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Settlement Residual Allocation Methodology: Consultation Paper

1. This is Vector's submission on the Electricity Authority's (Authority) Settlement Residual Allocation Methodology (SRAM) consultation paper.
2. We have significant concerns that the Authority's preferred pass-through option does not allow distributors to pass rebates directly to consumers.
3. Vector, through its majority shareholder Entrust, pays settlement residue directly to consumers who are Entrust beneficiaries. For consumers that are not beneficiaries (and therefore that Vector does not have a direct relationship with), Vector pays settlement residue to retailers with a request that this is passed on to consumers.
4. This approach is the most cost-efficient mechanism for Vector and its consumers. There are clear benefits for consumers that Vector can pay settlement residue directly, as it provides transparency that settlement residue has been returned to these consumers.
5. This year, this resulted in 351,000 Auckland households and businesses received a \$30 settlement rebate payment from Vector, along with a \$273 Entrust dividend payment.¹
6. We do not see how it is in the long-term interests of consumers to remove the ability of distributors to pay settlement rebates directly to consumers. This would remove the only transparent mechanism that would ensure consumers receive 100% of the settlement rebate. This has the potential to cause real harm to consumers, particularly in the current environment where consumers face rising inflation and a cost of living crisis.
7. We recommend the Authority adopt the 'limited disclosure' option or amend its preferred 'limited pass-through obligation' to allow distributors to pay the settlement rebate either to retailers or directly to consumers. This would best ensure pass-through to consumers, along with allowing distributors to pass the rebate through in line with the approach most appropriate and cost effective for their business and consumers.

SRAM pass-through

8. The proposed Code amendment states, "*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).*"²
9. We support the intent to allocate settlement residue to consumers (or retailers on behalf of consumers). However, as drafted, the Code amendment only allows distributors to pay the settlement residue to its customers. We understand this refers to retailers rather than end

¹ See: <https://www.stuff.co.nz/auckland/auckland-top-stories/300694534/more-than-350000-aucklanders-wake-up-303-richer-due-to-entrust-dividend>

² Proposed amended clause 12A.3(1)

consumers. This would preclude distributors from paying settlement residue to consumers directly.

10. We cannot see how preventing distributors from paying settlement residue directly to consumers supports the long-term benefit of consumers. This removes the only mechanism that would ensure these consumers receive 100% of the benefit of settlement rebate. It is also entirely consistent with the purpose of the Code amendment – to allocate settlement residue to consumers (or retailers on behalf of those consumers).
11. Unlike relying solely on retail competition, allowing distributor pass-through to consumers would provide transparency to these consumers that 100% of the settlement residue had been returned. The value of transparency to consumers should not be overlooked.

Support for the proposals in prior consultations

12. The prior round of consultation on the SRAM principles saw clear support from submitters that SRAM should be returned to consumers.
13. The Authority notes there was “relatively widespread support” in submissions for mandatory pass-through by distributors. However, we do not consider this should be taken as support for mandatory pass-through *exclusively to retailers*.
14. Unsurprisingly, submissions from retailers supported a requirement for distributors to pay settlement residue to retailers. However, other submitters such as Entrust, Network Tasman, Unison and Northpower suggested alternative approaches to return settlement residue to consumers without mandating pass-through to retailers. Furthermore, submitters such as MEUG and the ENA considered the Authority needed to undertake further work on the costs and benefits of pass-through before commenting on the need for a pass-through Code amendment.
15. In our view, the key theme from submissions was that the SRAM should be designed to return settlement rebates to consumers. It is unclear why the Authority considers it necessary to preclude distributors from passing-through settlement rebates directly to consumers to achieve this.
16. Vector is not opposed to mandatory pass-through of settlement residue to ensure consumers receive the rebates. However, distributors should be able to pass settlement residue either through retailers or directly to end consumers.

Retailer pass-through to end users

17. The Authority states in the consultation that it “*considered the possibility that distributors should have the option of passing through the settlement residual rebate directly to end users.*” It then refers to questions from submitters as to whether retailers would pass the rebate to consumers or retain the rebate as a windfall gain.
18. The Authority stated that, “*we consider that over time, competition in the retail market will mean that they will have to pass through the value of any settlement residual rebate that they receive. Instead, we consider that 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.*”
19. Ultimately, it is consumers who pay for transmission services and therefore who should receive the rebates.

20. It appears the Authority has decided to prevent distributors from paying rebates directly to consumers on the basis retail competition will ultimately lead to the rebates being delivered through lower charges.
21. The Authority previously signalled it would investigate the extent retailers had passed distribution savings on to consumers. However, this work has not yet taken place. It is even less justifiable to restrict the ability of distributors to pass rebates to end consumers ahead of the Authority investigating the extent retail competition has seen distribution savings being passed on in practice.
22. We are concerned the Authority intends to rely exclusively on retail competition to deliver the rebates to consumers but has not conducted analysis into the costs and benefits of this approach. This will remove the rebates from consumers that receive them directly from distributors without clear evidence they will receive higher benefit from those delivered to retailers.
23. A better approach – to allow distributors to pay settlement rebates to retailers or directly to end users – would ensure consumers paid directly by distributors receive 100% of the rebate.
24. Allowing distributors to pass settlement rebates through either retailers or directly to consumers is consistent with the Authority's SRAM principles:
 - It will reduce over-payment for transmission. Ultimately, it is consumers who overpay and who the settlement residue should be returned to. Allowing distributors to pay settlement residue directly to consumers will ensure they receive 100% of the benefit of settlement residue.
 - It does not undermine grid usage signals.
 - It does not undermine investment signals.
 - It does not add disproportionate cost or complexity. This approach would require little change from distributors, retailers or consumers. It would also allow distributors to choose which approach is most appropriate for their business and consumers. Accordingly, it is likely the lowest cost and least complex approach. It is also the most transparent.

Authority jurisdiction to mandate pass-through

25. We recommend the Authority consider whether it is encroaching on the jurisdiction of the Commerce Commission in mandating pass-through of the settlement residue.
26. The Commission's role under Part 4 is to determine the maximum revenues that EDBs can earn from the supply of electricity lines services. The Commission uses a building blocks model to determine an EDB's efficient costs, which then determines allowable revenue. Those costs include pass-through and recoverable costs, the most significant of which is transmission charges
27. In treating transmission charges as a recoverable cost, the Commission has determined that EDBs are entitled to recover from their customers the full amount of transmission charges levied by Transpower on a pass-through basis.
28. Separately, the Commission has determined that loss rental rebates are unregulated revenue. Accordingly, these are not passed through to distribution customers in the form of reduced recoverable costs or reduced building blocks revenue from prices.
29. By directing pass-through of settlement rebate to customers, the Authority is effectively reversing this position. Pass-through to customers is economically equivalent to reducing recoverable costs associated with transmission charges or reducing building blocks

revenue from prices. This is, in fact, precisely what the Authority is trying to achieve: it views loss and constraint excess as a component of transport charges.

SRAM options

30. We remain of the view the residual charge should form the allocator if a TPM based approach is used. The residual charge, by design, is intended to have a minimal impact on incentives for grid use, investment and price signals so this is the least distortionary option.
31. We note the use of the residual charge received significant support in the last round of consultation.
32. As raised in our submission on the SRAM principles, we do not support any allocation of settlement residue to generators who have already been fully compensated for their generation. This would result in a windfall gain for generators that would not translate into any benefit for consumers.

Yours sincerely



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