

## Consultation Paper - Transmission pricing methodology review - issues and proposal

### Introduction

1. Auckland Council welcomes the opportunity to comment on the Electricity Authority's proposed changes to the Transmission Pricing Methodology (TPM).
2. No part of this submission is confidential.
3. The following comments cover the key points that Auckland Council wishes to raise with regards to the proposed changes to the TPM.
4. Auckland Council recognises that the Electricity Authority's statutory objective focuses on 'the long-term benefit of consumers' and that the changes proposed are directed at improving dynamic efficiency.
5. Auckland Council questions whether the proposed changes will deliver sufficient net long-term dynamic efficiency benefits to outweigh the adverse effects on static efficiency and the significant costs imposed on market participants and Transpower in administering such a theoretically complex (and untested) method of recouping a comparatively small proportion of total transmission costs.

### Efficiency Impacts

6. Improvements in dynamic efficiency will only be realised in the longer term given that a major round of capacity building has already been committed. Introducing locational signals for sunk assets will have a limited positive influence on dynamic efficiency; however, the constant reallocation of transmission charges for sunk assets could incentivise market participants to act in ways that compromise static efficiency.
7. Auckland Council acknowledges that the Authority's modelling of the impact of the proposed methodology changes on retail prices are 'based on a number of broad and simplifying assumptions.'
8. The Authority's modelling indicates that the proposed regime changes will not result in significant price shocks for consumers.
9. Auckland Council is concerned that the modelling is oversimplified and that the potential impact for customers in terms of higher and more volatile retail prices may be significantly more material than suggested by the Authority's indicative estimates for the following reasons:
  - Generators will factor into their bids expected transmission charges which will reflect forecasts of hydrological conditions.
  - Generators will face incentives to change their bids to influence the charges under the counterfactual when the asset is removed and so attempt to deflect transmission charges to others.

- Retailers will have to price this forecast risk into their wholesale purchase costs in setting their tariffs. The modelling assumes that only the average incidence of the charge is passed through, but retailers will face incentives to pass through at a higher level to ensure cost recovery.
10. The uncertainty with regards to how generators and retailers will factor in this risk premium and the extent to which it will flow onto retail prices is of concern, as is the relationship between transmission charges and wholesale prices given the volatility experienced in wholesale prices in recent years associated with hydrological conditions.
  11. Auckland Council recognises that the Electricity Authority's decision criteria relate only to efficiency. However, higher and more volatile retail prices for households and businesses, which will impact on household budgets and business competitiveness, is not in the long-term benefit of consumers.

#### Conclusions

1. The proposed methodology involves a highly complex theoretical approach for which there is no precedent in any other electricity market.
2. The methodology involves significant wealth transfers that may incentivise participants to act in ways that compromise both static and dynamic efficiency.
3. From Auckland Council's perspective, a more robust analysis of the costs and benefits of the proposed methodology is required to take account of the potential for perverse incentives.
4. Static and dynamic efficiency objectives can conflict, but a clear and substantial net benefit needs to be demonstrated before the Authority considers making material changes to the TPM.
5. If the Authority has any queries regarding Auckland Council's submission or would like further information, please contact Geoff Cooper on 093542012.

Yours sincerely



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**Chief Planning Officer**