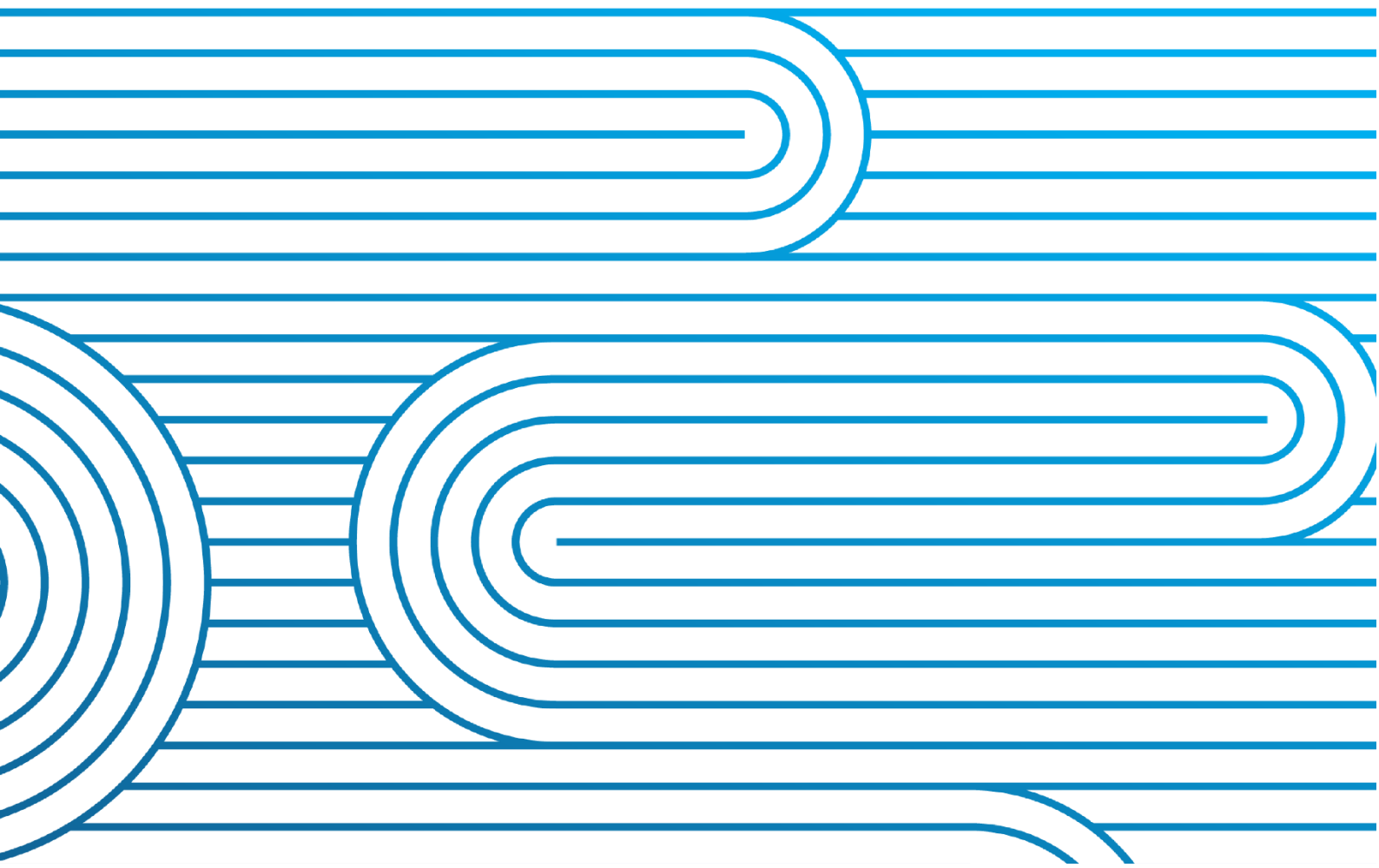


Settlement Residual Allocation Methodology

Transpower's submission to the Electricity Authority's consultation

Date: 27 September 2022



1. Transpower's views on the Settlement Residual Allocation Methodology (**SRAM**) are unchanged since our most recent submission and cross-submission in response to the Authority's SRAM principles consultation.¹
2. Transpower does not agree with the Authority's problem definition. We do not agree that "the basic problem" is that "Transpower's current allocation will become obsolete once the new TPM is in place". Rather, we consider the underlying problem is one generated by the wholesale electricity market's (**WEM's**) design: that consumers pay more for electricity than is needed to fully compensate generators for the electricity they generate.
3. As submitted previously, we consider Transpower should have no role in allocating settlement residue, as it arises due to the design of the WEM and is not a function of the transmission system itself. Removing Transpower from the process would also resolve the cost-recovery issue noted below.
4. Consistent with Transpower's views, there was strong majority support from other submitters to that consultation that:
 - a) settlement residue should not be allocated to generators;² and
 - b) allocation should be direct to WEM purchasers,³ or otherwise in proportion to residual charges.⁴
5. There was no support from submitters for the 'Simple BB' option, which is now the Authority's preferred option. Significantly, there was no support for the simple BB option from generators, who are the participants who stand to benefit the most from it.
6. Transpower does not support the simple BB option for the following reasons:
 - a) **Implementation costs for the simple BB option could be substantial.** We do not agree with the Authority's suggestion there is any benefit from adopting the simple BB option.
 - The simple BB option would be the most costly and complex option to implement: our preliminary estimate is \$1m extra in capex plus \$150k for investigation costs. We

¹ Transpower, submission, Settlement Residual Allocation Methodology (SRAM), 1 March 2022 and cross-submission 24 March 2022, are available on our regulatory submissions webpage:

<https://www.transpower.co.nz/our-work/industry/regulatory-submissions>.

² Submissions/cross-submissions by Electric Kiwi and Haast, Entrust, Flick, Independent retailers, MEUG, Unison, Vector and WPI in response to Electricity Authority, Settlement Residual Allocation Methodology: principles, options and pass-through, Consultation paper, 18 January 2022. The consultation paper and submissions are online at <https://www.ea.govt.nz/development/work-programme/pricing-cost-allocation/settlement-residual-allocation-methodology-sram/consultation/#c19111>.

³ Submissions/cross-submissions by Electric Kiwi and Haast, Flick, Genesis (implied 2nd or equal with option A), Independent retailers, Meridian, Nova and Transpower in response to Electricity Authority, Settlement Residual Allocation Methodology: principles, options and pass-through, Consultation paper, 18 January 2022, see link in footnote 2.

⁴ Submissions/cross-submissions by Electric Kiwi and Haast (2nd), Entrust, Independent retailers (2nd), Transpower (2nd), Unison (preference versus "Fund industry costs" unspecified) and Vector in response to Electricity Authority, Settlement Residual Allocation Methodology: principles, options and pass-through, Consultation paper, 18 January 2022, see link in footnote 2.

would not be able to implement the simple BB option in a systemised way in time for May 2023,⁵ and expect to need to work in a hybrid system across our current LCE system and a settlement residue spreadsheet for at least a year. This would introduce considerable inefficiency and risk for Transpower. Systemisation of the TPM charges option, or the residual charge variant of it may be achievable before May 2023.

- If Transpower is to have a role in allocating settlement residue, there needs to be a means by which it can recover its costs of carrying out this activity. We understand the Commerce Commission is of the view the costs of implementing the simple BB option (or any other option that retains Transpower’s involvement in the allocation of settlement residue) would not contribute to our regulated revenue because they are not costs of providing electricity lines services (as defined in the Commerce Act). On this view, Transpower could not recover the costs through transmission charges. The issue of cost-recovery needs to be resolved before the Authority adopts any option that incurs cost for Transpower.
- b) The simple BB option exacerbates the (real) problem by not returning all settlement residue to purchasers or at least load customers. We do not agree *“generators contribute to the surplus by recovering reduced margins”*. The fact that congestion elevates downstream prices and suppresses upstream prices does not change that generators are fully compensated (at a minimum) for their offer price. There is no ‘missing money’ problem generators need to be compensated for. Consumers, on the other hand, pay more than is required to fully compensate generators, which gives rise to settlement residue.
- c) **The simple BB option distorts benefit-based charge (BBC) and nodal pricing signals.** It is contrary to the Authority’s policy behind BBCs for customers to, in effect, receive a rebate of their BBCs proportionate to their benefits. It is unclear why the Authority has dropped its previous, and in our view well-founded, concern that *“Generators ... may have the incentive and ability to game the system by modifying their offers to take the treatment of LCE into account”* and *“some parties may have both the incentives and ability to inefficiently ‘game’ the spot market to alter the creation and allocation of LCE in order to reduce their transmission charges. This may be at the expense of other participants”*.⁶
- d) **The simple BB option does not measure up against the Authority’s own SRAM principles.** The simple BB option is clearly worse than the option of allocating settlement residue in proportion to residual charges when assessed against the Authority’s SRAM principles (emphasis added):

⁵ As noted by the Authority on page 2 of the consultation paper [\[online at https://www.ea.govt.nz/assets/dms-assets/30/Settlement-Residue-Allocation-Methodology-consultation-paper.pdf\]](https://www.ea.govt.nz/assets/dms-assets/30/Settlement-Residue-Allocation-Methodology-consultation-paper.pdf): “[i]f the Authority decides to incorporate SRAM provisions into the Code, Transpower would be required to apply the new methodology to settlement residue it receives from May 2023 (ie, relating to April 2023 trading).”

⁶ Electricity Authority, Working paper, Transmission pricing methodology: Use of LCE to offset transmission charges, 21 January 2014, paragraphs 1.5 and 1.10. Online at <https://www.ea.govt.nz/assets/dms-assets/17/17484TPM-LCE-working-paper.pdf>.

- “A well-designed SRAM should return the over-recovery to grid users without undermining the incentives provided by wholesale electricity prices and the TPM for efficient grid use and investment. This would promote the Authority’s statutory objective.”
 - “To support efficient grid use, a party’s rebate should not be correlated with its use of the grid.”
 - “To support efficient investment decisions, a party’s settlement residual rebate should not undermine the role of the TPM in encouraging users to take future grid upgrade costs into account when making their investment decisions.”
7. We re-submit that only options that allocate settlement residue to WEM purchasers or load customers (and not to generators) should be considered. Other options do not address the underlying problem that consumers pay more than is needed to fully compensate generators.
 8. If a TPM-based approach is to be used to allocate settlement residue, then we re-submit that the residual charge should be the allocator. The residual charge is designed to be a fixed and non-distortionary transmission charge. Allocation using the residual would mean the SRAM would not interfere with any TPM (BBC) or nodal pricing signals.
 9. Moreover, use of the residual is most consistent with the Authority’s own decision-making and economic framework (DMEF). The Authority has previously supported an equivalent option – crediting settlement residue against Transpower’s recoverable revenue – as *“market-based...and therefore the most preferred charging approach under the Authority’s [DMEF] under the TPM.”*⁷ The Authority’s current (footnoted) dismissal of the residual charge option on the basis *“it does not address generator over-payment”* is misconceived, as explained above.
 10. If the Authority limits its consideration to the simple BB option and the TPM charges option, we would prefer the TPM charges option on the grounds of simplicity and owing to our practical and policy concerns about the simple BB option.

⁷ Electricity Authority, Working paper, Transmission pricing methodology: Use of LCE to offset transmission charges, 21 January 2014, paragraph 8.5, see link in footnote 6.



