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Submissions
Electricity Authority
Wellington

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The Authority should not pursue policy options that were not supported by any stakeholders

2degrees, Electric Kiwi, Flick Electric, Haast Energy Trading (Haast), and Pulse (the independents) do not support either of the Electricity Authority's preferred options for loss and constraint excess (LCE) allocation.

Summary of our the independents' views

- The independents support: (i) allocating LCE to WEM purchasers (our preferred option) or, (ii) if a TPM-based allocation approach is adopted, allocating based on the residual charge (our 2nd preferred option).

- We do not support allocating LCE to generators, and we do not support the simple BB method or allocation based on transmission charges. The Authority provided sound reason previously for not allocating LCE to generators.

- Allocation to generators is inefficient and results in unwarranted wealth transfers. The Authority proposal is particularly incongruent given: (i) the concerns the Authority has raised about wholesale prices being above competitive market levels; and (ii) the Authority consultation is occurring at a time when the incumbent generators have all announced record profits off the back of their wholesale businesses.

	EBITDAF	Wholesale EBITDAF	Wholesale EBITDAF/EBITDAF
Contact	$537m	$548m	102%
Genesis	$440m	$354m	80%
Mercury	$581m	$584m	101%
Meridian	$709m	$675m	95%
Total	$2,267m	$2,161m	95%

- The Authority's preferred "simple BB option" garnered no support from any stakeholders in the last round of submissions and cross-submissions.

- We do not consider that the Authority proposal satisfies its SRAM principles or the DMEF. This is illustrated by the fact the Authority reached diametrically different (e.g. allocation using the residual) conclusions about LCE allocation previously when it used the DMEF.

- Application of simple BB method to load only: If the Authority considers that it is non-distortionary or efficient to allocate on the basis of historic grid usage (the simple BB method), then it could consider allocating to wholesale market customers only on the basis of their historic demand i.e. allocating to load using the historic load volumes in the simple BB method.

The Authority is pursuing the options which received the least support from stakeholders

The Authority's preferred "simple BB option" garnered no support from any stakeholders in the last round of submissions and cross-submissions. It is very rare that a regulator's proposal is rated so poorly it is not supported by a single submitter. The Authority is essentially saying that it is right and all of industry is wrong.

The Authority's second preferred transmission charge allocation option also received very limited support.

We reiterate, "[i]t is clear from submissions [and cross-submissions] that the overwhelming majority of submitters support: (i) allocating LCE to WEM purchasers (our preferred option) or, (ii) if a TPM-based allocation approach is adopted, allocating based on the residual charge (our 2nd preferred option). It is also clear from submissions [and cross-submissions] that there is little support for allocating LCE to generators. The independents support allocation to consumers only".

The only aspect of the Authority proposals that have support from the independents and other submitters is the proposal to require transparent pass-through of LCE by distributors to consumers, though the matter of whether this should be directly to end-consumers or via retailers was in dispute. Allocating LCE to WEM customers obviously avoids any requirement for additional regulation regarding how distributors pass through LCE residue.

The Authority's justifications for its proposal are unconvincing

We do not agree with the Authority's responses to submissions, and consider the Authority's justifications for its proposal to be unconvincing and counter-intuitive:

- The Authority provided sound reason previously for not allocating LCE to generators.

- The Authority provided sound reason previously for allocating LCE via the residual. It was surprising the Authority did not respond at the SRAM workshop to a question about why it had previously considered residual allocation to be market-based and therefore top ranked under the decision-making and economic framework (DMEF) but now does not consider it to even be an option that should be included in its consultation.[1] The written response did not answer this question either.[2]

[1] Question at Electricity Authority SRAM workshop, 29 August 2022.
[2] https://www.ea.govt.nz/development/work-programme/pricing-cost-allocation/settlement-residual-allocation-methodology-sram/sram-q-and-a/

> **The EA previously said residual allocation would be market-based which tops the DMEF. What caused the change in view such that it is no longer even considered to be an option?**
>
> We understand that this question refers to allocation of settlement residual rebates in proportion to the residual charge in the transmission pricing methodology (TPM).
>
> In response to the question we would note that we did consider a residual-charge-based approach in the August 2022 SRAM Consultation Paper, as part of the consideration of the TPM charges option (see page 12, footnote 21 and page 34, paragraph B.7 of the Paper). Chapter 4 lays out why we consider that the simple BB option better meets the Authority's statutory objective than a residual-charge-based approach.
>
> However, we would welcome any submissions on whether a residual-charge-based approach or a TPM-charges-based approach to allocation of settlement residual rebates should be adopted.

It appears that the Authority disagrees with its previously held views but isn't being forthcoming or transparent about the reasons for the change in views.

- The Authority's comments about generators receiving lower wholesale electricity prices when they are behind a constraint are spurious and irrelevant.[3] In no way does it shift the fact that LCE arises from "consumers [paying] more for electricity than generators receive" or generators need to be paid to be fully compensated and, therefore, LCE should be allocated to consumers.

- The statement that "To support efficient grid use, a party's rebate should not be correlated with its use of the grid"[4] ignores that the simple BB method allocations would be based on historic injection and consumption (either coincident peak or volumetric offtake). Using historic consumption information may weaken the variability but leaves allocation correlated to use of the grid.

  If the Authority considers that it is non-distortionary or efficient to allocate on the basis of historic grid usage, then it could consider allocating to wholesale market customers on the basis of their historic demand i.e. allocating to load only using the Authority's preferred allocator. This would address the concerns the Authority has raised about WEM allocation to wholesale customers.

- Allocation of LCE to generators/increasing the LCE allocation to generators would result in unwarranted wealth transfers to the detriment of consumers.

  It is unclear how a forecast that load customers might pay lower transmission charges in the longer-term would justify load customers receiving less LCE. The implicit logic seems to be either that generators should receive compensation for future price increases or that one price change in one part of the market can be used to offset or justify a price change in another part of the market. We do not consider that this argument is well-grounded against the Authority's statutory objective.

  The TPM results in adverse wealth transfers from consumers to South Island generators which we did not support. The LCE allocation proposals will make this worse.

- The optics of providing generators with windfall gains is not great at a time when there are major concerns about excessive/monopoly-type pricing in the wholesale market and the incumbent generators have announced record profits.

[3] The Authority omitted to mention generators can also receive higher wholesale electricity prices due to transmission constraints.

[4] Paragraph 2.13 of the Authority's consultation paper

- "Box 2: SRAM can mitigate locational price risk and preserve nodal price signals". The marginal price signal would only be the same if the rebate is fixed. If all the residue was auctioned as FTRs this would work. But the rebate is not fixed and the Authority is seemingly consulting on whether the FTR market should be retained, not on expanding it.

- It is unclear why the Authority would promote the merits of LCE allocation as a way to help manage location risk (a very very indirect and clumsy mechanism for risk management) while at the same time it questions the efficacy of FTRs as a risk management tool (which provide a very good risk management).

  Relatedly, the Authority describes the balance of LCE after FTR transactions as the "nodal transport costs". Is the LCE used in the FTR market also the "nodal transport cost" or is it something different? How can this "nodal transport cost" amount be identified separate from the LCE available for FTRs? The balance of the LCE after the FTR market is simply the balance of the amount overpaid by end consumers for electricity. Further, the amount of LCE used in the FTR market is allowed to be used by electricity purchasers for managing locational price risk.[5] Why is it not appropriate for the balance of the LCE to be available for the same purpose? We submit that the creation of 'nodal transport cost' is a fictitious distinction adopted by the Authority to support its preferred LCE residue allocation options.

Concluding remarks

We do not consider it makes any sense to allocate LCE to generators, or on the basis that the more a customer is deemed to benefit from the grid the more money they should be given (the simple BB method is a kind of reverse Robin Hood methodology). This would seem to undermine the tenant of beneficiaries-pay that the more you benefit the more you pay.

The consultation paper does not substantiate how what are intended to be fixed allocations "will encourage more efficient use of the grid, and support the right investments being made at the right time and in the right places" or "over time, lead to relatively lower prices to consumers for delivered electricity". Taking LCE off consumers and giving it to generators will lead to relatively higher prices.

There is nothing in the new consultation which would give us cause to change our views on this topic. Quite the opposite. We reiterate it is apparent submitters preferred the Authority's earlier thinking in its previous consultations on LCE allocation as part of the TPM review, which focussed on the importance of preserving the integrity of nodal pricing, and recognised allocation to generators could distort generator behaviour, as their offer strategy could be aimed at increasing their LCE share.

We remain strongly of the view that the LCE residue should be allocated to WEM customers by the Clearing Manager in their monthly reconciliation process. LCE is created and paid for in the wholesale market in a process managed by the Clearing Manager and it should be redistributed via the same mechanism.

[5] The balance of LCE, the residue, also fluctuates depending on activity in the FTR market.

Yours sincerely,

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