MAJOR ELECTRICITY USERS' GROUP

28 March 2013

Dr John Rampton
General Manager Market Design
Electricity Authority
By email to submissions@ea.govt.nz

Dear John

Cross-submission on Transmission Pricing Methodology

1. This is a cross-submission by the Major Electricity Users' Group (MEUG) on the submissions by 53 other parties responding to the Electricity Authority (EA) consultation paper "Transmission Pricing Methodology: issues and proposal" published 10th October 2012[1].

2. Members of MEUG have been consulted in the preparation of this cross-submission. Several MEUG members will be making cross-submissions. This cross-submission is not confidential.

3. Having considered the submissions of other parties MEUG makes no change to our submission and independent expert report by NZIER, both dated 28th February 2013, apart from the following:

   - The opening sentence of our response to the proposed treatment of LCE (Q16) stated "we are unsure what policy problem the proposed change is intended to solve". We remain of that view. The balance of our response suggested a detriment if changing from the status quo. We are now unsure if that suggested detriment is correct but still see no pressing reason to change from the status quo.

   - MEUG agrees with the submission of Pacific Aluminium that any revised TPM guidelines must give guidance on how current economic value sums recorded in Transpower's economic value accounts are to be treated. Pacific Aluminium submitted[2]:

[1] http://www.ea.govt.nz/our-work/consultations/priority-projects/tpm-issues-oct12/

[2] Pacific Aluminium, paragraph 9

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"*One other important issue that needs to be addressed concerns past overpayments for the HVAC assets and underpayments for HVDC assets. Transpower's economic value accounts*[3] *reveal that the current balance of the HVAC account is $52.1m, which represents an accumulated overpayment by consumers and must be returned to consumers only. However, the HVDC account is $104.1m in deficit which represents an accumulated undercharging of SI generators and must be recovered in future from them alone and not from consumers in whole or in part. It is important that the guidelines to Transpower for the TPM address this issue so that these balances are distributed to and recovered from the historic parties to which they relate, otherwise unnecessary windfall gains and losses will occur*."

This approach differs from that submitted by Meridian Energy[4]:

"*These balances are forward-looking and are to be recovered based on future consumption. They are not in the nature of a credit to or a debt owed by past customers, and do not attach to any parties. Rather, they record past under or over recovery of costs compared to forecasts. Consistent with this regulatory compact, these balances should continue to be recovered based on future consumption and the application of the TPM*."

We oppose the Meridian suggestion and support Pacific Aluminium's submission.

- A change in emphasis on our submissions[5] that because no major grid expansion is expected in the medium term that therefore progress on improving the TPM for new grid investment can be considered a low priority. That point is still valid but as history has shown, Transpower can change direction quickly from forecasting modest grid investment to demanding large new projects investments.

  In particular in March 2003 Transpower was continuing a "glide-path" approach with no significant planed investments because distributed generation was proving to be an effective peak transmission alternative. In June 2003 Transpower announced a major revamp of its asset base of up to $5 billion. Coincidentally a new Chief Executive started in May 2003. Ten years later having undermined the economics of many distributed generation projects as transmission alternatives, Transpower now expects future major transmission investments will be a decade or more in the future.

  A revised TPM must mitigate the risk of similar flip flop approaches emanating from Transpower.

4. The balance of this cross-submission comment on some themes observed in the submissions of other parties.

TPAG revivalists

5. Many parties submitted the majority view of the Transmission Pricing Advisory Group (TPAG) was preferable to either the status quo or the EA October 2012 proposal. Some suggested the earlier work of the CEO Forum and TPAG had either directly or indirectly the status of an agreed industry process that should have continued, eg

[3] Forecast closing balance for 2011/12 in Tables 33 and 34 of Transpower's Annual Regulatory Report for 2011/12
[4] Meridian Energy, p54
[5] Refer MEUG submission paragraph 5, bullet point six, and paragraph 12 b) iii)

Might River Power[6] "*Mighty River Power can see no compelling evidence in the Authority's analysis to suggest the 2011 TPAG majority proposal was not a proportionate and pragmatic solution to the* HVDC *issues. It is superior to the Authority's proposal when considered against good practice transmission cost allocation principles and the company continues to support this option*."

Contact Energy[7] "*It was assumed, we believe fairly, that the Authority's development of a new TPM would be a continuation from the work undertaken by TPAG and the CEO Forum*."

6. MEUG refutes any suggestion we accepted the CEO Forum or TPAG as having any decision making status. Accountability for developing TPM has resided with the Electricity Commission in the past and the Authority now and cannot be delegated to another party.

7. Some parties indirectly supported the TPAG majority view by submitting HVDC charges be included in interconnection charges. This amounts to the same outcome whereby all customers will immediately pay more.

8. MEUG asked NZIER for an independent expert view on TPAG's views in light of the Authority's October 2012 proposal. A copy of the NZIER report "Not time to revisit TPAG – NZIER views on revisiting the TPAG majority in light of the current TPM proposal", March 2013, is attached. Under the section headed "Our recommendation", NZIER conclude[8]:

Our view is that you (and the Electricity Authority) should disregard calls for reconsideration of aspects of the TPAG report.

Embedded generation

9. MEUG member and MEUG submissions noted concern on the effect on embedded generation. In addition another nine submitters[9] focussed their comments on embedded generation. Those other submitters corroborate our concerns.

Major weakness in SPD method of inelastic demand assumption not identified

10. NZIER identified a "major weakness" in the SPD approach was lack of allowance for demand response. This is the first of five "shortcomings" of the SPD method perceived by NZIER for recovery of sunk transmission costs[10].

11. Contact Energy, Meridian Energy[11] and Trustpower never mention this major weakness.

12. Covec in a report appended to the submission of Mighty River Power correctly identifies the assumption of inelastic demand in the SPD method[12] "*in reality the demand curve at a node in a given half-hour in SPD is vertical because demand-side bidding does not occur*". Covec then discuss the consequences on a retailer rather than end customers. On the other hand Frontier's report for Mighty River Power incorrectly assumes buyers can

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[6] Might River Power, p92

[7] Contact Energy, p20

[8] NZIER, March 2013, p 1

[9] Alinta Energy, Auckland District Health Board, Clearwater Hydro, Energy3, New Zealand Wind Energy Association, Pioneer Generation, Taharoa C Block, Tauropaki and Ventus Energy NZ Ltd.

[10] NZIER, 28th February 2013, piii

[11] For example not listed in suggested changes to the SPD charge, Meridian, p37

[12] Covec, p9

structure bids[13]. The main submission document by Mighty River Power is silent on this "major weakness" in the SPD approach identified by NZIER.

13. Other submitters incorrectly assume demand elasticity in the SPD method, eg

> Genesis Energy[14] "*Generators and demand responsive consumers (typically large direct-connect consumers) may be able to influence aspects of their exposure to volatility under the Proposed TPM*."
>
> EPOC[15] *Under current wholesale market arrangements the proposal provides incentives for consumers who bid a demand curve to change their bid strategies to decrease prices on dispatched tranches*.

14. The only major submitter that clearly recognised the flaw was Vector[16].

15. Those major submitters that did not identify the assumption of inelastic demand as a major weakness in the SPD method either didn't look hard enough or if they had identified it; didn't recognise or acknowledge its importance. The former could be because the complexity of the proposal was difficult for even large sophisticated parties to analyse. The latter may be because those submitters were supplier centric rather than having a holistic NZ Inc approach.

Unsubstantiated submissions that prices will increase

16. Contact Energy submitted[17]:

> *The Proposal will result in significant wealth transfer, whereby, for example, <u>prices significantly increase for Auckland consumers</u> but decrease for Rio Tinto"s Tiwai plant*.

17. Vector submitted[18]:

> *Vector notes we do <u>not believe</u> the Authority has demonstrated its TPM proposal would be to the long-term benefit of consumers or that it would not have <u>substantial adverse pricing impacts</u> on consumers.*

18. As far as we are aware the only evidence on the immediate effect on retail prices of the proposal was published by the Authority[19]. That analysis has a range of scenarios none of which could be described as resulting in "prices significantly increase for Auckland consumers" or "substantial adverse pricing impacts".

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[13] Frontier, s. 3.3.2, p15 and 16
[14] Genesis, p5
[15] EPOC, Executive Summary, finding #2
[16] Vector, paragraphs 74 and 75
[17] Contact Energy, p13
[18] Vector, paragraph 39
[19] EA, Transmission Pricing methodology review, Estimation of impact of Authority TPM proposal on consumer prices by line company area, 6th December 2012, http://www.ea.govt.nz/dmsdocument/14030

Concluding comments

19. There is sufficient uncertainty and unanswered questions by most submitters on the workability of the proposal and cost-benefit-analysis methodology employed that the Authority should quickly announce next steps. We repeat the first two recommendations in our February submission that the Authority[20]:

- Does not issue the guidelines in the proposal to Transpower; and
- Consults on possible next steps for reviewing the TPM.

20. The Authority has noted[21] it "... *is considering holding a public conference on the TPM proposal to enable the Board, and Authority staff considering submissions, to ask questions to better understand views and suggestions about the TPM proposal and way forward*." MEUG supports that approach and recommends the Authority adopt processes used by the Commerce Commission for their Input Methodologies conferences including:

- Requiring independent experts to sign a declaration that they abide by the Code of Conduct for Expert Witnesses as contained in Schedule 4 of the New Zealand High Court Rules[22];
- Consulting on a proposed conference agenda; and
- Inviting written post conference submissions on particular matters identified by the EA with reference to transcripts of the conference proceedings.

21. We would welcome an opportunity to discuss or clarify any part of this cross-submission.

Yours sincerely

Ralph Matthes
Executive Director

[20] MEUG, 28th February 2013, paragraph 12
[21] EA letter to Trustpower, Consultation on transmission pricing methodology, 8th March 2013 http://www.ea.govt.nz/dmsdocument/14499
[22] Refer "Code of Conduct Compliance" section at http://www.comcom.govt.nz/consultation-prior-to-december-2010/