27 September 2022

Genesis Energy Limited
155 Fanshawe Street
Auckland 1010
New Zealand

T. 09 580 2094

Submissions
Electricity Authority
Level 7, Harbour Tower
2 Hunter Street
WELLINGTON 6143

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

Consultation – Settlement Residual Allocation Methodology

Genesis Energy Limited (**Genesis**) welcomes the opportunity to provide feedback on the Electricity Authority's (**Authority**) consultation paper: *Settlement Residual Allocation Methodology* dated 16 August 2022.

Move to address regulatory gap and windfall gains welcomed

The omission from the Code of an express obligation on distributors to pass on the SRAM to retailers and other distribution customers, is a gap in our regulatory framework that has existed for well over a decade. As we have raised with the Authority previously, this has resulted in significant windfall gains for those distributors who have not passed the settlement residue rebate (**Rebate**) on in full, or at all.

We acknowledge that the Authority is seeking to address the regulatory gap, and welcome the Authority recognising this in its problem definition and moving to mandate the pass-through obligation.

Genesis supports a full pass-through obligation supported by enhanced disclosure

The Authority recognises that:[1]

(a) Distributors vary as to whether and how they pass on the Rebate to retailers and other transmission customers.

(b) The effect of distributors not passing on the Rebate in full (or at all) is that these parties pay more than the cost of providing them with transmission services. This over payment imperils the benefits of the TPM and ultimately, the objective of lower electricity prices for consumers.

The Authority also acknowledges that of the four options considered, the obligation to

[1] Consultation Paper, paras 5.1 – 5.3.

pass the Rebate through in full and on a monthly basis (**full pass-through option**), is the option that best addresses the overpayment of transmission charges. The Authority's principal concern with this option, however, was the risk of "unwarranted compliance costs".[2] Consequently, the Authority proposes the limited pass-through obligation supported by disclosure obligations as the preferred option.

We ask that the Authority reconsider its preferred option for the following reasons:

(a) Limited pass-through option results in continued and larger windfall gains

The limited pass-through option would allow distributors to hold the Rebate for up to a year before having to transfer it. This has two material and adverse consequences:

(i) It <u>continues</u> the windfall gains enjoyed by those distributors who have not transferred the Rebate. Given the Code amendment will not take effect until next year, these parties potentially have the use of $15 million[3] interest free and no obligation to repatriate this money. Then once the proposed amendment takes effect and assuming they choose to return the Rebate once a year, they have access to these funds interest free for 12 months. (It is difficult to see why they would make a different choice as the commercial incentive not to do so.) At current business lending rates,[4] this would represent a windfall gain in interest savings of $1.848 million – $2.448 million on $15 million of Rebate.

(ii) <u>Even worse, the limited pass-through option increases the potential windfall gains for all distributors</u>. This is because the option would allow <u>all</u> of the distributors who currently pass the Rebate through on a monthly basis (being the vast majority of distributors) to do so on an annual basis instead. If all distributors did so, then they potentially have the use of $40m[5] interest free for 12 months. At current business lending rates,[6] this would represent a windfall gain in the form of interest savings of $4.928 million – $6.528 million per annum.

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[2] Consultation Paper, para 5.32.

[3] Assuming that the aggregate settlement residue for the 2021-22 pricing year is the same as the previous pricing year. See "Table 2 Settlement residue is a material part of overall transmission revenue" at page 24 of the Authority's *Settlement Residual Allocation Methodology: principles, options and pass-through* consultation paper dated January 2022.

[4] Based on ASB Business Lending Base Rate range of 12.32% – 16.32% per annum on 27 September 2022 at: https://www.interest.co.nz/borrowing/business-base-rates

[5] Assuming that the aggregate settlement residue for the 2022-23 pricing year is the same as the previous pricing year i.e. $80m and assuming that 50% is passed through to retailers. See "Table 2 Settlement residue is a material part of overall transmission revenue" at page 24 of the Authority's *Settlement Residual Allocation Methodology: principles, options and pass-through* consultation paper dated January 2022.

[6] Based on ASB Business Lending Base Rate range of 12.32% – 16.32% per annum on 27 September 2022 at: https://www.interest.co.nz/borrowing/business-base-rates

It is unconscionable that parties who are not entitled to these funds would nevertheless have access to the funds at no cost, before transferring the funds - a year later - to the parties which are entitled to them.

If the Authority wishes to pursue this option further, we ask that it incorporate a use of money interest calculation into its cost benefit analysis to assess the impact on retailers and others.

(b) Unwarranted compliance costs unsubstantiated

Almost all of the distributors who pass through the Rebate, do so on a monthly basis. (In our experience, only one of these distributors does so on an annual basis.) Accordingly, a full pass-through obligation on a monthly basis should not give rise to an increase in compliance costs for those who already pass the Rebate on. If, for some reason it does, the increase should not be material.

(c) Compliance costs, even if material, are warranted

The Authority also suggests that compliance costs arising from the full pass-through option may be "unwarranted". As discussed in paragraph (b), the vast majority of distributors should not incur material compliance costs. In relation to those distributors that have chosen not to pass the Rebate through in full or at all, they are not entitled to these funds and have had the use of these funds without paying interest to those that are entitled to them. As described in paragraph (a), these parties have had the use of, and under the Authority's preferred option, will continue to have the use of, $15 million that they are not entitled to - interest free for 12 months.[7] Without taking into account use of money interest on Rebates that have not been paid over the last five years, these windfall gains on their own would justify the compliance costs incurred by them.

(d) Limited pass through introduces complexity and inefficiencies

The limited pass-through option allows distributors to devise their own methodologies and offset sums under a vague notion of "other considerations, such as administrative complexity". Multiple methodologies impose compliance costs for retailers and other transmission customers. The lack of standardisation, for example, would potentially mean retailers having to assess 29 different methodologies to determine the appropriateness of the deductions and the underlying assumptions. This approach also raises the risk of leakage as it allows distributors to potentially use the vagueness inherent in "other considerations" to withhold money that ought to be transferred.

While the Authority acknowledged the systems impact on retailers of multiple methodologies, it appears to have dismissed this as immaterial and instead has

[7] Assuming that the aggregate settlement residue for the 2021-22 pricing year is the same as the previous pricing year. See "Table 2 Settlement residue is a material part of overall transmission revenue" at page 24 of the Authority's January 2022 consultation paper.

placed more weight on the potential impact on distributors. As discussed in paragraph (b), there should not be a material impact on distributors given the vast majority pass the Rebate through monthly. Accordingly, we propose that a single methodology is prescribed and applied to all distributors. This should not give rise to administrative complexity or compliance costs for the vast majority who currently pass through the Rebate.

Given the above, the full pass-through obligation on a monthly basis (supported by annual disclosure obligations) should be the preferred option and we ask that the Authority reconsider the matter.

Return funds to those who have overpaid for transmission services

The Authority recognises that the Rebate should be transferred to retailers and those transmission customers who have overpaid for transmission services. However, the reference to "consumer" in the draft Code amendment is ambiguous and does not reflect the policy intent set out in the consultation paper.

To remove any uncertainty, we propose that in the principal provision imposing the full pass-through obligation, the term "consumer" is replaced with "*Distribution Customer*" and that this term is defined as "*in relation to a distributor, a trader that is party to a distributor agreement with that distributor*".

Please contact me should you have queries or wish to discuss our response further.

Yours sincerely

Warwick Williams
Senior Regulatory Counsel and Group Insurance Manager