FLICK

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

Dear team

Re: Consultation Paper – settlement residue allocation methodology

Flick appreciates the opportunity to submit on the Electricity Authority's (Authority) consultation paper on proposals for allocating the settlement residue from overpayment in the wholesale market.

Flick is disappointed the Authority continues to prefer allocation methodologies linked to transmission pricing when these options clearly had minimal, if any support, in the submissions and cross submissions made in March 2022. Allocating the settlement residue to WEM purchasers meets the Authority's adopted SRAM principles: allocation to WEM purchasers is clearly a more straightforward process and does not add disproportionate cost or complexity relative to the Authority's preferred methodologies – for the long term benefit of consumers; WEM purchasers do not 'use' the grid (generators do) so this process can not undermine grid usage signals; and, most importantly, allocation to WEM purchasers reduces their overpayment for electricity.

The Authority has created a new term for loss and constraint rentals which suits their preferred allocation methodologies – the 'nodal transport cost'. Losses occur due to the physics of electricity, there will always be losses[1] and they bear no relationship to the nodal price construct of our wholesale market and cannot be described as a 'nodal transport cost'. However, the value of these losses reveals itself at each pricing node. Maybe the Authority should separate out the value of losses and the value attributable to transmission constraints before settling on its allocation methodology for 'nodal transport costs'. The physical attributes of the grid mean that <u>purchasers</u> pay for the amount of electricity lost and the impact of transmission constraints.

Flick does not support the LCE being allocated to generators. We do not support the Authority's logic that generators 'overpay'. Generators at nodes upstream of

[1] For example, Transpower's draft Assumptions Book for the new TPM details HVDC losses for quantities of North and South flow

a constraint determine the price they are prepared to generate at, regardless of a constraint, and this is the amount they are paid.

Further, generator offers and offer behaviour (creating price separation) clearly also impact the value of the wholesale market settlement residual. Flick strongly disagrees with a methodology (particularly the Simple BB approach) which results in a significant increase in residual revenue payable to generators (~$20 million per year increase or 40% of total residual payments according to Figure 2) when they clearly have control over the level/value of the residual. The Authority acknowledged this risk of extending the scope for strategic offers in paragraph 4.13 of its January 2022 consultation paper. We also do not understand how the Authority's analysis in Figure 3 has resulted in generators receiving ~40% of the residual in 2035 when they are only allocated ~33% of transmission costs under the Simple Method BBC.

We disagree that it is essential the settlement residual be allocated to transmission customers[2]. 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 the investment signals expected from the 2022 new TPM. Payment of the residual to transmission customers will reduce their exposure to transmission costs (by ~10% using 2021/21 data) – is the Authority concerned that the signals provided by the new TPM are too strong? Doesn't this reduction in transmission costs for transmission customers undermine usage and investment signals provided by the new TPM?[3]

Flick's strong preference remains allocation to WEM purchasers. A settlement residual of ~$80million per year is a less than $0.002 per kWh on purchaser volumes. This amount is hardly going to incentivise any purchaser 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 allocation to WEM purchasers is consistent with the Authority's principles. 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 on how the residual arises due to constraints on the transmission grid in real-time so the integrity of the WEM nodal transport charge is maintained.

[2] Footnote 38

[3] Directly contradicted the objective in paragraph 3.10 of the consultation paper

We reiterate our support for 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 of 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.

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

Yours

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