult issues which cannot be given adequate consideration during a 3-week consultation period.

The group notes this is not the only fairness issue. As we have indicated in our earlier TPM submissions and noted above there are a large number of fairness issues associated with this TPM proposal.

Against this context, we are concerned that an individual stakeholder appears to have triggered this refinement (which was part of the Electricity Authority’s 2016 proposals, withdrawn from its 2019 proposal, but then reinserted in this current consultation round after submissions from Rio Tinto).

The media already believe that this is an example of the Electricity Authority indulging in corporate welfare. See for example:

- An article on Stuff on 11 February said:

  “The Tiwai Point aluminium smelter was thrown a lifeline by the Electricity Authority on Tuesday as majority owner Rio Tinto nears its decision on whether to scale back or close down the plant with the loss of up to about 800 jobs.”

- The New Zealand Herald on 28 February reported:

  “Rio Tinto met with the Electricity Authority (EA) to discuss the possibility of lower transmission charges, in a meeting believed to have also included Transpower, senior energy officials and many of New Zealand's major electricity generators….. {Minister} Woods appeared to believe the meeting was material to Rio Tinto's operations in New Zealand. " This is a meeting that's happening because people need clarity of what is going to happen with the smelter."

- The New Zealand Herald on 2 March reported:

  “*Arguments over transmission pricing are a zero-sum game. Every dollar one side saves is paid by the other. If Tiwai Point was granted special treatment, consumers in the North Island would face a hike….On Thursday Woods told me she thought it would be a good idea for Rio Tinto to hold a meeting with the Electricity Authority, and that setting up the meeting was the extent of her input. Not only would that suggest Woods was not aware how frequently Rio Tinto meets the regulator already, she seems to be suggesting that the timing of the EA’s significant change of mind on the smelter’s arguments on pricing was all just a massive coincidence*. *Were that the case she should have asked Barrios {Rio Tinto} to stick to that script. Given that the change in*

> *policy could be worth tens of millions of dollars a year to the mining company, surely he would have obliged*"

We also draw your attention to the comments made by the Minister for the Environment David Parker, on 13 February, in the context of a hazardous waste dispute, that the smelter's:

> *" got a history of crying wolf over their financial situation to try to wring out concessions from successive New Zealand governments"*

The TPM Group <u>does not support this change for all these reasons.</u> The proposal has not been well justified in the paper, and there has not been sufficient time afforded for consultation on the proposed changes.

Conclusion

The matters raised in this Consultation Paper highlight the flaws with the proposed methodology. It seems likely that if the Electricity Authority adopts the proposed TPM guidelines, it will have a patchwork of pricing arrangement which are opaque, volatile and deeply discriminatory. This is not going to be good for consumers or investors.

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