Submission

# Avoided Cost of Transmission (ACOT) – proposed TPM-related amendments

20 October 2022

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# 1. Introduction

## 1.1. Preliminary

1. We welcome the opportunity to submit our views in response to the Electricity Authority's (the Authority's) consultation – "Avoided Cost of Transmission (ACOT) – proposed TPM-related amendments" (Consultation Paper).

2. No part of our submission is confidential.

## 1.2. Glossary

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| ACOT | means Avoided Cost of Transmission |
| BBC | means Benefit-Based Charge |
| Code | means the Electricity Industry Participation Code 2010 |
| DGPP | means Distributed Generation Pricing Principles, being Schedule 6.4 of the Code |
| EDB | means Electricity Distribution Business |
| Existing TPM | means the TPM that has been used to calculate transmission prices to 31 March 2023. |
| GRS | means Grid Reliability Standards |
| IM | means the Electricity Distribution Services Input Methodologies Determination 2012 |
| New TPM | means the TPM that will be used to calculate transmission prices from 1 April 2023. |
| RPCD | means Regional Coincident Peak Demand |
| SSDG | means Small-Scale Distributed Generation |
| TPM | means Transmission Pricing Methodology |

# 2. Submission Summary

## 2.1. ACOT removal is supported.

3. Aurora supports the Authority's preferred option to amend the Code to make it explicit that EDBs are no longer required to make ACOT payments to DG owners. Aurora considers that:

 – in most circumstances, DG is likely to be acting as a transmission substitute without any particular benefit, rather than providing genuine grid support. ACOT payments are therefore inefficient and impose an unnecessary burden on consumers;

 – The structure of the new TPM provides no practical basis for continuing ACOT payments;

 – The current ACOT 'methodology' incentivises DG operation to avoid Transpower's charges; however, there is limited evidence that DG operation reduces underlying transmission costs in circumstances where ACOT is payable; and

 – Transpower is best placed to determine whether grid support is required and to contract directly with DG owners accordingly. EDBs do not need to be an intermediary in that process.

4. Aurora strongly opposes the Authority's secondary, phase-out option. The phase-out option relies on an artificial construct that uses a notional interconnection rate at its heart. If there is no logic to support continuing ACOT payments, then the proposed transition mechanism is more illogical.

## 2.2. Recoverable costs

5. It should be noted that, while the Consultation Paper states that the proposed Code amendments would mean that ACOT payments would no longer be a recoverable cost for distributors, that is not universally correct. That restriction would not apply to EDBs that are exempt from price-quality regulation under section 54G of the Commerce Act 1986. This is because clause 3.1.3 of the IMs, which specifies ACOT (distributed generation allowance) as a recoverable cost, applies only to price-quality regulated EDBs. Accordingly, any exempt EDG that has an obligation to pay ACOT through a commercial agreement with a DG owner will still be able to pass that cost onto consumers, irrespective of the Code amendment.

6. That being said, we consider that the structural changes between the New TPM and the Existing TPM mean that there is no reasonably practical and implementable basis on which any EDB could continue to make ACOT payments. Even for distributors with 'evergreen' connection agreements,[1] we expect these structural changes to be so significant as to render ACOT unpayable.

[1] We understand that these connection agreements generally relate to older generating plant and were struck at a time when the current structure of the electricity market and supply chain could not have been reasonably anticipated.

## 2.3. DG COULD STILL EFFICIENTLY DEFER TRANSMISSION COSTS

7. Aurora considers that the Authority's proposal may result in a residual issue, owing to the interplay between the Code and the IMs. There may be instances where DG efficiently defers investment in new or upgraded transmission connection assets, as opposed to interconnection assets. Under those circumstances, it would be appropriate that EDBs (as the connection customer) remain able to pass the efficient cost of deferral to consumers. To facilitate that, the Authority may need to consider amending its proposal to allow payments for efficient deferral of transmission connection asset investment, but make it explicit that ACOT cannot be paid on the basis of charge avoidance.

8. One underlying issue in such an approach is a generally reasonable expectation by the DG owner that it will be compensated at the marginal cost to the EDB of the avoided transmission investment. From the perspective of the EDB and consumers, however, there is no incentive to defer the transmission investment unless the ACOT payment is lower than the marginal cost of the avoided transmission investment. Ideally, the ACOT payment should be based on the DG owner's incremental operating costs in supporting the deferral.

# 3. Consultation Questions

**Chapter 2 – Background and context**

*Q2.1 Do you have any comments on the background and context material in this chapter or Appendix A?*

Aurora agrees that the current ACOT methodology reflects avoided charges rather than genuinely avoiding underlying transmission investment costs.

Because Transpower recovers its required revenue, irrespective of whether or not DG reduces an EDB's contribution to RCPD, ACOT acts as a transmission substitute and, in many circumstances, merely represents a windfall gain to DG owners.

Transpower has not included usage-based charges in the TPM, clearly signalling that RCPD reduction is neither necessary nor valued.

**Chapter 3 - We propose to remove provisions for ACOT payments from DG pricing principles**

*Q.3.1 Do you agree with the Authority's preferred approach of clarifying that ACOT payments are no longer required?*

We consider that, irrespective of a Code change, the structure of the New TPM does not provide any basis for the continuation of ACOT payments.

We consider an explicit clarification that ACOT payments are no longer required would provide useful direction to generators.

We agree that incentives to DG operation should be provided by nodal prices, and removal of barriers to DG offering into the market.

*Q.3.2 Do you have any comments on the alternative approaches that could be used to justify ACOT payments?*

We agree with the Authority that making ACOT payments based on allocator updates and diminished future investments would involve making ACOT payments to support charge avoidance, with no link to underlying transmission investment. Given the arcane nature of the methodology for determining BBCs, we are unsure how a distributor would practically go about calculating ACOT on the basis of either allocator updates or estimates of diminished future investments.

In neither case would it be clear that DG is providing grid support or efficiently deferring grid investment.

*Q.3.3 Do you have any comments on the Authority's proposed amendments to the Code?*

The proposed Code amendments appear to be clear. However, we note that the ACOT issue arose because it was referenced against the costs that a distributor could avoid, which included avoided charges incurred by EDBs (as an intermediary provider), even when it was unclear that the underlying costs of Transpower (as the primary provider) were being reduced. Accordingly, if the Code amendment made it clear that a distributor's avoided costs excluded charges from the transmission provider, then concerns about making ACOT payments based on allocator updates and diminished future investments would largely disappear.

## Chapter 4 - Alternative option – phase out could mitigate transition risk

*Q.4.1 Do you agree with the transition risks we have identified, and our assessment of them?*

We agree that removing the obligation to make ACOT payments is unlikely to materially impact grid reliability risks. Should those risks emerge, then Transpower is best placed to understand the impact of DG operation on grid reliability. It should be remembered that, under clause 8.25 of the Code, Transpower receives information about DG above 1MW.

*Q.4.2 Do you think there are any other transition risks we should consider?*

No, there are no Aurora network transition risks.

*Q.4.3 Do you have any information that would allow the Authority and Transpower to better assess the risk that removing the requirement to make ACOT payments could lead to changes in distributed generation behaviour that could impact reliability?*

No.

*Q.4.4 Do you have any comments on the design of the phase-out option?*

Given that, under the existing TPM, Transpower's operating costs are fully recovered from transmission customers, irrespective of the impact that DG operation has on RCPD, ACOT payments to DG generally make no sense.

On that basis, it makes even less sense to phase out ACOT payments by using an artificial framework. The issues with such an approach include:

1. the rate of payment would be notional, being based on Transpower's interconnection rate for the 2023 pricing year ($96.89/kW) which, irrespective of the transitionary multiplier used, cannot be reflective of Transpower's costs (avoidable or otherwise) for pricing years 2024 and 2025;
2. by the Authority's admission, not all listed generation is necessary to meet GRS; and

3. it would be inefficient for the Authority to commit resources to calculating the 4 instances of RCPD that would be required, annually, to support the transition, noting also that RCPD fails to have any relevance to transmission pricing from 1 April 2023.

*Q.4.5 Do you agree with our preference that ACOT payment obligations cease from April 2023 with no phase out?*

Yes, Aurora supports an immediate cessation of ACOT payments.

## Chapter 5 - Further work on network pricing for distributed generation

*Q.5.1 Do you have any comments on the distributed generation pricing context material provided in Appendix C?*

No.

*Q.5.2 Do you have any comments on the Authority's plans for further work on whether there is a future role for additional price signals for grid support technologies?*

Aurora agrees with the concept of Transpower contracting directly with DG owners for grid support. We do not see any compelling reason why EDBs should be drawn into those arrangements as an intermediary.

Aurora agrees with the Authority's 'starting view' principles for potential additional price signals for grid support technologies, as set out in paragraph 5.7(b) of the consultation paper.

If nodal pricing is not sufficient to incentivise economic/efficient grid technology support then the first step should be an additional pricing signal, and as a last resort, grid support contracts could be considered where future pricing cannot be forecast with enough confidence to enable investment certainty in grid support technologies.

## Chapter 7 - Regulatory statement for the proposed amendments

*Q.7.1 Do you agree with the objectives of the proposed amendments? If not, why not?*

Aurora agrees with the objectives of proposed amendment 1. Aurora disagrees with the objectives of proposed amendment 2, where we consider that risks have been overstated (qualitatively).[2].

*Q.7.2 Do you agree the benefits of the proposed amendments outweigh their costs?*

Aurora agrees that the benefit of option 1 is likely to outweigh its cost.

2 No quantitative risk assessment has been performed.

*Q.7.3 Do you agree that alternative means of meeting the objective are not as effective in meeting the Authority's statutory objective? If you disagree, please explain your preferred alternative option in terms consistent with the Authority's statutory objective.*

Aurora agrees that alternative option 2 is less likely to meet the Authority's statutory purpose.

*Q.7.4 Do you agree the Authority's proposed amendment complies with section 32(1) of the Act?*

Aurora considers that the proposed amendment (option 1) appears to comply with section 32(1) of the Act.

*Q.7.5 Do you have any other comments on this chapter?*

No.

*Q.7.6 Do you have any other feedback on any other aspect of this consultation paper?*

Refer to section 1.