Mercury

Via email: network.pricing@ea.govt.nz

24 March 2022

Cross submission on Settlement Residual Allocation Methodology consultation

Mercury welcomes the opportunity to provide feedback on the submissions that the Electricity Authority (Authority) received in response to its consultation paper *Settlement Residual Allocation Methodology: principle, options and pass-through*, 18 January 2022 (Consultation Paper).

Mercury's submission, dated 28 February 2022, presented positions that in general are consistent the with the majority of submissions received by the Authority. That is Contact, Electric-Kiwi, ERANZ, Flick, Genesis, Meridian, NOVA, Transpower, along with Mercury proposed in general that the settlement residual should be passed through to retailers, either by requiring the distributors to pass it through or directly by the settlement manager. However, Entrust, MEUG, Northpower, Unison, and Vector proposed an alternative approach that in general would either not allocate the settlement residual to retailers or leaving it to the discretion of distributors to determine the extent of any pass through.

Mercury's cross submission responds to these alternative approaches by highlighting that passing the settlement residual to retailers, and allowing the process to competition in the retail market to determine how it is passed through in line and energy prices to end users, would promote economic efficiency.

Mixing TPM/benefits based and wholesale-market based allocation methodologies raises regulatory risks

The Consultation report addresses two sets of methodologies for allocating the settlement residual rebate:

i. TPM/benefits based methodologies which includes the Authority's Options A, B and C; and
ii. Wholesale-market based methodologies which includes the Authority's Option D.

There are a number of reasons for supporting each methodology which the Authority addressed in its Consultation Paper. Mercury does not have a particular preference for one or the other methodology set, but we have provided comments on each in our submission.

Mercury's concern, however, is that some submitters' proposals are mixing and matching the outcomes taken from these two methodology sets, which would reduce transparency and increase uncertainty, thereby raising the risk of unintended outcomes.

In particular, Entrust, MEUG and Vector argue in their submissions for a TMP/benefits based allocation but also that generators should not receive a settlement residual rebate. As Figure 2 in the Consultation Paper illustrates, the TPM/benefits based allocation would result in generators, along with distributors and direct connect customers, receiving an allocation of the settlement residual rebate. Entrust, MEUG and Vector's proposals, therefore, would diverge significantly from the TPM/benefits based principles. This divergence from the TPM/benefits based principles would raise a regulatory risk and create uncertainty about the future application of the SRAM.

In contrast, if it is not appropriate for generators to receive the settlement residual rebate then a wholesale market based methodology, such as the Authority's Option D, would achieve this outcome. We note that Electric Kiwi, Flick, NOVA, and Transpower raise issues with generators under the TPM/benefits based methodologies which is a factor

The Mercury Building, 33 Broadway, Newmarket 1023
PO Box 90399, Auckland 1142 New Zealand
PHONE: + 64 9 308 8200
FAX: + 64 9 308 8209
mercury.co.nz

for their support for Option D. As noted in our submission, Mercury is open to further consideration being given to Option D.

Distributor pass-through requirement would promote economic efficiency

The economic analysis prepared Sapere for Mercury[1], which the Authority has included in its consultation, would suggest that Entrust, MEUG, Northpower and Vector's proposal would not be more efficient than mandating the pass through of the distributor rebate to their customers. That is, Sapere found that the alternatives to a distributor pass-through requirement[2], such those proposed by Entrust, MEUG, Northpower and Vector, would "*artificially lower charges for lines services (transmission and or distribution) while raising total energy prices*".[3]

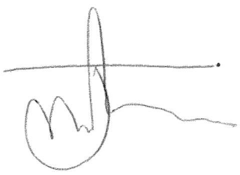
As also discussed in Mercury's submission, this distortion in line and energy prices could potentially impact many decisions made by end consumers concerning fuel choices particularly during the transition to the low emissions economy.[4] Mercury considers that promoting efficient line and energy prices is crucial for reducing emissions and meeting New Zealand's emissions targets. Entrust, MEUG, Northpower and Vector's proposals would make achieving these targets more challenging.

Following Sapere's line of reasoning, Mercury also considers that in general a wholesale market based methodology would also promote economic efficiency better than the alternatives considered by Sapere, such as a rebate that is credited to transmission charges; distributors passing through the rebate to customers; and maintaining the status quo as in 2019. This is because, similar to the distributor pass-through requirement, the wholesale market based methodology would maintain efficient infra-marginal prices as retailers would receive the settlement residual rebate and the process to competition in the retail market would determine how it is passed through in line and energy prices to end users.

In conclusion, Mercury reiterates the proposal made in its submission, that the distributor pass-through requirement should be implemented separately from the SRAM, and as soon as possible in 2022. Separating the implementation of the distributor pass-through requirement the SRAM would promote economic efficiency without further delay. This would allow, furthermore, the Authority to finalise a SRAM in due course, ensuring that is aligned with the new TPM.

Mercury looks forward to engaging constructively with Authority and industry stakeholders on implementing the distributor pass-through requirement in 2022 and continuing to work on finalizing the TPM and the SRAM.

Yours sincerely



Nick Wilson
Head of Government and Industry Relations

[1] *Loss and constraint rentals - economic analysis of Mercury code change proposal*, Kieran Murray, Dean Yarrall, Sapere Research Group, 26 March 2019.
[2] Sapere's analysis provided a comparison of the impact on economic efficiency between the distributor pass-through requirement that is the same as the Authority's proposal and alternative approaches including; a rebate that is credited to transmission charges; distributors passing through the rebate to customers; and maintaining the status quo in 2019.
[3] Ibid. page 25.
[4] Ibid. page 26