

24 March 2022

Rob Bernau
Director, Network Pricing Directorate
Electricity Authority
By email to network.pricing@ea.govt.nz

Dear Rob

Settlement Residual Allocation Methodology cross-submission

1. This is a cross-submission from MEUG on the submissions that closed 1 March by eight sellers or representatives of sellers, seven-line businesses or their representatives, and one other consumer (16-other submitters in total) on the Electricity Authority consultation paper "Settlement Residual Allocation Methodology" (SRAM) dated 18 January 2022.¹
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Members may lodge separate submissions.
3. MEUG welcomes the Authority undertaking this cross-submission step.²

Defining the policy problem

4. The best summation of the policy problem was by Transpower:³

"Going back to first principles, we consider the underlying problem is that consumers pay more for electricity than generators receive. In TPM Guidelines' language, purchasers pay more for electricity than the stand-alone cost of generating it. The role of the SRAM should be to close the gap between what consumers (ultimately) pay and the cost of electricity generation, and to do so in the most direct way possible without undermining transmission or nodal price signals."
5. This aligns with the intent of MEUG's submission though we were not as concise as Transpower. We agree with Transpower's submission above apart from one caveat regarding the importance of aligning policy on settlement residuals with ongoing improvements in the Financial Transmission Rights (FTR) market discussed later in this submission.

¹ Submissions and EA material published at <https://www.ea.govt.nz/development/work-programme/pricing-cost-allocation/transmission-pricing-review/consultations/?ct=t%28Special+Market+Brief+-+The+proposed+TPM%29#c18989>

² MEUG was the only submitter that suggested a second consultation round.

³ Transpower, paragraph [12].

SRAM Principles must be subservient to the DME framework

6. Network Tasman submitted:⁴

“It is not clear from the consultation document, why Authority’s statutory objective is insufficient to guide the development of the SRAM and how the introduction of principles will assist the Authority to better achieve its statutory objective.”

7. Transpower submitted⁵:

“The Authority has proposed four new decision-making principles for allocating settlement residue. It is unclear why the Authority has done this instead of continuing to apply its decision-making and economic (DME) framework that it has used throughout the TPM review.

We think the Authority should be cautious about creating new decision-making principles when it undertakes new consultations. There is a risk using different principles for different decisions will cloud or pre-determine the Authority’s thinking, resulting in regulation that is inconsistent and unpredictable.”

8. MEUG agrees with the submissions above from Network Tasman and Transpower. The proposed SRAM principles in the consultation paper could better be described as initial screening factors that are to assist, but not replace, the existing Authority’s DME framework and statutory objective.

Options

9. There is no change in MEUG’s submission proposing new options E and F be considered apart from agreeing with other submitters that another option, being a modified option A using residual charges as the allocator, should be considered also.

10. MEUG’s option E was a modified option A, with allocation to generators removed and consideration of batteries as generators to be worked through. Many submitters agreed with MEUG’s view that Settlement residual rebates should accrue to end customers rather than generators. For example, Vector put this theme succinctly^{6,7}:

“... ensuring LCE is returned to end consumers ...”

MEUG’s solution to achieve this outcome was to strip out payments to generators in option A, hence option E. No other submitter aligned with the above theme proposed this. Instead, many suggested if a TPM type option were to be considered, a modified option A was preferred over option B and C, with the allocator in the modified option A being residual charges.⁸ MEUG agrees this alternative should also be considered.

11. MEUG’s Option F was a modified option D using national volume as the allocator. Flick Energy and Winstone Pulp International (WPI) submitted similar options with the difference being MEUG used a national volume allocator whereas Flick and WPI used regional volume allocators. Both alternative volume allocators should be considered.

⁴ Network Tasman, p2.

⁵ Transpower [13] and [14].

⁶ Vector, p1.

⁷ Other submitters explicitly agreeing with this theme included Electric Kiwi and Haast Energy Trading, Entrust, Transpower, Unison and Vector.

⁸ Refer Electric Kiwi and Haast Energy Trading, Entrust, Flick Energy, Transpower and Unison.

Transpower, while supporting the modified option A using the residual as the allocator, had a first preference for option D noting:⁹

“There are a number of different allocator options worth considering, including dollar value and volume”

MEUG agrees with Transpower that volume could be an allocator for option D, but disagrees, as set out in paragraph 7 of our submission, that dollar value is an appropriate allocator.

FTR

12. MEUG supports the submission by Electric Kiwi and Haast Energy Trading.¹⁰

“Issuing more FTRs and residue products against the LCE can make SRAM more predictable and uncorrelated with spot outcomes (consistent with the consultation paper’s principle 1). This could keep the price signals consumers and generators see net of SRAM close to efficient levels and increase wholesale market liquidity via increased opportunities for risk repackaging.”
13. While the devil-will-be-in-the-detail on how to achieve the above, there is full alignment between the above quote and MEUG’s submission that stated:¹¹

“We are also conscious of the possibility, in our view high probability, that improvements to the Financial Transmission Rights (FTR) market will be considered later this year. Ensuring decisions on SRAM and FTR align is important.”
14. Disappointingly none of the other seven seller and seller representatives that made submissions made any comment on the importance of the forthcoming opportunity to improve the FTR market and the likely effect on the value of settlement residual rebates. There may be, and hope there are, views in cross-submissions on what we believe is an important aspect of this discussion.

Requiring distributors to pass settlement residual rebates on

15. MEUG did not make a submission on this topic. There were several claimed examples of inefficient practices by sellers and rebuttals by distributors and their representatives. The EA needs to investigate those further if cross-submissions fail to clarify those issues. At this stage MEUG is not convinced there is a well-defined problem and hence we would not support calls by sellers for urgency to change the code. A code change may be the solution eventually; but we need more analysis from the Authority.¹²

Yours sincerely



Ralph Matthes
Executive Director

⁹ Transpower [23], footnote 11.

¹⁰ Electric Kiwi and Haast Energy Trading, bullet point three, p1.

¹¹ MEUG [3].

¹² MEUG agrees with ENA, refer second to last paragraph, “It would be inappropriate for the ENA to comment on either at this time without full details on the nature, cost and benefits of each including, most importantly the cost-benefit to the consumer.”