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Submissions  
Electricity Authority

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### **Settlement Residual Allocation Methodology – Cross-submission**

Meridian appreciates the opportunity to provide further feedback in response to the first round of submissions on the Electricity Authority's consultation paper *Settlement Residual Allocation Methodology: principles, options and pass-through*.

A wide range of views has been expressed by submitters. The Authority will not be able to please everyone. The need to decide on a new settlement residual allocation methodology places the Authority in an unenviable position. Meridian supports the Authority's process and the early testing of principles and tentative options prior to firming up a proposal for consultation.

This cross-submission responds to the following themes from the first round of submissions:

- the inherent tension between some of the Authority's proposed principles;
- whether settlement residual should be allocated only to wholesale purchasers or transmission load customers;
- whether transparency requirements might achieve distributor pass-through rather than a pass-through requirement; and
- the benefits of regulating pass-through ahead of final decisions on a settlement residual allocation methodology.

## **The inherent tension between some of the Authority's proposed principles**

Several submitters note that there is some tension between two of the proposed principles that should inform the settlement residual allocation methodology, namely to:

- preserve the integrity of nodal pricing in the wholesale market; and
- help to mitigate wholesale price volatility.

These submitters ask the Authority to ignore the benefits of mitigating wholesale price volatility. While ignoring this principle would perhaps make the Authority's task simpler, Meridian encourages the Authority to continue with the more nuanced application of the principles that it has proposed while keeping in mind the underlying objective of the Authority. There is nothing wrong per se with there being some tension between the guiding principles. Allocation of settlement residuals is a complex problem and to date allocation of residuals has provided some offset for parties exposed to congestion costs.

Meridian notes that while some submitters seek to delete the principle regarding mitigation of volatility, others like Flick see it as the most important principle.<sup>1</sup>

Meridian agrees with the Authority that "if ways can be found to return the settlement residue to those who pay the nodal transport charge for the investment – without undermining nodal prices – that could substantially mitigate the financial risk due to the nodal transport charge and the settlement residual rebate."<sup>2</sup>

## **Whether settlement residual should be allocated only to wholesale purchasers or transmission load customers**

Several submitters note that settlement residuals arise due to over-payment in the spot market by wholesale purchasers. Some of these submitters therefore suggest that wholesale purchasers or consumers alone should receive settlement residual with some suggesting the residual charge to transmission load customers be used as a basis for allocation.

Meridian agrees that settlement residuals arise due to over-payment in the spot market by wholesale purchasers. However, efficient settlement residual allocation would provide the residual to those that face the costs of congestion giving rise to the residual in the first place.

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<sup>1</sup> Flick submission at page 3.

<sup>2</sup> Consultation paper at paragraph 3.11.

In Meridian's view there needs to be some targeting of residual allocation to the assets that have given rise to the residual (as opposed to say a broad \$/MWh allocation based on wholesale purchases or transmission charges). For example:

- residuals that arise because of losses and constraints on connection assets should be allocated to the connecting party at that asset because that party is the one exposed to the associated costs of congestion;
- residuals that arise because of losses and constraints on interconnection assets should broadly be allocated to either the transmission customers that pay for those assets or the wholesale purchasers who paid more for energy as a result of the losses and constraints in respect of that asset (i.e. grid connected industrial consumers and retailers on a targeted regional basis).

In an ideal world, a settlement residual allocation methodology would broadly match settlement residue to the *wholesale purchasers* paying higher energy prices as a result of the assets where congestion occurs. However, to do this efficiently this would require construction of a bespoke and highly complex allocation methodology amongst wholesale purchasers. The Authority's preferred Option B instead would broadly match settlement residue to the *parties paying for transmission assets* where the congestion occurs. While imperfect, and necessitating distributor pass-through rules, this option does have the benefit of an established methodology upon which to allocate settlement residual.

### **Whether transparency requirements might better achieve distributor pass-through**

Two submissions from distributors suggest that the Authority should not pursue a pass-through requirement and should instead implement transparency mechanisms while allowing distributors discretion to pass through settlement residual to network customers any way they see fit.

Meridian does not support such an approach and considers a standardised pass-through method to better promote the efficiency limb of the Authority's statutory objective. Without a standardised pass-through method, there will continue to be considerable inefficiency in the ad hoc processes across 29 distributors all passing through settlement residual in different ways. These ad hoc processes increase retail cost to serve and ultimately cause harm to consumers. There is also evidence that ad hoc processes cause consumer confusion.


With a clear pass-through rule in the Code the Authority will also be able to minimise monitoring and enforcement costs. Monitoring and enforcement of pass-through would be far more challenging if each distributor followed a completely different approach and the Authority needed to unpick and understand each approach and the accounting used in each instance. As the Network Tasman submission reveals, sometimes the effect (if any) of the pass-through on consumer bills will be buried within wider pricing decisions and require the Authority to undertake forensic accounting and development of hypothetical distributor pricing with and without settlement residual pass-through to understand what has occurred and whether it in fact gives effect to the Authority's intent.

### **The benefits of regulating distributor pass-through now rather than later**

Meridian agrees with the submissions of Mercury and Genesis that a distributor pass-through requirement could be introduced now under the existing Transmission Pricing Methodology and settlement residual allocation process, and that this would deliver benefits to consumers. The requirement could then be rolled over to work with the new settlement residual allocation methodology once implemented.

Please contact me if you have any queries regarding this cross-submission.

Yours sincerely



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