

Northpower

**Avoided Cost of
Transmission (ACOT) –
Proposed TPM related
Amendments**

20 October 2022

Overview

Northpower welcomes the opportunity to provide feedback on the Electricity Authority's consultation on ACOT.

We **support** the Authority's preferred approach to explicitly provide in the Code that ACOT payments are no longer required.

We **support** an effective date of 1 April 2023 and **oppose** any phase out.

We have concerns with some of the proposed drafting to amend the Code.

Removal of ACOT

We **support** the removal of ACOT payments. We broadly agree with the Authority's previously expressed view that ACOT payments are inefficient, and that payments don't result in less transmission investment, meaning a higher total overall transmission cost for consumers.

In addition:

- Under the new TPM, generators could only earn ACOT on benefit based investment (BBI) charges. This is because residual charges are calculated on a gross basis, and so the distributor does not avoid any residual charges through have embedded generation on its network.
- It will be virtually impossible for distributors to calculate ACOT on BBI charges, as Transpower uses specialised software that is not available to its customers. Furthermore, Transpower is not able to provide breakdowns of its BBI charges to an end consumer level, so distributors are not able to pass-through BBI charges transparently to their customers.
- Even if ACOT *could* be calculated on BBI investments, given that BBI charges are initially only calculated on a limited number of historic investments, and ramp up over time as new investments are made, BBI charges will initially be low. This means that revenue foregone by generators will be low in initial years if ACOT were to be retained.
- If there is a genuine requirement for grid support, Transpower can contract directly with the generator to provide grid support. This is a much more transparent and efficient option, as Transpower can weigh the cost of new assets against purchasing the grid support, select the most efficient option, and ultimately recover the cost through transmission charges. This reduces transmission costs, and ensures that generators are only reimbursed for grid support that is genuinely required. It also means that Transpower can regularly review its ongoing requirement for grid support, and terminate said support when it is no longer required.
- Retaining ACOT risks exacerbating differences in connection charges for generators between connecting via distributors or the grid, providing inefficient incentives to connect to one party over the other. Enabling Transpower and distributors to contract directly with generators for grid support, and to weigh the cost of that grid

support against traditional 'poles and wires' solutions, enables the most efficient option to be selected.

No Transition out period

We **support** the Authority's preferred option that ACOT ceases to apply from 1 April 2023. We **oppose** an option under which ACOT would be phased out over a number of years, noting it is not the Authority's preferred option.

The rationale for this is that:

- Transition arrangements would require a methodology to be developed to calculate ACOT under the new TPM. Due to the software used by Transpower, this would not be able to be achieved in an accurate manner without significant support and modelling by Transpower. Distributors do not have access to the tools required to accurately model ACOT, and Transpower has indicated it is not able to provide further breakdowns of transmission pricing for pass-through purposes.
- Based on previous statements by the Authority, and the inability to calculate ACOT under the new TPM, we understand most distributors and generators are planning on the basis that ACOT will be removed. The change has been well signalled, and there has been plenty of time to exit contractual arrangements requiring ACOT to be paid.
- As the residual charge is based on gross not net demand, and the residual charge will reflect the largest component of transmission charges in the first years of the new TPM, distributors are unlikely to 'avoid' much transmission cost due to generation in the near term. Therefore there is likely to be very little ACOT payable to generators during the phase out period.
- The Authority considers that spot market price signals are sufficient to incentivise generators, and send signals around constraints and generation shortfalls. Under this logic, if ACOT were to continue to be paid, effectively a double strength price signal would be sent, which is inefficient.
- We don't believe there is an increased reliability risk as a result of this change:

If ACOT continued to be calculated on RCPD:

- Generators currently receive ACOT based on their prior year RCPD, so their behaviour this year (as we understand most generators are acting on the assumption that ACOT will be removed) was on the basis of spot market price signals only. Therefore effectively they have already changed their behaviour to reflect the removal of ACOT, and it is unlikely there will be any increase to reliability risk in future years, compared to this year.
- Retaining ACOT due to reliability risk would be inconsistent with the removal of transmission price signals to distributors to control load at peak times. Unlike generators, distributors are not subject to spot market price signals, and therefore now have no price signal to respond to. If the Authority and

Transpower are satisfied there is no reliability risk from the removal of the RCPD price signal (which effectively is already in place for the winter of 2022) then it follows they should also have no concerns about the removal of ACOT.

- The strength of the price signal diminishes each year under the proposal. If RCPD was to be used, next year's ACOT has already been determined by this year's generation, and therefore generators would receive their revenue with no ability to change their behaviour, and therefore the price signal is ineffectual. Further years, which generators can respond to, have a price signal with diminishing strength.

If ACOT was calculated on the actual transmission avoided under the TPM:

- Practically, if ACOT was retained it would have to be recalculated under the new TPM, otherwise it would not actually be a calculation of avoided transmission.
- This would no longer align with RCPD reflecting peak demand and resulting potential capacity issues, so if there were to be a reliability risk, retaining ACOT but calculated on the new TPM would likely not resolve it.

Impacts

ACOT is a pass-through cost, so removing ACOT will not increase distributor profitability. Rather, the benefit will be passed through to consumers, and help to offset the additional pass-through costs allocated to some distributors under the TPM.

We note we are not able to reconcile with the amounts in Figure 2 on Page 21. This figure implies that our ACOT is around \$420k, and the TPM increase is \$960k. While ACOT is approximately correct, our TPM increase (for FY23 with/without new TPM) is \$2.2m.

Drafting

Our comments on the drafting in Appendix F are below:

Part 1, Definition of “incremental costs”

We **partially oppose** changes to the definition of “incremental costs” in clause 1.1(a) of Part 1. At best, it is unnecessary to give effect to the EA's ACOT proposal and, at worst, has the potential to give rise to uncertainty in relation to the DGPPs.

The proposed change is to remove the words 'with connection services' from the definition, leaving only a reference to “distribution services”.

Our submissions are:

- The proposed change is inconsistent with Part 6 which refers to *connection services* not *distribution services*. This is a critical feature of the incremental costs principle in Part 6 which, put broadly, recognises that distributors can only charge the additional cost of connection (and not the underlying cost that they would have incurred anyway in relation to distributing electricity to consumers).

- This change does not appear necessary to give effect to the proposed change relating to ACOT. We would welcome a separate and focused review by the EA on whether Part 6 is fit for purpose and effective, including a review of the DGPPs.

Part 6, Schedule 6.4 - Pricing Principles

We **support** the removal of the second part, which removes the rebate of avoided transmission costs. But, this part should be clarified to ensure it is clear that incremental transmission costs (i.e. costs allocated under the new TPM because of the benefit that a generator receives from transmission investments) can be passed through as incremental costs.

If you have any queries regarding this submission please contact Shane Ruxton (shane.ruxton@northpower.com)