

1 October 2019

Jean-Pierre De Raad
Manager, Network Pricing
Electricity Authority
By email to submissions@ea.govt.nz

Dear Jean-Pierre

Consultation Paper – Transmission pricing review

1. This is a submission by Pan Pac Forest Products (Pan Pac) on the Electricity Authority consultation paper "Transmission pricing review, 2019 issues paper" dated 23rd July 2019 (the "2019 proposal") along with other relevant consultation materials.
2. Pan Pac is a member of the Major Electricity User Group (MEUG) and supports the submission made by MEUG on this paper.
3. Pan Pac will submit on the following issues of the TPM consultation.
 - a) We do not consider the existing TPM to be materially broken. There are aspects of TPM that could be adjusted however there is little evidence that the current methodology has caused widespread economic hardship or widespread inefficient business decisions.
 - b) The residual portion of \$300m of unallocated assets represents 58% of the forecast 2022 total network charges. Transpower must be using a completely different method of valuing the assets otherwise those assets of no benefit would have been financially impaired in a normal business environment.
 - c) Pan Pac supports the method of allocation of asset costs on the value of peak usage of those assets as the network capacity is based on peak usage of the asset and not average energy used through the network.
 - d) Benefit based charges allocation method should be transparent to all users.
 - e) Pan Pac supports a simple price cap mechanism for all users.
4. Pan Pac has answered selected questions and focussed on a few of the topics in the consultation paper. Pan Pac's silence on other questions and topics should not be read as agreeing with that aspect of the proposal.

Pan Pac Background

5. Pan Pac has been operating a Mechanical Pulpmill, Chipmill and Sawmill at the Whirinaki site since 1972 (47 years). The electrical load during this period has been steady circa 450 to 500 GWhr per annum. Pan Pac has paid transmission charges for the direct connection assets and contributed to a share of the interconnection assets for these 47 years.
6. The mechanical pulping process has and will continue to represent most of the electrical load to this site. In 2012 Pan Pac invested in plant to convert 2/3 of the mechanical pulping capacity from TMP newsprint grade pulp to BCTMP Board grades pulp. The relevance of this is that the board grades require lower energy to produce than the newsprint grades, (2500kwhr/adt down to 1000kwhr/adt). Hence future electrical energy demand growth from overall production growth on the site will be offset by our transition to lower energy pulp grades.

Existing TPM

7. Pan Pac submits that the existing TPM methodology is not materially broken. The existing TPM has been operational since 2008 and has provided revenues to develop and maintain the network asset base with high reliability and availability. We are not aware of any businesses or individuals that have undergone material economic hardship due to the existing methodology.
8. The RCPD method of allocation of shared assets is understandable and can be explained to Shareholders.
9. We acknowledge that parties are motivated to reduce all costs of business, however significant business investment decisions have been made under the current allocation rules, hence changing the rules now that results in significant transfer of costs between parties is quite destabilising for future investment decisions by overseas shareholders.
10. Pan Pac has responded to RCPD signals as we have the flexibility in our production environment to do so without significant loss of economic production. Most of the electrical load at Pan Pac is the large refiner motors. The refining process is not the bottleneck/constraint in the overall process. Short periods of load reduction by Pan Pac during the morning and evening peak winter network loads caused by residential consumers is offset by production during non-peak periods. This is in conflict to the EA assertion that users avoiding peak demand is economically inefficient for NZ.
11. We believe that the RCPD signal is a very strong and efficient market signal to maximise efficient usage of the network and avoid premature overbuild of network capacity.

Residual Charge

12. The size of the residual charge is distortionary and undermines the durability of future TPM because some costs recovered confer no benefit to those that are deemed to have to pay.

13. MEUG has estimated that the Unallocated residual charge of \$300m represents 58% of total charges to be recovered based on the forecast 2022 charges.
 - a) The fraction of the \$300m for unallocated residual capital charges and \$200m other unallocated costs including overhead expenses that confer no benefit to those that must pay is not known for sure.
 - b) Pan Pac submits that the EA methodology of determining the value of this \$300M of assets must be materially different to the method used by Transpower in their annual financials' preparation. IAS 36 requires assets to be impaired if they do generate enough cash return. If the EA proposed methodology cannot determine a beneficiary of the assets, then how does Transpower?
 - c) We submit that there should be consistency between the method of financial asset valuation by Transpower and the allocation of asset values to beneficiaries by the EA.
14. With the proposed transfer of the new TPM guidelines to Transpower to more fully implement then we are concerned that the beneficiary method used by Transpower will result in significantly different TPM charges in the final version to those estimated by the EA consultation paper.
15. We submit that on the basis that \$300m of assets have no beneficiary then those assets should be impaired and temporarily written down by Transpower until future time that the assets have an identified beneficiary at which point, they can be written up.
16. Examples of other Government as a shareholder where a portion of the assets have been temporarily written down.
 - a) In 2015 (Air New Zealand Gas Turbines) based on a downturn in the market reduced the value of the maintenance facilities by \$17m. They have reviewed it each year since then and increased it by \$18m in 2016, before reducing it back to \$14m in 2019.
 - b) KiwiRail asset write downs where the rail assets are no longer serving a benefit to users.

Allocation of the Residual Charges

17. Pan Pac submits that any residual charges not allocated by the user benefits method should be allocated on the users ongoing peak utilisation of the network.
18. The design and hence capital applied, and ongoing maintenance costs of the existing network are determined by the peak demand placed on the network, not an average load requirement.
19. It therefore follows that the allocation of the residual charges should be based on the user's peak demand of the network. We submit that using true AMD as the denominator is a fairer method of allocation than a MWh basis.

20. The AMD must represent the true AMD level of a consumer and those consumers for large commercial and industrial consumers should be used at consumer level – rather than a diversified AMD for those users connected within an EDB GXP.
21. The AMD figure should be reviewable on at least a 2-yearly basis. Without the possibility of a review consumers are being forced to pay in the future for assets that they are no longer utilising. We appreciate that over time this may lead to a reduced user base of the network however we consider that would need to be addressed at the time, either by write downs of the network value or review of the allocation of the residual charges.

Benefit-based charges

22. Pan Pac would like to see a more transparent method for describing the benefit based charges. In the case of material increases in TPM charges companies must be able to describe to shareholders in plain English what has led to the determination of those charge increases.

Cap on transmission charge changes

23. Pan Pac fully supports a cap and transition process for changes to TPM. We would prefer a simple time-based transition over say 3 years that is predictable and explainable to shareholders, rather than a complicated multiplier of total energy costs as proposed by EA.

Yours sincerely



Tony Clifford

GM – Pulp Division
Pan Pac Forest Products Ltd

Appendix: Selected Questions from Consultation Paper

Q1 Have the problems with the current TPM been correctly identified? In what ways does the current TPM work well?

Pan Pac agrees that if the assumptions for future network utilisation made by the EA hold true, then the current TPM may not be durable in the long term. However, some of the EA considerations are based on future assumptions, such as what is to be considered a material change in circumstance. C.5 (b) claims “The increasing range of technologies available to electricity consumers are fundamentally changing the way people engage with electricity markets”. While Pan Pac agrees that there is this potential, we do not agree that unproven adaptation of technology should be an input into allocation of costs now.

Pan Pac believes that the current TPM has functioned well to this point in that it has reduced peak grid loading. While the top 100 peaks are determined ex post, it has been possible to respond in such a way that minimises production downtime.

Q2 What are your overall views on the Authority’s proposal for changes to the TPM guidelines?

Pan Pac believes that if change to TPM is required, then the proposed TPM fundamentals of allocating most costs on a benefit-based charge, a small residual charge, and implementing a pricing cap on transmission charge increases for EDB’s and Direct Connects seem reasonable. Pan Pac disagrees with some aspects such as the high residual value used in the proposal, and is unsure about how effective the nodal pricing signal will be to base load industries for reducing peak loading.

Q24 Should charges be revised if there has been a substantial and sustained change in grid use? If so, what threshold would be appropriate to define such an event?

Pan Pac firmly believes that there must be a function to revise charges due to a substantial and sustained change in grid use. Pan Pac’s grid load is primarily from refiner motors in the pulpmill and future developments in that area could change our grid load significantly. It would not be efficient for parties to be locked into a fixed benefit based charge and Pan Pac believes this would make the proposed TPM less durable.

Q29 Should the residual charge be allocated based on AMD, annual consumption, a mixed approach, or some other approach?

Pan Pac agree with the EA’s preferred option of using historical AMD as the fairest way to allocate residual charges as it reflects the true requirements for grid-connected industry and EDB’s.

Q39 Should the TPM include a price cap? Does a price cap of 3.5% of total electricity bills provide a reasonable balance between the desirability of limiting price shocks and the desirability of transitioning to the new TPM?

Pan Pac strongly supports a price cap being included in the proposed TPM. Pan Pac will face a significant increase in transmission charges should the proposed TPM be implemented and having a period of adjustment will help avoid a price shock that may undermine the confidence of our shareholders in the credibility of the NZ Electricity Market.

Q40 Should the price cap be specified as a percentage of electricity bills or in some other way?

Pan Pac believes that the price cap could be simplified to a staged introduction of the proposed TPM (three or four years, uniformly stepped). This makes it predictable for budgeting.

Q44 Should the guidelines include a peak charge? If so, should it be a core component of the proposal or an additional component?

Pan Pac submits that some form of peak network charging is required to increase the average utilisation of the network which reduces early investment requirements.

Q55 Do you agree that nodal prices enhanced by RTP, and supplemented if necessary with administrative demand control, are the most efficient means of constraining grid use to capacity?

We consider this a significant area of unknown risk. Pan Pac statistical analysis of demand versus nodal pricing at our GXP shows a very low correlation. Hedging and other forms of energy contracts could negate nodal pricing strategies for peak demand management in the near term.

Pan Pac has been considering adopting RTP (and DD lite) opportunities for several years now, however it requires IT investment, change in operating strategies and significant user experience before we would consider its application to network load management.

Q57 Do you agree that nodal prices (supplemented if necessary, by administrative load control) will be allowed in practice to efficiently restrain grid use to capacity?

If administrative load controls are required to artificially lift nodal pricing, then by definition we consider this to be an inefficient mechanism.

End.