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28 March 2013

Submissions
Electricity Authority
P O Box 10041
Wellington

By email: submission@ea.govt.nz

Dear Sir / Madam

CROSS SUBMISSION RE CONSULTATION PAPER 'TRANSMISSION PRICING METHODOLOGY: ISSUES AND PROPOSAL

Energy for Industry (EFI) welcomes the opportunity to make a cross submission on the Electricity Authority's (Authority) consultation paper 'Transmission Pricing Methodology: issues and proposal' (TPM).

Energy for Industry's cross submission reiterates our key points, acknowledges other submitters with similar views and details the proposals from other submitters that EFI support.

In summary, Energy for Industry:

- notes the majority of submitters have commented on the complexity of the proposed methodology, the resulting volatility in monthly charges and the impact this is likely to have on electricity prices for consumers;
- remains concerned about the impact of the proposed TPM on signals for demand-side initiatives to manage peak load on the transmission grid and local networks;
- supports numerous submissions that the residual charge should be levied only on network companies based on RCPD; and
- suggests a strawman for a TPM that achieves a long term benefit for electricity consumers.

These points are discussed in more detail below. EFI works very closely with commercial and industrial electricity consumers to provide energy solutions and manage their future energy needs. This cross submission is made taking into account our perspective of the likely impacts on our customers.

EFI's shareholder, Pioneer Generation, has made a separate cross submission on the impacts of the proposed TPM on embedded generation – which EFI also fully endorses in the context of our industrial and institutional customer markets.

Complexity, volatility, uncertainty and the impact on electricity prices

As previously stated, the proposed transmission pricing methodology is in our view overly complex and will result in volatile charges for sunk assets that have a long life, creating disincentives for market participants and barriers to new entrants. We also note the difficulty electricity consumers will have in understanding their transmission charges and checking the accuracy of their monthly bills.

We note the perspectives of large electricity users:

NZ Steel:

"For NZS the transmission charges are a significant part of the business, particularly when related to current low profitability of the core steel business. Being able to budget and manage any costs is an important part of good business. The proposals guarantee Transpower their total revenue and leave them indifferent as to how this is allocated to users. It however, becomes a seemingly impossible task for those on the consumption side of the equation to accurately predict how charges will flow through. This includes the volatility that will arise from the SPD charge based off the spot market.

Variability and uncertainly invariably lead to higher risk premiums which are not in the interests of consumers."

Auckland Energy Consumer Trust:

"In particular, we point to the cost uncertainty created by the new system and the lack of a clear analysis that demonstrates the gains are worth having. We see these as matters that need to be addressed before any changes to the TPM proceed."

KiwiRail:

"The key issues of concern to KiwiRail are primarily;

1. Annual price certainty for line charges so that budgets can be set accordingly."

Auckland Chamber of Commerce:

"Our core concern is that we do not believe the Authority has demonstrated the proposal will deliver the above outcomes to the long-term benefit of consumers. Instead, we are deeply concerned that the opposite impacts may be established in the market in respect of electricity – uncertainty, higher costs, more disputes, increased inefficiency – and to the general loss of credibility of New Zealand's brand as a positive and progressive nation to invest and do business." (para 37)

"We have substantive concerns about the proposed variable monthly pricing method, which we believe could create substantial and unnecessary risk and uncertainty across all stakeholder groups." (para 39)

Fonterra (paras 33 – 36):

"33. The current proposal will impact on businesses budgets, forecasts, and cash flows due to the uncertainty of how much to budget for on a monthly and yearly basis.

34. There is considerable uncertainty regarding the amount of transmission charges that are allocated to generators/retailers that are able to be passed-through to consumers.

35. The uncertainty is further exacerbated by the considerable volatility in the amount of the charge being calculated on a half-hourly basis. The allocation will reflect the numerous changes that occur in the wholesale market, in load profiles, and any change in connections.

36. A preferable approach would be to average the charge over a long period of time (i.e. monthly, yearly) to remove the volatility and increase the certainty in charges."

Auckland Council:

"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…" (para 9)

EFI strongly submits the Authority change the basis of charging from 'monthly ex post'. We discuss our preference in the strawman below.

Signals to network companies for demand-side initiatives

As well as EFI's submission, a number of other submitters have commented on the commercial implications of any change to the transmission pricing methodology which:

- reduces the interconnection charge based on RCPD; and/or
- changes the counterparties to interconnection charges from the contract between Transpower and the network companies.

There are a number of alternatives to investing in, and paying for the cost of, transmission assets and NZ businesses are making decisions about these alternatives on a daily basis.

Auckland District Health Board:

> "At present ADHB can respond to regional peak demands that are likely to be the in the 12 highest for the year and expect to achieve significant savings on its transmission costs in the following year. This is because the charging methodology is weighted primarily to ADHB's load coincident with these regional peaks. We understand that the proposed new methodology will reduce the weighting given to these peaks and that the weighting may also change from month to month.
>
> Such changes would reduce the likelihood that ADHB would respond in an efficient manner. Firstly it will be less worthwhile to respond to peaks in general as the potential savings would be significantly reduced. Secondly it will be more difficult to predict which peaks to respond to, as the weighting of any particular peak in the pricing methodology will only be known post-event based on factors not directly related to the magnitude of the peak."
>
> "Our comments are simply those of a consumer who is able to respond efficiently to the current pricing methodology and who has concerns that this may not continue under the proposed new regime."

Powerco:

> "There is also the question of load control, given that the RCPD charge aims to flatten usage during regional peaks, at least in the Upper North and Upper South regions. At present, distributors carry out this function very well using conventional load control. It is not clear how well retailers would respond to the RCPD signal to manage GXP peaks, as there are multiple retailers at each node and they are constantly changing and any benefit from transmission cost savings would flow to all retailers." (page 4)

Electricity Networks Association:

> "The importance of the level of the charge arises due to it presenting participants with a trade-off between using capacity at transmission peaks periods versus taking other actions or investing in substitutes (e.g. shifting demand, embedding generation, or investing in storage). If the charge is well below the incremental cost of transmission capacity the incentives to take other actions or invest in substitutes will be sub-optimal, and if too high these incentives will be stronger than optimal." (para 102)
>
> The stability of the charge is also important to establishing appropriate incentives for participants to take other actions to invest in substitutes. The alternatives to transmission have typically long payback periods and many will not be economic if the stability of the charge is highly uncertain. (para 103)

MainPower:

> "Furthermore, allowing the distributors to opt out of the interconnection charges, and sharing the charges among a wider section of beneficiaries will dilute the price signals that encourages reduction of transmission peaks.
> Because of this, we argue the distributor should be subject to payments for the interconnection services." (page 2)

Strawman that simplifies the proposed TPM

EFI supports the following proposals, also made by other submitters, which would substantially simplify the proposed TPM for the long term benefit of consumers.

Basis of charges:

The Authority proposes a 'monthly ex post' billing cycle. In EFI's view this introduces unnecessary complexity and volatility in transmissions charges with unproven efficiency benefits. EFI supports using a process whereby the prior year's data is used to calculate charges fixed for the next twelve months. Transpower would publish these charges in December (as they do now) and the charges would be known and incorporated into prices set in April the following year. This is a change to **annual ex ante** charging. This change should apply to SPD and residual components of the transmission pricing methodology and will:

- significantly reduce the set up and ongoing costs for Transpower, as discussed by PwC, due to reduction in complexity and shift to annual processing of data, as well as mitigating some of the operational pressures on Transpower;
- provide the appropriate signals to market participants using market behavior in the last twelve months to determine charges faced by the same in the following twelve months;
- preserve the ability for network companies, embedded generators and large users to calculate the Avoided Cost of Transmission payments efficiently on an annual basis under the existing Part 6 provisions, which require network companies to pay for avoided and avoidable capital and operating costs, and eliminating the need to change other Code;
- all participants will be more informed about the costs they face in the next twelve months, reducing the risks (and resulting prudential security) associated with a volatile transmission charge, such that:
    - Transpower can publish its charges under the existing timeframes (in December);
    - network companies will be informed about the transmission charges they face in the next twelve months, and incorporate this in their pricing effective 1 April;
    - network companies will find it easier, relative to the current proposal, to meet their obligations under the price-quality controls regime of the Commerce Commission;
    - retailers will face the same timing and certainty of charges from network companies; and
- most importantly make it significantly easier for industry participants to budget for transmission costs and check the accuracy of their bills.

SPD charge:

EFI strawman's would:

- reduce the number of transmission assets included in the SPD model initially – say to the top 5;
- raise the threshold for new transmission investments that are included in the SPD model to be consistent with the Commerce Commission's investment approval process (ie $100m);
- apply a longer time period for benefit capping (ie weekly or monthly);

Residual charge:

EFI strawman's would:

- make the residual charge payable 100% by network companies based on RCPD (with the definition of RCPD to be provided by the Authority to Transpower in the TPM Guidelines); and
- not offer network companies the option to 'opt-out' of the residual charge.

Further consultation

Energy for Industry urges the Authority to take as much time as is needed to ensure implementation of durable transmission pricing methodology that achieves the right investment signals from recovering the cost of sunk, long life transmission assets for the long term benefit of consumers. Setting up a working group, holding a conference and further consultation all appear to be necessary to conclude a TPM that achieves the Authority's economic efficiency objectives.

Yours faithfully

Grant Smith
Chief Executive