1 March 2022

Electricity Authority
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By email: network.pricing@ea.govt.nz

Dear team

Re: Consultation Paper – congestion rebate methodology

Flick appreciates the opportunity to submit on the Electricity Authority's (Authority) consultation paper on initial thinking about options to allocate the wholesale market settlement surplus residue (LCE).

We note the Authority emphasises that this consultation is to "seek initial feedback on our early thinking on options"[1] for allocating this residue. Flick queries whether the consultation is really "early thinking" when:

- LCE has been the subject of numerous consultations over the long period of development of a new transmission pricing methodology. It is unclear if the learnings from prior consultations have been considered in the proposed four options; and
- four options are briefly discussed but the Authority has already eliminated two options that "will likely be ruled out" with the customer impact from one of these options not even modelled in Figure 2.

Flick hopes this consultation is genuine, especially as the allocation methodology that we prefer appears to have already been ruled out by the Authority.

The proposed principles are reasonable, although the application of these to the options appears contradictory.

The focus on 'congestion rebate methodology' is a bit misleading when the surplus residue arises because purchases pay more for the electricity than generators are paid – effectively an 'overpayment' by purchasers.[2] This surplus includes electricity losses on the transmission grid which are a function of the

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[2] The Authority acknowledges this overpayment in paragraph 2.15 and 5.5. Paragraph 5.5 if distributors do not pass on the rebates, retailers and industrial consumers appear to be overpaying for use of the grid and do not receive any benefit from settlement residual rebates offsetting volatile congestion costs" [emphasis added]

physics of electricity - there will always be some losses due to the long stringy nature of the grid no matter what transmission investment is made. This surplus also includes the reconciliation washups from the entire cycle of recalculation of where the electricity went.

While constraints or congestion on the transmission grid contributes to some of the surplus, Flick disagrees with the Authority's appeared preference for the allocation of this surplus to supplement / accentuate the investment signals expected from the 2020 proposed transmission pricing methodology.

There are a number of reasons for our view:

- the proposed TPM residual charge (over half of transmission revenue for some time) is designed to have no impact on participant behaviour. It would be inconsistent if allocation of the rebate was inclined to influence customer's behaviour.
- the Benefit-based (BB) charge is designed to allocate a cost to exacerbators / beneficiaries of a transmission investment. A transmission customer paying BB charges would benefit from higher residue revenue the longer a constraint exists. That is, the BB charge and residue revenue encourages a generator and distributor transmission customer to not support a new investment to relieve the constraint to avoid BB charges going up and residue revenue going down. Further, the estimated benefits from an investment must reflect transmission grid usage – how can benefits from using the grid not be related to usage of the grid[3]?
- the consultation paper reveals that LCE revenue arising from the wholesale market is ~10% of the total ~$800 million transmission charges.[4] Allocating this revenue to transmission customers is a much higher proportionate reduction to transmission charges than if the revenue was allocated to wholesale market purchasers where energy revenue is in multiple billions of dollars.

Flick also does not support the LCE being allocated to generators. Generator offers and offer behaviour (creating price separation) clearly also impact the value of the wholesale market settlement surplus residue. Flick strongly disagrees with a methodology (particularly the Simple BB approach) which results in a significant increase in residue revenue payable to generators (~$30 million per year increase or 52% of total residue payments according to Figure 2) when they clearly have control over the level/value of the residue. The Authority acknowledges this risk in paragraph 4.13 about extending the scope for strategic offers.

Flick's preference is Option D of allocation to WEM purchasers. We disagree that it is essential the settlement residual rebates are allocated to transmission

[3] Flick notes the Authority confirms this in footnote 36 "This is because the user's benefit-based charge and so settlement residual rebate is based on its expected use of the grid …"
[4] Source: Table 2 Appendix A

customers[5]. The current relationship / connection of this surplus to Transpower and transmission charges is because the current Code requires the Clearing Manager to pay this surplus to Transpower, Transpower cannot keep these funds and Transpower has a specific group of customers. The residue surplus arises in the wholesale market price which is only paid by purchasers (not distributors or generators who are transmission customers). As discussed above, this residue surplus is the overpayment by purchasers of electricity, of which only some arise because of use of the transmission grid.

Of the Authority's four principles the key is mitigation of volatility from a retailers' perspective. Flick agrees with all the analysis of why allocation of the residue to mitigate spot price volatility is a good idea (paragraphs 3.10 to 3.12). Thinking about how much control a retailer has over the level of spot prices – generator offers and grid congestion determine the spot price in real time. A retailer can change their behaviour in reaction to high or volatile wholesale prices but this is more likely to occur over a period of time or after the real-time period that has already created a settlement residue.

Further, settlement residues of ~$80million per year is a less than $0.002 per kWh. This amount is hardly going to incentivise anyone to change their behaviour or impact the signals provided by nodal pricing.

The settlement residue does not have to be allocated based on purchaser settlement amounts paid. Flick supports allocation to purchasers based on volumes as this would eliminate any potential interference with nodal pricing signals.

This Option D is also consistent with the other three principles proposed by the Authority. Allocation to wholesale purchasers:

- has no impact on the full cost recovery of total transmission charges
- maintains the integrity of benefit-based charges – because there is no impact on the estimation or allocation of benefits from using the grid
- is likely to have only a minute impact how the residue arises due to constraints on the transmission grid in real-time so the integrity of the WEM nodal transport charge is maintained.

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

[5] Footnote 38

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.

We welcome the opportunity to discuss our information in this submission with you in more detail.

Yours

James Leslie
Chief Financial Officer