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Submissions
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Consultation - Transmission Pricing Methodology Review - 2019 Issues Paper

The transmission pricing methodology (**TPM**) has been the subject of intense debate in the electricity sector for almost a decade. Accepting that no methodology is perfect, reaching a long-term, durable solution on who should pay for transmission and how much they should pay must be resolved to enable all affected parties to move forward with certainty and to enable the electricity sector to help decarbonise our economy.

In principle, Genesis supports a TPM that incorporates a benefit-based charge and a residual charge, and we commend the Electricity Authority's (**Authority**) efforts to engage with the industry following the issue of the TPM paper. Some of the proposed changes have, however, given rise to material concerns as reflected in the robust discussions between the Authority and the industry since the TPM paper was released.

We are also of the view that there are opportunities for improvement and as a retailer and a generator, our submission focuses on:

(a) The transitional price cap, which is intended to strike a balance between market efficiency and other considerations such as the impact on customers and acceptance of the new TPM.

(b) Concerns with the modelling and assumptions that support the Authority's cost-benefit analysis (**CBA**) and the Authority's suggested cost impact on customers.

If the price cap is not well designed, it will unfairly impact customers, erode confidence in electricity market mechanisms and detract from wider electrification initiatives. Similarly, for the proposed TPM to be acceptable and durable, there must be confidence in the model used by the Authority and its results.

With over 600,000 customers across the country, generation assets in the North and South Islands, and transmission costs impacting both, Genesis considers that any TPM must not unfairly impact a particular group of transmission customers or the end consumer and that it should encourage efficient grid use.

Genesis believes that it is critical for consumers and for the country that the TPM issues are resolved quickly. New Zealand cannot afford a further lengthy delay on this matter, particularly given the pivotal role that the electricity sector, and future generation connections to the grid, will play in enabling New Zealand to meet its Paris climate change commitments. In relation to the latter, the principle of the first to connect to the grid paying the full connection charge (the so-called "first mover disadvantage") must also be resolved to assist with increasing the electrification of New Zealand's economy.

The transitional price cap should apply to transmission charges only

Genesis supports a transitional price cap that mitigates the impact of the proposed changes on all customers, allowing them certainty and time to adjust. This is because providing certainty and limiting "price shocks" for direct connect and other large customers would also, among other things, facilitate initiatives to electrify other sectors of the economy as part of New Zealand's transition to a low emissions economy.

While the Authority's preferred option is for a transitional cap to apply to increases in the total electricity bill,[1] we believe that the price cap should only apply to increases in transmission charges for the following reasons:

(a) Applying the cap to the transmission component only:

   (i) Is consistent with the objective of mitigating increases in transmission costs arising from the new TPM. It would target the direct effects of the proposed policy change. In contrast, applying the cap to the total electricity bill is fundamentally inconsistent with that objective.

   (ii) Will reduce the complexity of the current price cap proposal which requires Transpower to estimate the total electricity cost for customers on a network. We note that in previous TPM consultations, Transpower raised concerns with the

[1] Excluding retail margins and metering costs.

implementation of the price cap, including in relation to estimating the total electricity cost.

(b) Applying the cap to the total electricity bill will:

(i) Result in pricing inefficiencies as this distorts price signals reflected in wholesale electricity prices and, in essence, provides a subsidy for non-transmission cost increases.

(ii) Penalise customers who have hedged their wholesale electricity cost exposures appropriately and subsidises those who have not. This is not equitable.

(iii) Potentially result in a greater overall increase in costs for customers than would have been the case if the cap applied solely to transmission cost increases.

The Authority states in relation to the transmission cost only option that:[2]

> *"We are not proposing this option because we consider that the electricity bill is more salient to consumers than the transmission charges implicit in it. If we adopted this option, it would make the impact of the proposal on load customers (and mass market consumers) total bills less consistent as grid charges make up a different proportion of the total bill for each customer."*

We note that:

(a) The Authority has not demonstrated the material harm to consumers or to the market that would arise from adopting a transmission cost only approach.

(b) Whether or not the total electricity bill is more relevant to consumers, the Authority's preferred option obscures drivers of increases to the total electricity bill. Transparency is important to ensure that the objectives of the price cap are met.

(c) The rationale:

(i) Ignores large transmission customers (including generators) to whom all components of their energy costs are important.

(ii) Is internally inconsistent. That is, if the assertion in the first sentence is that the total electricity bill is all that really matters, then the inconsistency between bills driven by grid charges referred to in the second sentence is not material or relevant.

[2] TPM issues paper, Appendix B, para. 279.

The transitional price cap should apply to all transmission customers

The transitional price cap should apply to all transmission customers, including generators. We disagree with the view that concerns about certainty and price shocks mainly arise for direct connect customers and residential customers as opposed to generators.[3] These concerns apply to all transmission customers, including generators. Further, although generators are not impacted by the residual charge (except to the extent of their load), they are nevertheless impacted by the proposed TPM changes particularly those with North Island generation.

Accordingly, we see no credible reason why the price cap should not apply to all transmission customers. Applying the cap to all affected parties is a principled and equitable approach and should be the preferred option.

The vSPD Model

Our principal concerns with the vSPD model used by the Authority for analysing the implications of the proposed TPM are that:

(a) the model does not account for how hydro generation offers will change as water values change; and

(b) participants' behaviour concerning transmission network changes, such as to continue generating at a constraint, have not been taken into account.

This failure to recognise market behaviour results in several challenges and illogical outcomes. For example, because market dynamics are not modelled, the vSPD model simply suppresses prices in a region when the export of electricity is limited as a result of particular generation projects being removed.

Given the failure of the model to recognise market behaviour, we question the CBA and the cost estimates for transmission customers presented by the Authority.

To improve confidence in the CBA and the cost estimates, we recommend that:

(a) the Authority use a model that optimises hydro/thermal usage rather than solves for specific scenarios with the majority of assumptions static; or

(b) have the output of the current model peer-reviewed, particularly, where there are large regional price separations, and publish a comparison against the CBA and cost estimates from the current

[3] TPM issues paper, Appendix B, para. 281.

model. This comparison would allow both the Authority and industry to better assess the CBA range and anticipated costs.

The use of a dynamic model is our preferred option.

If you wish to discuss any of these matters further, please contact me on 09 951 9299 or warwick.williams@genesisenergy.co.nz.

Yours sincerely

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