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SUBMISSION ON TRANSMISSION PRICING FRAMEWORK PAPER

1 Orion New Zealand Limited (**Orion**) welcomes the opportunity to comment on the "Decision-making and economic framework for transmission pricing methodology review" consultation paper (the **paper**) released by the Electricity Authority (the **Authority**) in January 2012.

2 Transmission pricing is controversial. The associated costs are significant. As such it has, not surprisingly, been much discussed and much reviewed. Even in just the last couple of years there have been three major reviews: one under the auspices of the industry Chief Executive's forum, one by the Electricity Commission, and one (subsequent to the other two) by the Authority's TPAG, whose approach and findings were in turn subjected to some external scrutiny commissioned by the Authority[1].

3 At the risk of some oversimplification, we had thought that the first two reviews mentioned above had reached the conclusion that, within the range of options under consideration, it doesn't much matter which one is used – generation will be built in pretty much the same locations (since it is driven largely by fuel availability), and load will go to pretty much the same locations (since it tends to go where load is already, and electricity cost is usually only a relatively small consideration in any case). Moreover the current TPM is not notably and unambiguously inferior to other options considered. On the other hand any material change is very likely to create both significant wealth transfers, and

[1] Before that there was a lengthy period where - most would now agree - insufficient grid investment occurred, and where, for a while, it was unclear if Transpower was even able to require anyone to pay its bills.

unintended consequences. In our view there must be a very compelling rationale for change. We don't think the paper provides this.

4 Transmission pricing currently occurs within a framework that has developed over many years to deal with the specific circumstances of a grid owner. Transpower is an SOE providing a very specific and asset intensive service in a broadly commercial context, not a government department providing services under appropriation, with chargeable services not their core - and certainly not there sole - activity. The TPM has developed following considerable consultation and is now enshrined in the Code and administered by a third party (now the Authority). There is also the wider regulatory framework which, pursuant to Part 4 of the Commerce Act, recognises the natural monopoly characteristics of Transpower, establishes its allowable revenue and considers and approves (or otherwise) major components of its investment programme. The paper doesn't really even describe this framework, let alone present any reasons why such a well established and specific framework should be re-examined at all, let alone replaced by a "market based" approach or the Treasury framework.

5 The current administrative process by which Transpower's proposed investments are approved (or not) includes, amongst other things, consideration of the economic impact and justification of the projects, and requires Transpower to consider alternatives to building transmission assets[2]. As such, the investment decision making that alternative transmission pricing approaches might seek to influence is:

5.1 to a considerable extent already in place (albeit via an administrative mechanism) and,

5.2 not particularly relevant, as a number of the major decisions for the New Zealand transmission system for the next 10 years or so have already been made – for example the 400kV link in the north of the North Island, and Pole 3 of the HVDC.

6 The key economic outcome of all of this is that once Transpower has made an approved investment, it will, one way or another, recover the cost. So it is actually important that the TPM *does not* create perverse incentives to avoid using the transmission system to its full extent. And indeed the TPM is, quite intentionally, largely a cost allocation methodology, rather than a pricing methodology.

[2] As most recently set out by the Commerce Commission in its documents related to "Transpower's Capital Expenditure Input Methodology" (final determination and reasons paper), and before that the Grid Investment Test process administered by the Electricity Commission.

7 Finally in this context, the paper fails to note that transmission charges, to the extent they are paid by distributors, are "recoverable costs" under the Commerce Commission's input methodologies. So even if transmission pricing was changed so that everything was "market-based", it is highly likely that distributors would continue to simply pass this on, rather removing one of the key concepts normally underlying market based arrangements!

The HVDC

8 As with other aspects of transmission pricing, HVDC charging to South Island generators has been contentious and is certainly material.

9 We have some sympathy for arguments that the HVDC is just part of the core grid, and its cost would therefore be most appropriately recovered via interconnection charges. (However it is an extra leap to say that interconnection in this context should stay as it is (a charge to distributors and direct connect loads), rather than, for example, all being charged to generators.)

10 Likewise we see merit in the argument that, since it enables power flows in both directions, the HVDC should be charged to all generators in both islands.

11 But these perspectives and arguments have been around for years. In the meantime New Zealand has decided to invest in Pole 3, and that cost (and the existing HVDC cost) will be recovered from someone. The question is what would be materially better for consumers? We are not sure it makes much difference from an efficiency perspective, but we can say that, in the event that the HVDC is added to interconnection charges faced by distributors, they will ***certainly*** find their way to consumers via delivery charges. There ***might be*** a more than compensating reduction in consumers' energy costs, but that is at best uncertain. In this simple context the status quo has a lot going for it.

Relevance to distribution pricing

12 While we are concerned about the possibility of the Authority leading New Zealand down new paths to transmission pricing, we are more concerned that the Authority considers that it should "*Ensure alignment of approach to distribution pricing principles with Transmission Pricing Economic Framework Paper*" as indicated in its 2011 summary of its work plan[3].

13 We strongly disagree that the "*Transmission Pricing Economic Framework Paper"* or any transmission pricing methodology, including the current one, provides much useful guidance for distribution pricing.

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[3] As presented at the 21 December 2011 Regulatory Managers' meeting. See slides 9 and 10.

14 After extensive consultation over a number of years, the Authority has put in place a principles and guidelines based approach to regulation of distribution pricing, with occasional external review. The Commerce Commission, sensibly, intends to piggy-back this approach into its information disclosure regime. The Authority needs to provide a compelling reason why existing regulation, recently established through robust consultation, needs to be overturned.

Concluding remarks

15 Overall, we believe the Authority already has a decision-making framework for considering changes to the Code, and we can see no obvious reason why a different one is needed for transmission pricing. Furthermore we are not convinced that a reasonable application of the Code amendment principles can make further review of transmission pricing a high priority. Moreover, we see no particular inadequacy in the existing economic framework for transmission pricing and charging - which has been established over many years - and certainly no reason to replace it with a new framework designed for a very different purpose.

16 Thank you for the opportunity to make this submission. Orion does not consider that any part of this submission is confidential. If you have any questions please contact Bruce Rogers (Pricing Manager), DDI 03 363 9870, email bruce.rogers@oriongroup.co.nz.

Yours sincerely

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