1/03/2022

Electricity Authority
PO Box 10041
Wellington 6143.

By email to submissions@ea.govt.nz

To whom it may concern,

SUBMISSION TO THE ELECTRICITY AUTHORITY ON SETTLEMENT RESIDUAL ALLOCATION METHODOLOGY

Opening comment

Unison appreciates the opportunity to submit on the principles and method for allocating surpluses arising in the wholesale electricity market. In this submission we make brief comments on the proposals. We also contributed to the development of ENA's submission which we support.

Proposed principles

The Authority makes the following proposals for evaluating allocation options:

a) Integrity of the WEM nodal transport charge – promoting more efficient grid use.
b) Integrity of (proposed) TPM benefit-based charge – promoting more efficient investment.
c) Mitigation of volatility – providing a partial offset against nodal transport charge volatility.
d) Full cost recovery – avoiding over-payment for grid use.
e) Cost and practical considerations – considering the cost and difficulty of developing, implementing and operating the SRAM.

Unison submits as follows:

1. We agree with principles a) and b) and consider that achievement of these principles should have highest weighting in any assessment.

2. We do not agree with principles c) and d). Volatility is an inherent part of the nodal pricing model and if there are concerns about volatility in nodal prices, which are inherently more driven by aggregate supply-demand conditions than price variances between nodes, then other options should be considered, such as widening the FTR markets. We do not see the relevance of proposed principle d), especially in light of principle b), which seeks to promote the integrity of benefit-based charges.

3. We think that principle e) should be reframed and, as it stands, is not stated as a principle. It would be better redrafted as "Minimise transaction and administration costs of allocation".

4. The Authority should consider a further principle: "Maximise the likelihood of pass-through to end-grid users."

Options for allocation

The Authority proposes four possible allocation options:

Option A: TPM charges – allocates in proportion to total TPM charges.
Option B: Simple BB – uses regional allocators (BBC simple method in the proposed new TPM).
Option C: Full BB – uses proposed new TPM allocators based on all applicable methods.
Option D: WEM purchasers – based on wholesale energy purchase volumes.

Unison submits that the Authority should consider a wider set of options than listed above. We recommend the Authority also considers:

1. Use of all or part of the LCE to defray other industry costs, for example, the costs of the system operator or Transpower's corporate overhead costs or other non-network costs. This would reduce charges elsewhere that recover these costs.

2. Use of all or part of LCE to reduce residual charges (i.e., as a contribution to Transpower's revenue requirement), which would flow through to lower delivered electricity prices to end users. We understand that Transpower historically wanted to avoid managing the volatility of LCE through offsets to its revenue requirement. However, if the use of LCE to defray some of Transpower's charges were capped at, say, $40 million per year, with the rest passed on via another means, it could still avoid exposure to volatility.

Unison's overarching view is that consumers ultimately bear all the costs of the electricity supply chain. Therefore, if there is a surplus that arises that is unnecessary to compensate for a cost that is incurred within the industry (as is the case with LCE) then it should be proportionately allocated back to consumers in a manner that is simple and cost effective.

We also note that from a materiality perspective, even at its highest level of $80 million in 2021, this represents less than 1% of total delivered electricity costs. Accordingly, in our view, finding a simple, cost-effective manner of delivering this value to end-consumers should be a primary consideration. Options B and C above seem overly complex allocation mechanisms for the scale of the issue.

We have severe doubts that volatile LCE payments that are currently passed on to retailers by many EDBs are then being passed on to consumers via lower electricity retail prices: that would seem to be a commercially very risky proposition for a retailer to take a bet on. Accordingly, allocation of LCE payments to offset other industry costs, resulting in lower charges elsewhere, would likely deliver a more certain consumer benefit. We note that the issue of pass-through mechanisms is to be subject to future consultation, but in our view it is relevant to the consideration of allocation options. If the Authority choses an allocation mechanism that relies on retail competition to pass through a volatile LCE allocation, then that is relevant to the consideration of that option. 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.

Closing comment

We look forward to further engagement with the Authority on these issues.

Yours sincerely

Nathan Strong
GENERAL MANAGER COMMERCIAL