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Submissions
Electricity Authority
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By email: submissions@ea.govt.nz

Consultation Paper – Transmission pricing review: 2019 Issues Paper – New Zealand Steel cross-submission

1. Thank you for the opportunity to provide a cross-submission on the Electricity Authority's consultation paper, *2019 Issues Paper – Transmission pricing review* (**2019 Issues Paper**).

2. This submission should be read in conjunction with the submissions provided by the Major Electricity Users Group.

SUMMARY

3. New Zealand Steel continues to have serious concerns about the methodology underpinning the Authority's revised Transmission Pricing Methodology (**TPM**) proposal, for the same reasons outlined in NZ Steel's initial submission on the 2019 Issues Paper dated 1 October 2019.

4. Other submissions provided to the Authority on the 2019 Issues Paper raise similar concerns to the concerns that NZ Steel raised in its initial submission. A substantial number of the 93 submissions disagree (to varying levels) with the Authority's proposal, with a number of submissions challenging the core philosophies and methodology underpinning the Authority's proposal. Significantly, this includes the submission of Transpower – the entity that is closest to the issues because it operates the grid and sees the effect of the TPM in action, and (as Transpower states in its submission) it is "…well placed to provide a balanced, impartial, and informed commentary on the Authority's proposal".[1]

5. The strength of the submissions that raise fundamental issues with the Authority's proposal support NZ Steel's submission that the Authority's proposal will not be durable. If the Authority continues to pursue its current proposal, the TPM review process will continue to be protracted and fractious.

[1] Transpower, *Submission: Transmission pricing review 2019 issues paper*, 1 October 2019, p. 2.

6. As outlined in our initial submission, and supported by submissions such as Transpower's submission, the more pragmatic and durable approach would be to focus on incremental reform (ie, improving the key issues identified with the current regime rather than undertaking radical reform). This may be more efficiently achieved by Transpower undertaking an operational review of the current TPM. This is consistent with Transpower's submission that "[t]he problems the Authority has identified with the current TPM can, in our submission, be dealt with more quickly, more efficiently, and more cost-effectively through incremental reform of the existing TPM and Guidelines. This approach would also carry a lower risk of unintended consequences."[2]

OTHER SUBMISSIONS HIGHLIGHT FUNDAMENTAL FLAWS IN AUTHORITY'S PROPOSAL

7. Our initial submission raised a number of concerns about the proposal set out in the 2019 Issues Paper, including (in summary) that:

   (a) The proposal fails to meet the principles of good regulatory practice, as the proposal is not proportionate, fair or equitable in the way that it treats regulated parties, and is inconsistent with the Authority's statutory objective.

   (b) The Authority's proposed (very large) residual charge methodology is arbitrary and contrary to objective of efficiency, including because the proposed anytime maximum demand (**AMD**) allocator fails to recognise the value of embedded/local generation, and penalises efficient use and would result in inconsistent treatment of different consumers.

   (c) The Authority's proposal lacks credible economic support and ignores the risk of significant damage to dynamic efficiency from moving to imperfect and largely arbitrary rules for allocating transmission costs to customers.

   (d) The Authority's proposal fails to adequately take into account the critical importance of peak pricing in the TPM.

   (e) The proposed benefits-based charge is complex and uncertain, and involves the inappropriate reallocation of the costs of past grid investments.

   (f) The proposed cap on transmission charges does not go far enough to remedy the deficiencies relating to the residual and benefits-based charges, and will not stop price shocks.

   (g) Aspects of the Authority's cost/benefit modelling are questionable.

8. A number of submissions that have been made to the Authority on the 2019 Issues Paper support the concerns that we have raised. Our comments on specific issues raised in other submissions are set out below.

[2] Transpower, *Submission: Transmission pricing review 2019 issues paper*, 1 October 2019, p. 11.

Residual charge methodology

9. NZ Steel reiterates its concerns that the residual charge is disproportionately large and the methodology for gross AMD as the allocator is arbitrary and contrary to the objective of efficiency.

10. The proposal also applies AMD in an inconsistent manner (ie, at the ICP level for direct connect consumers, but based on an after diversity basis for consumers connected to distribution networks). This point is also made in the MEUG submission.[3] In Transpower's submission, Transpower seeks discretion as to the allocator and submits that the residual charge allocation methodology should not be determined as part of the guidelines.[4] While there is merit in this suggestion, if an AMD allocator is to be used, there is an important need for consistent application at the ICP level and this should be included in the guidelines.

Importance of peak pricing

11. We remain strongly of the view that peak pricing is a critical component of the TPM. We agree with Transpower's submission on this point, which notes that the "dynamic efficiency benefits from peak-pricing outweigh any allocative efficiency benefits from their removal" (ie, "the potential long-term economic costs from having a peak signal that is 'too weak' outweigh the near-term costs associated with a signal that is 'too strong'").[5]

12. A number of submissions are consistent with NZ Steel's submission that, although the current Regional Coincident Peak Demand (**RCPD**) charge has flaws, removing the RCPD charge entirely is not the right solution.[6] We urge the Authority to place significant weight on these submissions, particularly given Transpower (the operator of the grid) has serious concerns about the removal of peak pricing.

13. Transpower's submission also raises the fundamental issue that the Authority's proposal may consciously encourage additional consumption during peak periods, with a net result of higher electricity prices and elevated greenhouse gas emissions (which would exacerbate energy affordability problems and compromise the achievement of climate change objectives).

14. We acknowledge that the Authority's interpretation of its statutory objective is that the efficient operation of the electricity industry does not allow consideration of pan-industry externalities such as carbon emissions.[7] While we do not necessarily disagree with the Authority's interpretation of its statutory objective, the idea that the Authority could plough on in a manner that is inconsistent with the Government's efforts to meet its international commitments relating to climate change is questionable. Climate change may be regarded as an externality that, if not addressed, would result in an inefficient allocation of resources in a

[3] Major Electricity Users' Group, Submission: *Consultation Paper – Transmission pricing review*, 1 October 2019, p. 7.
[4] Transpower, *Submission: Transmission pricing review 2019 issues paper*, 1 October 2019, p. C13.
[5] Transpower, *Submission: Transmission pricing review 2019 issues paper*, 1 October 2019, p. 8.
[6] See, for example, Vector, *Vector submission to Electricity Authority – Transmission Pricing Methodology 2019 Issues Paper*, 1 October 2019, p.11.
[7] Electricity Authority, *Interpretation of the Authority's statutory objective*, 14 February 2011, at [2.4.1(b)], [A.60-62], and [A.67(b)].

broad sense, and require other Government action to correct the issue – meaning that the Authority's proposal would not be durable.

15. We urge the Authority to seriously consider the issues that Transpower has raised relating to the impact of the Authority's proposal on encouraging additional consumption during peak periods, and the relevance of the impact that this could have on New Zealand's climate change response, and consequently the durability of the TPM.

Benefits-based charge and the reallocation of costs of past grid investments

16. Our initial submission outlined NZ Steel's concerns about the complexity and uncertainty of the proposed benefits-based charge. Transpower's submission highlights some of the challenges that will be faced in seeking to apply the proposed benefits-based charge, which must be carefully considered by the Authority (given Transpower will be responsible for developing and applying the benefits-based charge component of the TPM).

17. Transpower's submission also questions the Authority's suggestion that an advantage of the benefits-based charge is that participants will have a stronger incentive to engage with the Commerce Commission's grid investment approval process, resulting in more efficient expenditure.[8] Transpower submits that it is more likely to result in the proceedings getting bogged down in private interests and disputes that hinder timely, efficient investment in transmission. Transpower's submission is based on Axiom's expert report, which states that "if the proposal has any effect on the grid investment approval process it is likely to be negative, since it would create more sources of dispute and generate incentives for parties to strategically withhold information".[9] This issue warrants further consideration, particularly in terms of the benefit attributed to encouraging greater scrutiny of grid investments in the Authority's cost-benefit analysis.

18. As outlined in our initial submission on the 2019 Issues Paper, the unusual approach that the Authority has taken in relation to the proposed benefits-based charge has been noted by the Electricity Price Review Panel. The Final Report of the Electricity Price Review (published on 3 October 2019) also highlights the unusual approach, recommending that the government policy statement on transmission pricing (if made) should provide for the reallocation of the cost of past grid investments "only if the Electricity Authority can estimate with a high degree of confidence that such a reallocation will result in substantial, long-term benefits to consumers".[10] The Final Report states that this policy on the treatment of past investments is sensible because:[11]

> *… it minimises unjustified cost reallocations, or "wealth transfers", that are inherently unfair to companies that made investment decisions based on the existing methodology. The Electricity Authority previously proposed reallocating*

[8] Transpower, *Submission: Transmission pricing review 2019 issues paper*, 1 October 2019, p. C7.
[9] Axiom Economics, *Economic review of transmission pricing review consultation paper*, September 2019 (Attachment A to Transpower submission), p. iv.
[10] Electricity Price Review, *Final Report*, 21 May 2019 (published 3 October 2019), p.48.
[11] Electricity Price Review, *Final Report*, 21 May 2019 (published 3 October 2019), p.49 [footnotes omitted].

> *some of the costs of three big investments Transpower has made since 2000 that would move hundreds of millions of dollars of charges from one set of grid users to another for an uncertain and much smaller benefit. A government policy statement could rather guide the Authority to focus on the efficiency of future grid investment – a more important matter than tussling over cost allocations for past grid investments.*

19. For the reasons outlined in our initial submission, the Authority's current proposal relating to the benefits-based charge and reallocation of costs of past grid investments is inconsistent with the Authority's statutory objective and will not result in substantial, long-term benefits to consumers.

Proposed price cap

20. As outlined in our initial submission, NZ Steel supports a cap on transmission charges, but the Authority's proposal does not go far enough to remedy the deficiencies relating to the residual and benefits-based charges.

21. The importance of a phasing in period to avoid price shocks has been recognised in the Final Report of the Electricity Price Review. In particular, the recommendation for the government policy statement in the Final Report suggests that policies (outlined in a government policy statement) that the Authority should have regard to as it prepares new guidelines should include a phasing-in period where necessary to avoid price shocks.[12] As previously submitted, the Authority's proposed cap will not stop price shocks if the cap only applies for a short initial period, because the cap will only delay the inevitable price increases and will therefore not mitigate potential price shocks in future.

22. Issues raised in submissions (such as Transpower's submission) relating to the proposed calculation methodology for the price cap need to be further considered. We also observe that those 'funding' the cap have submitted against the proposal, which raises further durability issues. If the Authority decides to proceed with its radical proposal, rather than focus on addressing key issues with the current regime and undertaking incremental reform as suggested by us and others, we urge the Authority to further engage with participants on the proposed cap once it has considered submissions.

Criticism of Authority's cost-benefit analysis

23. Although NZ Steel has not undertaken a detailed critique of the Authority's cost-benefit analysis, we observe that some submissions raise fundamental and serious issues with the cost-benefit analysis in the 2019 Issues Paper.[13]

24. Significantly, the cost-benefit analysis is subject to severe and detailed criticism from expert consultants including Houston Kemp for Trustpower and Axiom Economics for Transpower. The Axiom expert report concludes, for example, that "it is not possible to conclude that the

[12] Electricity Price Review, *Final Report*, 21 May 2019 (published 3 October 2019), p.48.
[13] Including, for example, the submissions of Transpower, Trustpower, Vector, and the TPM Group, and the report of NZIER for MEUG.

Authority's proposal would deliver a net benefit to New Zealand's economy or improve the overall efficiency of the electricity industry", stating that:[14]

> *The CBA modelling contains some obvious and, in many cases, very serious mistakes. Many of these errors are sufficient in their own right to cast considerable doubt over the efficacy of the estimated net benefit. In culmination, they serve to undermine completely the reliability of that result. In our opinion, the new CBA is just as flawed – if not more so – than its ignominious predecessor.*

25. This strongly suggests that the benefits of the Authority's proposal are not as significant as claimed by the Authority, and the Authority must reconsider its cost-benefit analysis to take the issues with the analysis that have been identified into account.

NEXT STEPS IN THE TPM REVIEW

26. A number of other submissions on the TPM review support our position that the Authority should reconsider its proposal and work further with participants to develop changes to the TPM that are more consistent with the Authority's objective and principles of good regulatory practice.

27. Contrary to Meridian's submission that the Authority "has a duty to issue new TPM Guidelines to address the problems with the current TPM",[15] the Code does not require the Authority to issue new guidelines. Clause 12.86 of the Code enables the Authority to review an approved TPM if it considers that there has been a material change in circumstances (providing that the Authority *may* review the TPM), but does not require (ie, provide that the Authority *must*) issue new guidelines. Further, as outlined in our initial submission, the Authority is not required to radically reform or undertake a wholesale rewrite of the TPM if there has been a material change in circumstances.

28. The Authority should fully assess the submissions made on the 2019 Issues Paper and respond to the fundamental issues raised, before seeking comments on the details of the draft guidelines. One option for achieving better consultation and enabling the Authority to properly consider the different points raised by participants would be to have a conference of the parties, as was done in 2012.[16]

29. If the Authority is not prepared to take on board and address the substantive issues raised in the submissions on the 2019 Issues Paper, it appears likely that a government policy statement will be issued, which will further extend the protracted and fractious TPM review process.[17] It is also possible that the process could be further extended by judicial review

[14] Axiom Economics, *Economic review of transmission pricing review consultation paper*, September 2019 (Attachment A to Transpower submission), p. xxxvi-xxxvii.

[15] Meridian Energy, *Meridian Energy Submission - Transmission Pricing Review: 2019 Issues Paper*, 1 October 2019, p.3.

[16] This is consistent with the submissions of Transpower, which strongly supports a conference as part of the final stages of the Authority's review (p. 1), and the TPM Group, which urges the Authority to consider incorporating a public hearing into the next stage of consultation to help further facilitate this important discussion and provide an opportunity to present directly to the Board of the Authority (p. 6).

[17] We understand from the Government's response to the Electricity Price Review Final Report published on 3 October 2019 that the Government is intending to assess whether a government policy statement on transmission pricing is warranted after considering stakeholder submissions on the 2019 Issues Paper.

proceedings that could be initiated by one or more dissatisfied parties if the Authority does not adequately take into account stakeholder concerns. Proceeding with the Authority's current proposal is therefore likely to result in heavily disputed guidelines and, at best, a non-durable methodology.

30. NZ Steel is ready and prepared to constructively engage with the Authority and Transpower in working through the detail of developing a workable methodology based on guidelines that have broad industry acceptance. However, there remain fundamental issues with the Authority's proposal and NZ Steel sees little value in submitting further on points of detail at this stage.

31. We urge the Authority to re-think its approach to this important subject and find a way to work collaboratively. As set out in our initial submission, rather than seeking to radically reform the TPM, a more pragmatic and durable approach would be to focus on improving the key issues identified with the current regime. This is consistent with other submissions, such as Transpower's submission, which states that:[18]

> *… extensive reform of the sort proposed by the Authority may not be the most effective or efficient manner to address TPM concerns. We consider that the concerns with the TPM may be more effectively and efficiently addressed through measured and incremental reform of the existing methodology. This would have the benefit of bringing the reforms to the market more quickly with a substantially lower risk of unintended consequences.*

32. We look forward to the Authority's response to submissions and information about the next steps that the Authority intends to take in response to submissions.

Yours sincerely

Gretta Stephens
Chief Executive

[18] Transpower, *Submission: Transmission pricing review 2019 issues paper*, 1 October 2019, p. 2.