

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

27 September 2022

Settlement Residual Allocation Methodology (SRAM)

Mercury welcomes the opportunity to provide feedback on the Electricity Authority's (Authority's) consultation paper *Settlement Residual Allocation Methodology*, 16 August 2022 (Consultation Paper).

The Authority seeks stakeholders' views on its proposed new SRAM principles, and draft Code amendments, to replace the current method. The Authority has developed a proposed new SRAM and is proposing to introduce pass-through and reporting obligations that would direct how distributors pass rebates through to the parties who bear nodal transport costs.

Mercury supports the Authority's proposed '*Simple BB*' option for allocating rebates to parties that use congested parts of the grid, using the regional allocators that Transpower has developed for allocating the costs of low-value benefit-based investments via the benefit-based charge (BBC) simple method in the TPM.

Mercury also supports the Authority's principle that distributors should pass their settlement residual rebates through to their customers.

Mercury submits, though, that current drafting of the proposed Code amendment creates an ambiguity as to who the rebate may be paid to by the distributors.

Mercury also submits that the Authority's *full pass-through obligation* would give better effect to Authority's objective than the *limited pass-through obligation* option.

Mercury, therefore, proposes in Annex A very targeted edits to the Code amendment that address these two concerns.

Mercury's submission focuses on the ambiguity in the current drafting of the Code amendment and the reasons that the *full pass-through obligation* is preferable to the *limited pass-through obligation*. Further comments on the other topics covered in the Consultation paper are provided in Annex B in response to the Authority's consultation questions.

Code amendment drafting ambiguity

Mercury's concern with the current drafting of the Code amendment is that the term "customer" is not defined under the Code, introducing the potential for distributors to interpret the provision broadly and to make such payments to the end users of electricity.

Accordingly, Mercury's proposed edit to the Code amendment, which is provided in Annex A, addresses this ambiguity, so that it is clear that the "customer" is the party with the direct contractual relationship with the distributor.



An additional reason for proposing this edit is that it supports the implementation of the *full pass-through obligation*, which is discussed next.

Distributor settlement residual pass-through requirement

Mercury considers that the Code should prescribe a *full pass-through obligation* on distributors to pass through to their customers any settlement residual rebate they receive, rather than the *limited pass-through obligation* as presently drafted in the proposed Code amendment. In particular, Mercury supports in general the full pass-through obligation approach that the Authority has set out in paragraphs 5.27 to 5.30 of the consultation paper.

Mercury agrees that distributors should be required to pass-through the settlement residual rebate directly to their customers and not to parties that are not their customers, for example, end users. For the reasons set out in Mercury's cross-submission on the Authority's previous SRAM consultation, requiring distributors to pass-through the settlement residual rebate directly to their customers would promote economic efficiency.

Mercury also agrees with the full pass-through obligation as summarized in in paragraph 5.27 of the consultation paper, as it would promote economic efficiency better than the limited pass-through obligation – i.e.:

- a) *it would mandate the allocation of the settlement residual rebate at each grid connection location to distribution customers in proportion to each customer's transmission charges for that location; and*
- b) *it would mandate monthly pass-through.*

Taking each of the above points in turn, Mercury agrees with the Authority that this approach has the advantage that the settlement residual rebate would be closely tied to the overpayments, which would promote economic efficiency.

Furthermore, Mercury considers that explicitly addressing point a) in the Code above would address the ambiguity in the current Code amendment as discussed above.

In addition, mandating a monthly pass-through would also promote economic efficiency better than mandating a pass-through that is at least annual, as presently drafted in the proposed Code amendment, because it would better align the pass-through with the retailers' monthly billing cycle. This alignment would enable retailers to allow for the pass-through better in retail prices, and with the process of competition, it would result in retail prices that are more efficient. As the Authority notes in paragraph 5.18 ... *competition will provide an incentive for retailers to repackage all the costs they face - including charges for transmission services (ie, transmission charges, rebates and nodal prices) - into the form of charges that are most attractive to retail customers.* Mandating monthly pass-through would facilitate this process.

Mercury considers that the full pass-through option is sufficiently high-level to give distributors the flexibility to accommodate any differences in how they might accommodate and recover transmission charges from their customers.

In contrast, Mercury notes that the *limited pass-through obligation* would create ambiguity, uncertainty and reduce transparency as it may to allow distributors to continue their current different approaches to pass-through of the settlement residual.

Mercury considers, in sum, that the *full pass-through obligation* would enhance the general transparency, efficacy and economic efficiency of the overall pass-through process for distributors and their customers when compared with the *limited pass-through obligation*. Mercury proposes, therefore, the two edits to the draft Code amendment, as set out in Annex A.



Mercury looks forward to engaging constructively with Authority and industry stakeholders on implementing the distributor pass-through requirement and continuing to work on finalizing the TPM and the SRAM.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Tim Thompson', with a stylized flourish at the end.

Tim Thompson
Head of Wholesale Markets



Annex A: Mercury proposed Code amendment

Mercury proposes the following edits marked up in red to the proposed Code amendments at 12A.3 in order to reflect the Authority's "full pass-through obligation" under the "Simple BB" option, as commented on this this submission.

12A.3 Distributors must pass-through settlement residue

- (1) The purpose of this clause is to allocate **settlement residue** to **consumers** (or **retailers** on behalf of **consumers**) in proportion to the transmission charges paid by those consumers (whether directly or indirectly) [in respect of each **connection location**]. [Text in square brackets is for the "Simple BB option" only]
- (2) A **distributor** that is paid any amount of **settlement residue** under clause 14.35A(1) of Part 14 must, ~~at least annually~~ on a monthly basis, allocate and pay this amount to its customers (being those customers of the distributor that pay distribution and/or transmission charges directly to the distributor) in accordance with a methodology developed under subclause (3).
- (3) Each **distributor** to whom subclause (2) applies must develop a methodology for allocating **settlement residue** to its customers that has regard to the purpose described in subclause (1) [and the information provided to the distributor by **Transpower** under clause 14.35A(7) of Part 14]. [Text in square brackets is for the "Simple BB option" only]
- (4) A **distributor** must publish the methodology developed under subclause (3), including an explanation of the rationale for the methodology.
- (5) A distributor must publish annually a breakdown of payments made under subclause (2) by location and type of customer (for example retailer, direct generation customer, direct load customer).
- (6) A distributor may adjust any payment made under subclause (2) to correct for a previous overpayment or underpayment under that subclause.
- (7) An amount payable under subclause (2) is recoverable in any court of competent jurisdiction as a debt due to the person to whom that subclause requires payment to be made.



(8) A payment required under subclause (2) may be met by way of a credit against any amount owed to the **distributor** by the customer.



Annex B: Mercury response to consultation questions

Transpower consultation question	Mercury comments
<p><i>Chapter 2</i></p> <p>Do you have any comments on the problem definition and background material in this chapter?</p>	Mercury has no comments.
<p><i>Chapter 3</i></p> <p>Do you have comments on our proposed SRAM principles?</p> <p>Do you have comments on anything else in this chapter?</p>	Mercury has no comments.
<p><i>Chapter 4</i></p> <p>Do you have comments on our preference for the Simple BB approach to the SRAM?</p> <p>Do you have any comments on our assessment of other SRAM options, including in particular the TPM charges method?</p> <p>Do you wish to propose another option for consideration?</p> <p>Do you have any comments on the proposed Code to incorporate the SRAM into the Code?</p> <p>In particular, do you have any comments on:</p> <ul style="list-style-type: none"> • the proposal to make a party's allocation of settlement residue a debt recoverable in a Court? • the relationship between the Code Amendment, the benchmark agreement and transmission agreements? <p>Do you have comments on anything else in this chapter?</p>	<p>Mercury broadly supports Transpower's preference for the Simple BB approach compared with the TPM charges method.</p> <p>Mercury also broadly supports Transpower's assessment of the relative detriments and benefits of the Simple BB approach compared with the TPM charges method.</p> <p>Regarding the proposed Code amendment under the "Simple BB option", clause 14.35A(7) prescribes the information that Transpower would be required to disclose to distributors. Mercury suggests that all Transpower customers that receive the settlement residue rebate should receive the same information.</p> <p>Mercury does not have any further comments.</p>
<p><i>Chapter 5</i></p> <p>Do you agree that the Code should impose a limited pass-through obligation on distributors to pass through any settlement residual rebate they receive?</p> <p>Do you agree that they should be required to pass-through the settlement residual rebate to their customers rather than to, for example, end users?</p> <p>Do you agree that the Code should require Transpower to inform distributors of their rebate breakdown each month by location and (where applicable) by offtake vs. injection?</p> <p>Do you agree that the Code should require the distributor, in passing through and allocating the rebate, to have regard to the intent that the rebate be allocated region by region in proportion to transmission charges paid by each customer type in respect of each connection location?</p>	See the discussion under section <i>Distributor settlement residual pass-through requirement</i> in the above letter.



<p>Do you agree that distributors should be required to disclose their rebate methodology and its rationale, and to report on its application?</p> <p>Do you think that distributors should be required to explicitly disclose to customers the amount of any allocation of settlement residual rebate they are being credited with at the time they are credited with it?</p> <p>Do you agree that the Code should require distributors to pass-through the rebate at least annually?</p> <p>Do you have any other comments on this chapter?</p>	
<p><i>Chapter 6</i></p> <p>Do you agree with the objectives of the proposed amendments? If not, why not?</p> <p>Do you agree the benefits of the proposed amendments outweigh their costs?</p> <p>Do you agree that the alternative means of meeting the objective are not as effective in meeting the Authority's statutory objective? If you disagree, please explain your preferred alternative option in terms consistent with the Authority's statutory objective.</p> <p>Do you agree the Authority's proposed amendment complies with section 32(1) of the Act?</p> <p>Do you have any other comments on this chapter?</p> <p>Do you have any other feedback on any other aspect of this consultation paper?</p>	<p>Mercury has no comments.</p>