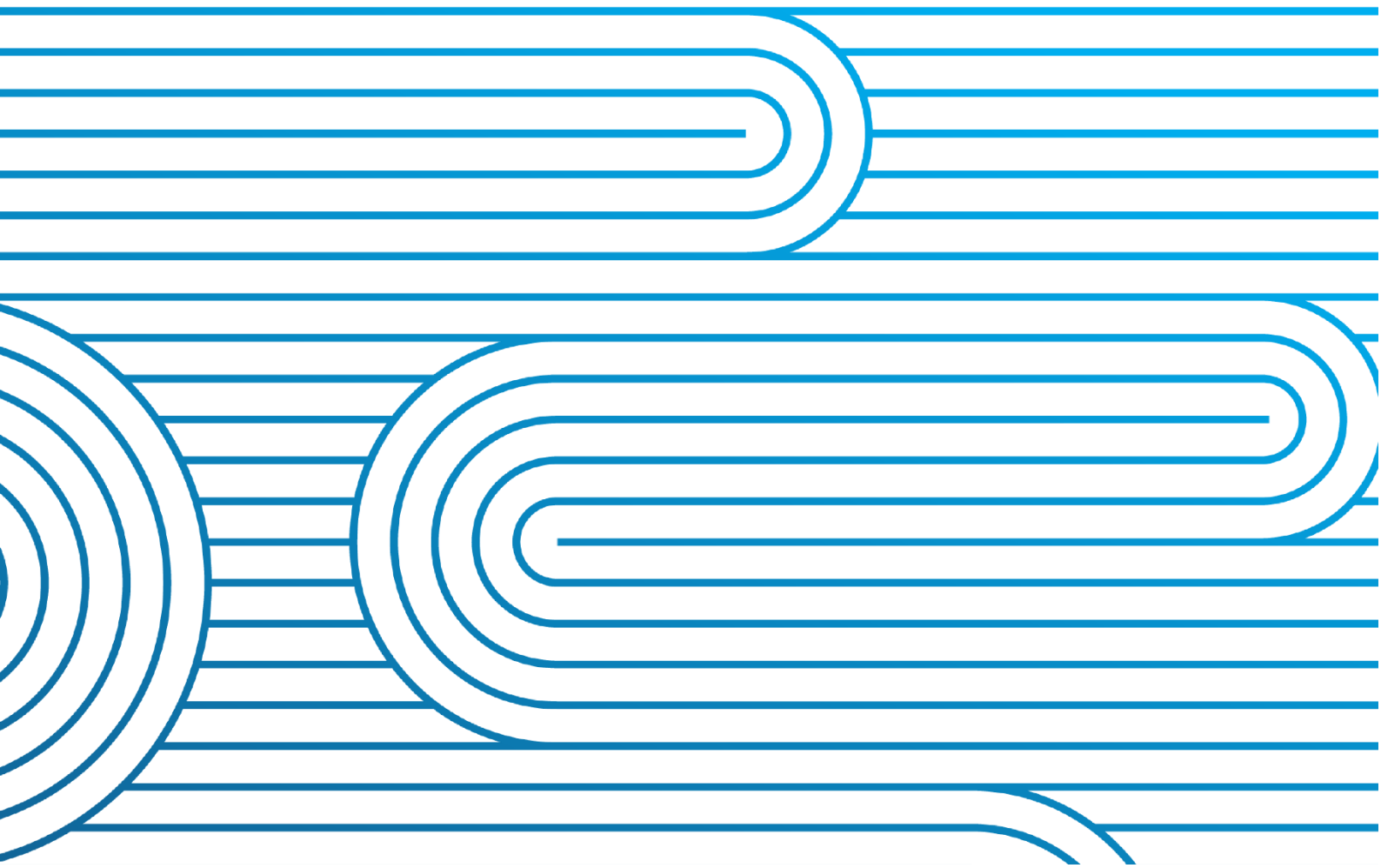


Settlement Residual Allocation Methodology (SRAM)

Cross-submission by Transpower New Zealand Limited

Date: 24 March 2022



1. Introduction

1. Transpower welcomes the Electricity Authority's (**Authority**) decision to ask for cross-submissions in response to its settlement residual allocation methodology (**SRAM**) consultation.¹
2. Having carefully reviewed the other submissions, the views we expressed in our submission remain unchanged. We note there was strong support for the SRAM options we advocated in our submission.²
3. Consistent with the majority of submitter views, Transpower considers the priority should be to ensure pass-through of settlement residue to consumers, and settlement residue should not be used to reduce spot market volatility or alter transmission charges.
4. Option D (our first preference) and allocation based on residual charges (our second preference) are the only options the Authority should consider further. We consider the submissions provide a robust basis for the Authority to rule out options that result in allocation of settlement residue to generators, including options A, B and C. Only four of 17 submitters supported options involving allocation to generators.

2. Pass-through of settlement residue to consumers

5. A common theme amongst submitters, including electricity networks, gentailers and independent retailers, is that settlement residue should ultimately go to consumers. For example:

WPI: *"Importantly, consumers are paying more than they should for energy through the wholesale market and one of the principles should [be to] ensure the SRAM addresses this issue and aligns with the long-term benefits of consumers."*

MEUG: *"It's end consumers that pay [the] higher nodal prices at GXP[s] that create the transmission constraint rentals. It is therefore consumers, not generators, that should be allocated the Settlement Residue."*

6. There is near consensus that the allocation should either be to wholesale purchasers or distributors and direct connect customers. Electric Kiwi and Haast, Entrust, Network Tasman and Vector raised concerns the Authority's preferred option B would result in windfall gains (wealth transfers) to generators. Various submissions (e.g., Flick and Vector) detailed why it is reasonable to assume any allocation to generators would have the lowest rate (if any) of pass-through and could distort nodal prices.
7. Where the consensus breaks down is how pass-through to consumers should be achieved. The options discussed by submitters included:
 - 7.1 Settlement Residual should be passed directly through to wholesale purchasers, i.e., option D (supported by Electric Kiwi and Haast, Flick, Genesis, Meridian,³ Nova and Transpower).
 - 7.2 There should be a regulated requirement for distributors to pass settlement residue through to retailers (supported by the incumbent gentailers - Contact, ERANZ, Genesis, Mercury and Meridian). Various submitters raised doubts about whether retailers would

¹ [Settlement Residual Allocation Methodology: principles, options and pass-through: Consultation paper](#), 18 January 2022.

² We have not responded to submissions that raised matters outside of how settlement residue should be allocated, such as the design of the proposed new TPM and the method for calculating nodal prices.

³ Our interpretation of Meridian's submission is that Meridian is principally concerned about ensuring pass-through of settlement residue to retailers/wholesale purchasers, rather than which particular allocation option is adopted, but supports option D for consideration as it would ensure full pass-through to retailers/wholesale purchasers.

pass-through settlement residue to consumers. Unison submitted that if distributor pass-through is regulated there should be a matching retailer obligation.

- 7.3 There should be a requirement for electricity distributors to pass settlement residue through to consumers in a transparent manner and without adopting *“heavy-handed regulation mandating how this is done”* (supported by electricity distributors and Entrust).
8. Transpower considers the Authority should test which SRAM option is likely to result in the highest rate of pass-through to consumers. We note Unison’s submission that *“As part of its evaluation exercise, we recommend the Authority seek evidence from retailers on how LCE payments are currently factored into retail electricity prices”*.

3. Transpower’s preferred SRAM

9. Option D remains our first preference. We agree with the reasons put forward by Flick for why option D should be adopted:

We also support the Clearing Manager being responsible for both receiving (currently) and then allocating this surplus revenue. This is significantly more straightforward than current arrangements, especially as Transpower is responsible for least cost dispatch and indifferent about the actual level of wholesale prices. Removing the link between the settlement residue and transmission customers has the added advantage of not having to introduce additional regulation (as the Authority discusses) to require distributors to pass on the residue revenue to their customers – who are ‘purchaser’ participants. Making the Clearing Manger responsible for allocating the settlement residue to purchaser participants directly eliminates this ‘merry-go-round’. Consumers ultimately pay for any allocation / payment process and taking the opportunity to simplify this process will provide a long-term benefit to consumers.

10. Several submitters do not consider a TPM-based SRAM is needed (Electric Kiwi and Haast, Entrust, Flick, Transpower and WPI). However, if a TPM-based SRAM is to be adopted, our preference remains allocation based on residual charges. We agree with Electric Kiwi and Haast that:

This is ... consistent with the Authority’s desire for a ‘two-part tariff’ with nodal pricing sending the variable pricing signals and the TPM being recovered through fixed charges. Our understanding is that the residual is intended to be fixed and non-distortionary so, as a corollary, it follows that allocation of LCE using the residual would be fixed and non-distortionary, preserving variable nodal pricing signals.

11. Based on the submissions, the only SRAM options the Authority should consider further are option D and allocation based on residual charges:

- 11.1 Option D is supported by Electric Kiwi and Haast, Flick, Genesis, Meridian,⁴ Nova and Transpower. Allocation based on residual charges is supported by Electric Kiwi and Haast (second preference), Entrust, Flick (second), Transpower (second), Unison and Vector, despite not being included in the SRAM consultation paper as an option.⁵ These are by far the most supported SRAM options.
- 11.2 There is strong opposition to allocation to generators (Electric Kiwi and Haast, Entrust, Flick, MEUG, Network Tasman, Unison, Transpower Vector, and WPI).
- 11.3 Option A has only limited support - from Contact (with a variation to address concerns Contact has with the residual charge), Genesis (who also supports option D), Mercury and Network Tasman.
- 11.4 There is no support for the benefit-based options (options B and C), including from the incumbent gentailers despite the large wealth transfers from consumers to generators that

⁴ See footnote 3.

⁵ MEUG’s submission did not address the residual charge option, which we think reflects the absence of that option from the SRAM consultation paper. However, we note *“MEUG sees the inclusion of residual charges in the allocation base as a benefit.”*

would result from either of the options.⁶ Several submitters expressly opposed the benefit-based options. Some submitters raised questions about whether the use of the benefit-based options would be consistent with the Authority's TPM decisions (Entrust, Flick and Transpower).

12. Relatedly, several submitters consider the Authority's principle (a) (integrity of nodal prices) should take precedence over principle (c) (mitigation of volatility), or principle (c) should be rejected outright (Electric Kiwi and Haast, ENA, Genesis, Transpower, Unison and Vector). Vector submitted *"We think the Authority has confused itself as to whether the LCE should provide a partial hedge to volatility, or should be allocated in a non-distortionary manner"*.
13. We consider prioritisation of the integrity of nodal prices lends weight to SRAM options that allocate to consumers (option D and allocation based on residual charges) in preference to options that include allocations to generators (options A, B and C).

⁶ Option C is Contact's second preference. It appears if the Authority adopts one of options A, B and C, Meridian would prefer option B, but, as noted above, Meridian appears to be principally concerned about ensuring settlement residue is passed-through to retailers/wholesale purchasers rather than the SRAM per se.