

Decision-making and economic framework for transmission pricing methodology

Summary of submissions

7 May 2012

Background

- 1 The Electricity Authority (Authority) published a consultation paper on the Decision-making and economic framework for the transmission pricing methodology review (consultation paper) on 26 January 2012. The Authority received 18 submissions and 13 cross submissions on the paper and met with 15 submitters to discuss their submissions.
- 2 This paper provides a summary of the views and points raised by submitters in submissions, cross submissions and meetings. It focuses on the submitters' comments on the decision-making and economic framework, and on their responses to the questions posed by the Authority, although a number of submitters provided additional material on the analysis of transmission pricing methodology (TPM) options.
- 3 The structure of this summary broadly follows the structure of the consultation paper. Submitter comments are grouped under themes that emerged through the submissions.

Decision-making framework

- 4 The consultation paper described the regulatory framework for transmission pricing and the role of the statutory objective. Consistent with the Authority's interpretation of the statutory objective, the framework for decision-making about options for the TPM should focus on overall efficiency of the electricity industry for the long-term benefit of consumers.

Submitter themes: decision-making framework

The Authority needs to follow good administrative decision-making processes

One submitter comments that the Authority faces legal requirements beyond those set out in the Electricity Industry Act 2012 (Act), in particular the public law obligations of a decision-maker to act in accordance with the law, and not to make decisions that are arbitrary, unreasonable or inconsistent.

Treatment of wealth transfers

Some submitters argue that the Authority should take wealth transfers into account where their impacts cause inefficiencies or outweigh efficiency gains. In addition, one submitter notes that focusing on overall economic efficiency may risk failing to take into account the impacts of options on different consumers.

Relative weight given to static and dynamic efficiency effects

There are different views among submitters on whether the focus of the Authority's decision-making about the TPM should be on static or dynamic efficiency. Some suggest the TPM should be about static efficiency because the Commerce Commission's investment test focuses on dynamic efficiency, others say the inclusion of the 'long term

Submitter themes: decision-making framework
benefit of consumers' in the statutory objective points to a focus on dynamic efficiency.
Practical v abstract framework Some submitters consider that the framework is too abstract and should focus on more practical outcomes, or include a clearer set of principles. One submitter considers that the Authority does not need a decision-making framework as it already has its statutory objective and Code Amendment Principles (CAPs).
Competition Some submitters comment that competition is less important than reliability and efficiency because of the Commerce Commission's role in regulating new investment and that there is little likelihood of competition in transmission services.
Reliability One submitter makes the comment that reliable supply means different things to different consumers, and consumers should be able to make trade-offs.
Efficiency Submitters mention a number of issues that they consider generally affect efficiency for transmission pricing: <ul style="list-style-type: none"> · fairness and perceptions of the legitimacy of the regime; · uncertainty; · the effectiveness of price signals due to muting of price signals or the relative impact of signals; and · ambiguity.
Distributed generation One submitter requests that the interpretation and application should consider distributed generation.

Economic framework: high-level views

- 5 The economic framework presented by the consultation paper set out a hierarchy of approaches that the Authority proposed to use to identify and assess options for the TPM. The more preferred approach would be applied wherever its charges were efficient, implementation was practicable, and any Code amendments needed complied with the Authority's Code amendment principles. If a more preferred approach is unable to meet these requirements and raise all the revenue required the Authority will consider the next ranked approach.

Submitter themes: economic framework
How does the framework fit with cost-benefit assessment Some submitters note that the hierarchy should not replace robust assessment. In the meetings with submitters, a number sought clarification of how cost-benefit assessment will be undertaken within the framework.
Hierarchy of approaches Some submitters argue the framework may not involve a strict hierarchy as there are overlaps between approaches. For example, beneficiaries may also be exacerbators, or an approach may have elements of two or more approaches. For example, the current interconnection charge is part postage stamp as all customers face the same interconnection rate but part exacerbators pay as the charges are levied on regional coincident peak demand. A number of submitters argue there is no reason to prefer exacerbators pay over beneficiaries pay. One submitter derives the framework by considering a pure administrative charge as a starting point, then the beneficiaries pay and exacerbators pay as possible improvements, and finally the market-based options as the top options. The submitter considers this alternative is easier to understand, but is essentially the same framework.

<p>Submitter themes: economic framework</p> <p>Some submitters have views on which options should be preferred, or consider that there are factors that mean one or other of the preferred options cannot be practically adopted and so consider the other administrative options (such as postage stamping) should be preferred.</p>
<p>Regulatory and market context</p> <p>Submitters recommend that the Authority consider and explain the regulatory and market context for the framework including:</p> <ul style="list-style-type: none"> · the wider Commerce Commission regulatory framework including the transmission investment test; · which parties have decision-rights; · the design and operation of the market, particularly nodal pricing and open-access arrangements; · the state of transmission investment in New Zealand (recent significant investment approval and future investment expectations); and · Transpower’s incentives and regulatory arrangements.
<p>Major transmission investments have been made</p> <p>This relates to the market context above and also to the submitter comments on the relative weight given to static and dynamic efficiency effects. Some submitters argue that, because the Electricity Commission approved substantial transmission investment, there is significantly less transmission investment forecast for the next 10 to 15 years or longer. This means, according to these submitters, that there are few dynamic efficiency gains to be made from options that signal future investment in transmission.</p>
<p>Treatment of perverse incentives such as free-riding and hold-out</p> <p>Submitters point to issues such as free-riding and hold-out that could create perverse incentives for some of the framework approaches, particularly exacerbators pay and beneficiaries pay, although for some, there are measures that can be taken to resolve these issues.</p>
<p>Retrospective applications of approaches and different approaches for existing or committed and new assets</p> <p>Some submitters have strong concerns about retrospective (or ex-post) applications of market-based, exacerbators pay and beneficiaries pay approaches. These concerns are principally that, for existing assets, decisions have already been made, and retrospective applications could affect efficient use of transmission and wider electricity industry assets. Some consider that there will be efficiency gains from a retrospective application of an approach through signalling the value of assets, or through enabling consistent approaches for both new and existing assets. Some of these, or other submitters, also comment on the problems of recovering the costs of existing or committed and new assets differently. These problems are political or practical issues but also relate to the potential for consumers to ultimately ‘pay twice’ if new transmission assets were to be charged to generators with costs then reflected in wholesale prices, and existing assets charged directly to consumers.</p>

Submitter views: market-based approaches

6 The consultation paper set out the Authority’s proposed preference for market-based solutions.

<p>Submitter themes: market-based approaches</p>
<p>Issues that affect efficiency or practicality</p> <p>Submitters mention issues that affect the efficiency or practicality of market-based approaches:</p> <ul style="list-style-type: none"> · free-riding, hold-out and the open-access grid arrangements; · the monopoly characteristics of the grid and the common good nature of the grid; · the lack of international precedents;

<p>Submitter themes: market-based approaches</p> <ul style="list-style-type: none"> · inefficient signals for use of the grid; · the impact on Transpower's risk profile from market-based approaches; and · the ability to accommodate change and reduce investment uncertainty (on the one hand a submitter considers that market-based approaches will best accommodate change, another disagrees claiming that market-based approaches would adversely affect investment certainty).
<p>Comments on long-term contracting</p> <p>Submitters set out concerns or comment on long-term contracting approaches:</p> <ul style="list-style-type: none"> · general comments that a TPM would still be needed to underpin any long-term contracting arrangements; · the risk of locking in industry structures through long-term contracting, which may reduce dynamic efficiency benefits that many reforms are trying to achieve; · NZ experience of long-term contracting drove need for a regulatory solution and stifled transmission investment; · the Transport Working Group approach was developed in a different context, prior to the introduction of regulation for transmission investment; and · Transpower's negotiating power – one submitter considers this would be too strong, but others argue the opposite because Transpower cannot practically exclude parties.
<p>Comments on capacity rights</p> <p>Some support capacity rights as an instrument to drive dynamic efficiency. Some argue that capacity rights involve practical and implementation issues such as: complexity; impact on efficient dispatch; and abuse of market power.</p>
<p>Replicating competitive market outcomes</p> <p>One submitter suggests the most appropriate approach should be to aim to replicate market outcomes and references the Commerce Commission objective to replicate market outcomes for monopoly businesses.</p>
<p>Connection contracts are not a pure market approach</p> <p>Some submitters note that the paper does not acknowledge aspects of the current arrangements which mean the connection contracts are essentially a regulated contract and not a purely negotiated contract.</p>

Submitter views: administrative approaches

- 7 In situations where a market-based charge is inefficient, the consultation paper proposes that an administrative approach to charging would be required. The consultation paper set out the Authority's hierarchy of preferred administrative approaches.

<p>Submitter themes: administrative approaches</p>
<p>Exacerbators pay</p> <p>Submitters make the following comments:</p> <ul style="list-style-type: none"> · exacerbators (and beneficiaries) should pay no more than their private benefits; · those that mitigate transmission - such as distributed generation - should benefit; · it will be difficult to identify exacerbators (and beneficiaries) because of economies of scale and the need to plan transmission investment well ahead of when it is needed; · some parties may be exacerbators but may not be able to receive or respond to signals due to market structures or the regulated investment test; and · 'last cab off the rank' approach may compromise efficient investment.

Submitter themes: administrative approaches
Beneficiaries pay It will be difficult to identify beneficiaries as this relies on subjective analyses.
Other pricing approaches Submitters make the following comments: <ul style="list-style-type: none"> · as large a portion as possible of transmission costs should be allocated via market-based, exacerbators pay or beneficiaries pay; the residual should be as small as possible; · 'incentive-free' approaches will affect dynamic efficiency and is unlawful and will be unstable; · the RCPD approach requires review.

Submitter views: inefficient disconnection

- 8 The consultation paper proposed that determining the extent that a party benefits from the grid involves considering the costs of any alternatives available because the benefit to a party should not exceed the cost of its next best alternative. The consultation paper included a worked example considering the potential for inefficient disconnection: Appendix B: 'the Whirinaki case study'.

Submitter themes: inefficient disconnection
General comments on the potential for inefficient disconnection Some large users note that as transmission costs increase there will be some point at which disconnection becomes viable, although a number of other submitters claim this is unlikely as there are significant benefits associated with connection to the grid and significant costs associated with disconnecting entirely.
Appendix B 'the Whirinaki case study' Some submitters provide detailed comment on the Appendix B analysis and argue it contains inaccuracies and that significant benefits of connection and costs of disconnection have been left out of the analysis.

Submitter views: other issues

- 9 Submitters raise other issues that are summarised here.

Submitter themes: other issues
Process Some submitters stress that there has been significant work undertaken, particularly by the Transmission Pricing Advisory Group (TPAG), and the Authority should build on this and not start from scratch. Other submitters welcome the framework approach and recognise that TPAG did not provide a comprehensive decision-making framework. Some submitters would like to see public hearings or workshops, or an additional consultation stage. This is in order for participants to contribute to the analysis of transmission pricing options.
Priorities and timeframes Some submitters have concerns that major changes will mean considerable resource and time spent on transmission pricing (that is unlikely to meet current stated timeframes).
Generators facing charges Although some submitters would like to see generators facing at least a portion of interconnection charges, others

Submitter themes: other issues

have concerns about any approaches that result in generators facing transmission charges as they consider that the charges will be passed through in wholesale prices with little transparency or ability for consumers to respond to price signals.

Consumer resources

Consumers, supported by one generator, are concerned that the ability to apply resources by the supply and consumer sectors is significantly different and recommend that the Authority assist with resources.

Clear rationale for change

A group of submitters stresses the importance of a clear, compelling rationale for change.

Analogies

Whilst some submitters agree with the analogies employed in the consultation paper, some do not support their use as they claim the analogies are either incorrect or misleading.