23 September 2014

Electricity Authority
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**Transmission Pricing Review: LRMC Charges**

Mighty River Power welcomes the opportunity to comment on the Transmission Pricing Review working paper on Long-Run Marginal Cost (LRMC) Charges. No part of this submission is confidential.

Mighty River Power recommends the Authority defers the decision on whether to consider in more detail a LRMC charging approach until a clear problem definition for transmission pricing reform has been established.

We appreciate that the Authority has sought to broaden its consideration of alternative pricing approaches to beneficiary-pays in response to feedback.

Notwithstanding the technical challenges, the Authority considers LRMC charges could potentially advance its statutory objective. Dynamic efficiency could be promoted by signalling the scarcity value of transmission capacity prospectively over time and improving locational signals for generation and load.

However, an important empirical question is whether there are material inefficiencies with the locational signals provided by nodal pricing, or that generation and load decisions can be sufficiently influenced by transmission charging, to justify an additional LRMC locational signal. The working paper casts some doubt on the analysis from previous reviews regarding the need for locational signalling, without providing a definitive view.

Mighty River Power observes that the dynamic efficiency benefits of any LRMC signal at present is likely to be very low[1]. This is due to the fact that further investment in transmission is unlikely to be required for the next decade due to recent significant capital expenditure and the continued outlook for decreasing electricity demand.

In order for Transpower to recover the vast majority of its regulated revenue, an additional mechanism will be required. The Authority's economic and decision making framework creates unnecessary complexity here by requiring that a beneficiary-pays approach, followed potentially by a residual charge should be implemented.

[1] Mighty River Power has previously advocated for consideration of a Tilted Postage Stamp approach but notes this was prior to the recent transmission investment and that the value of such a signal is now appears to be considerably diminished.

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The risk of this approach is that the combination of the various pricing signals as well as the effects of nodal price differences could, in aggregate, result in over signalling and efficiency loss. We note that the international examples quoted of LRMC pricing do not require beneficiary-pays as an additional cost recovery mechanism.

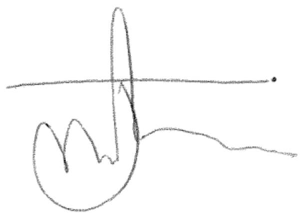
Mighty River Power does support the Authority evaluating whether any reform to the TPM could be applied prospectively, as implied in its consideration of a LRMC charge.

The current status quo arrangements for interconnection cost recovery are likely to achieve a high degree of static efficiency in recovering sunk or fixed costs. The proposed amendments to the HAMI charge under Transpower's review will also likely resolve the investment and dispatch inefficiencies associated with the current HVDC charging arrangements.

The question therefore for the Authority to resolve is whether introducing significant changes to the status quo arrangements to promote dynamic efficiency is warranted, particularly as this will entail inevitable trade-offs with static efficiency. Mighty River Power and others have raised concerns that the market offer counter-factual model (using SPD to derive benefits) would not provide dynamic efficiency benefits and could lead to material static inefficiencies in the wholesale and retail markets.

If you have any questions regarding the above please contact me directly at nick.wilson@mightyriver.co.nz or 095803623.

Yours sincerely



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