

New Settlement Residual Allocation Methodology

Decision paper

15 November 2022



Executive summary

The new transmission pricing methodology (TPM) comes into force on 1 April 2023 and will render Transpower's existing method for allocating settlement residue obsolete. The Electricity Authority (Authority) has decided to amend the Electricity Industry Participation Code 2010 (Code) to provide for development of a new Settlement Residual Allocation Methodology (SRAM) and ensure the pass-through of settlement residual rebates by distributors.¹

The Authority has chosen the Simple BB method for the new SRAM

The Authority has decided to amend the Code to require Transpower to allocate settlement residue to its customers using the "Simple BB" method proposed in the August 2022 consultation paper. While support was mixed, having considered the various submissions made, the Authority considers that this method is the most consistent with the Authority's statutory objective and the SRAM principles that the Authority developed (and consulted on) earlier in 2022.

Distributors will have a mandatory but limited pass-through obligation

The Authority has decided to require distributors to pass through settlement residual rebates to their customers. Most submitters agreed with this requirement, although there were differing views on how much flexibility distributors should have as to how they achieve this. On considering the submissions, the Authority has chosen the "limited pass-through" option, meaning it will not prescribe distributors' pass-through methodologies.

While the Authority has chosen the limited pass-through option, following submissions it has made some changes to the proposed Code amendment that make some aspects of pass-through slightly more prescriptive. In particular, settlement residual rebates must be passed through on a monthly basis. The Authority has also adjusted its earlier drafting to clarify that rebates must be passed through to a distributor's customers rather than to end users.

Other adjustments to the proposed amendment have been made

The Authority has made some small changes to clarify the commencement date for the provisions and remove the proposed amendment that would make a party's allocation of settlement residual rebates a debt recoverable in court.

The Code amendments promote the Authority's statutory objective

The Code amendments set out in this decision paper promote the Authority's statutory objective by improving the efficient operation of the electricity industry and promoting competition. This is achieved by reducing the overpayment for transmission services that occurs due to customers paying nodal transport charges (in addition to transmission charges) by rebating revenue from nodal transport charges back to customers. The Code amendment achieves this while supporting efficient incentives for grid usage and investment, which over time should lead to consumers paying lower prices for delivered electricity (ie, lower compared to the alternatives).

The SRAM should also promote competition, by reducing distortions, where it can – again this results in downwards pressure on prices. Including generators in the SRAM allocation is an important part of ensuring that competition between generators in different locations (local and distant) is on a level playing field.

¹ The Code amendments are published on the Authority's website: [2022 Code amendments — Electricity Authority](#)

Contents

Executive summary	2
The Authority has chosen the Simple BB method for the new SRAM	2
Distributors will have a mandatory but limited pass-through obligation	2
Other adjustments to the proposed amendment have been made	2
The Code amendments promote the Authority's statutory objective	2
1 Introduction	4
2 SRAM options	6
Our decision	6
What we proposed	6
Submitters' views and our assessment	7
3 Distributor pass-through	11
Our decision	11
What we proposed	11
Submitters' views and our assessment	11
Distributors' methodologies must give effect to purpose	12
Distributors must pass through settlement residual rebates monthly	13
The Authority may prescribe the form of annual disclosure	13
Distributors may not pass-through rebates to end consumers directly	14
4 Other issues	15
Commencement date	15
Enforceable debt provisions	15
Negative settlement residue	15
5 Regulatory statement	17
Submitters' views and our assessment	17
Appendix A Submissions received	19

Tables

Table 1: List of submitters	19
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1 Introduction

- 1.1 Due to the upcoming introduction of the new Transmission Pricing Methodology (TPM) in April 2023, Transpower's existing method for allocating settlement residue² will become obsolete and will need to be replaced.
- 1.2 The Authority has completed two rounds of consultation regarding a potential new Settlement Residual Allocation Methodology (SRAM). The first focused on the principles behind the SRAM and closed on 1 March 2022.³ The second focused on the methodology options and distributor pass-through requirements and closed on 27 September 2022.⁴
- 1.3 Following these consultations, the Authority has decided to amend the Code to—
- (a) require Transpower to allocate settlement residue to its customers in accordance with the regional allocators it has developed for allocating the costs of low-value benefit-based investments via the benefit-based charge simple method in the TPM (the Simple BB option)
 - (b) require distributors to pass through settlement residual rebates on a monthly basis to their customers (being those that pay lines charges to the distributor directly)
- 1.4 The Code amendment is consistent with the SRAM principles adopted in the August 2022 consultation paper, because it:
- (a) addresses over-payment for transmission
 - (b) does not undermine grid usage signals
 - (c) does not undermine investment signals
 - (d) does not add disproportionate cost or complexity.
- 1.5 The Code amendment is also consistent with the Authority's statutory objective, because it requires development of a SRAM and the pass-through of settlement residual rebates in such a way as to create efficient incentives for grid usage and investment, which over time will lead to relatively lower prices for delivered electricity (ie, lower than the prices that would apply under the alternative SRAMs we considered). The SRAM should also promote competition, by reducing distortions, where it can and resulting in downwards pressure on prices.
- 1.6 This paper sets out the Authority's decision on the chosen allocation approach, the obligations on distributors to pass through settlement residual rebates, and several other SRAM-related issues raised in submissions.
- 1.7 Following this decision, the next step will be for Transpower to develop and implement a SRAM that complies with the new requirements in the Code. Distributors will also need to publish their methodologies for passing rebates through to their customers. These steps will need to be completed in time for the first allocation of settlement residue under the new TPM in May 2023.

² Settlement residue is the balance of funds received by Transpower from the clearing manager, drawn from wholesale market loss and constraint excess (LCE) and FTR market surplus (if any).

³ See [Settlement Residual Allocation Methodology: principles, options and pass-through - March 2022 consultation paper \(ea.govt.nz\)](#)

⁴ See [Settlement Residual Allocation Methodology - August 2022 consultation paper \(ea.govt.nz\)](#)

- 1.8 We note that this paper uses the same terminology as the August 2022 consultation paper:
- (a) “loss and constraint excess” (LCE): surplus funds generated by the wholesale market resulting from consumers paying more for electricity than generators receive
 - (b) “settlement residue”: balance of funds received by Transpower from the clearing manager comprising the remainder of revenue from the financial transmission rights (FTR) market and LCE not used in the FTR market
 - (c) “settlement residual allocation methodology” (SRAM): the method used to allocate those funds amongst transmission customers
 - (d) “settlement residual rebate” (rebate): the payment received by a transmission customer.

2 SRAM options

Our decision

- 2.1 The Authority has decided to amend the Code to require Transpower to develop a method to allocate settlement residue in accordance with the Simple BB option from the August 2022 consultation paper.
- 2.2 Under this option, Transpower must develop a methodology to allocate:
- (a) settlement residue related to connection assets to the customers associated with that connection asset
 - (b) settlement residue related to interconnection assets to the customers assessed as benefitting from those assets under the simple method from the new TPM.

What we proposed

- 2.3 The August 2022 consultation paper considered four main options for allocating settlement residual rebates:
- (a) ‘TPM charges’ option: allocate rebates to each transmission customer in proportion to that customer’s total transmission charges;
 - (b) ‘Simple BB’ option: allocate 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;
 - (c) Outside options: transfer surplus LCE outside of the system, for example transfer it to the Crown or use it to fund service providers;
 - (d) ‘Wholesale market’ options: allocate rebates to wholesale market purchasers, in proportion to their monthly settlement value or energy volume.
- 2.4 Having evaluated these options against the principles, the Authority expressed a preference for the Simple BB option as the most balanced option. It allocates settlement residue based on the parts of the grid that generate LCE in the first place (ie, congested links), so it reduces overpayment by the parties that use those parts of the grid. The allocation does not vary with use, so grid usage signals will not be undermined. Rebates are also linked only to the transmission assets where the congestion occurs and are allocated in proportion to historical usage, so when choosing whether and where to increase grid use, customers have the correct investment incentives. Finally, the Authority did not consider this option to be overly costly or complex.
- 2.5 The Authority considered that the TPM charges option would be simpler than the Simple BB method and would not undermine grid usage signals. However, the Authority was concerned that this option would undermine investment signals and competition, as customers with high transmission charges (ie, large customers) would consistently be better shielded from grid congestion and upgrade costs than customers with low transmission charges (including new entrants).⁵ The Authority was also concerned this

⁵ Rebates ‘shield’ participants from the transport component of nodal prices. Participants benefit less from grid upgrades if they are well shielded, so shielding can extend to benefit-based charges for upgrades. Shielding can either enhance or impair pricing signals, depending on how rebates are allocated.

option would not be effective at reducing overpayment, as allocations would be unaffected by where congestion occurred each month.⁶

- 2.6 Outside options were not considered further in the August 2022 consultation paper as they do not address the over-payment problem. Grid users would pay for transmission costs in full via transmission charges, plus pay nodal transport charges (without rebate).
- 2.7 The Authority considered that wholesale market options, whether based on electricity purchase values or volumes, would undermine grid usage signals because a purchaser increasing their consumption in response to high prices would also increase their rebate. The Authority also noted that these options perform poorly against other principles, including that over-payment by generators is not addressed as they would receive no rebate under this option. The importance of generators also receiving rebates is addressed in paragraph 2.10 below.

Submitters' views and our assessment

- 2.8 We received 12 submissions relating to the allocation methodology. Most generator-retailers⁷ and ERANZ supported the Authority's preference for the Simple BB option and the rationale explained in paragraph 2.4 above. Meridian noted that this option "strikes a balance between a fixed allocation (thus preserving grid usage signals) and allocating settlement residue to parties using congested parts of the grid each month (reducing over-payment for transmission)."
- 2.9 Multiple parties preferred allocation methodologies that did not allocate settlement residue to generators, for example wholesale market options or the residual charge.⁸ Reasoning for this position included that:
- (a) "nodal transport costs" is a misleading term
 - (b) generators are already fully compensated for their offers, so allocating settlement residue to generators would arguably result in a wealth transfer from consumers
 - (c) the Authority previously supported allocating settlement residue to load customers only via the residual charge
 - (d) generator behaviour affects the amount of settlement residue.
- 2.10 The Authority disagrees with submissions that generators should not be allocated settlement residue.⁹ As Nova noted, "the share of the rebate accruing to generators under the Simple BB approach is appropriate as the TPM is introducing transmission charges under the TPM that generators did not previously incur."
- 2.11 "Nodal transport costs" may not be a familiar term, but it is useful for communicating the impact of transmission congestion on nodal prices. It refers to the component of the price at a node that is attributable to marginal loss and constraint signals from parts of the grid used by that node. This can be a price uplift (cost to load) or reduction (cost to generation). These costs push generator earnings lower than they would be in the

⁶ For example, a small customer would receive a small rebate every month regardless of whether the parts of the grid that they use were congested that month.

⁷ Contact, Mercury, Meridian and Nova.

⁸ Entrust, Flick, Haast/Independent Retailers, MEUG, Transpower, Vector.

⁹ See paragraph B.14 of the August 2022 consultation paper.

absence of congestion. As such, nodal transport costs are borne by both consumers and generators.

2.12 Further, if the residue is not paid to generators, then a competition issue also arises. To explain:

- (a) a core aspect of the TPM reform is to enhance locational incentives for new generation and load, ie, they pay the costs that arise from where they are sited. That includes paying higher costs if they are geographically distant from load, or behind a congested part of the grid
- (b) locational costs include nodal prices, TPM charges and any settlement residue payable
- (c) by disqualifying generators from receiving any settlement residue, a relevant component of locational costs would be ignored, which creates a distortion
- (d) in practical terms, this distortion means that generators that are distant from load, or behind a congested part of the grid, essentially overpay for nodal transport costs (compared to what is justified by their location)
- (e) as these distant generators compete with local (and embedded) generators, that overpayment results in an unjustified competitive advantage to those local generators. The unjustified competitive advantage means that, all other things being equal, local generation may be built in preference to distant generation despite the local generation being objectively higher cost (in terms of the aggregate generation and transport costs)
- (f) preferring higher-cost generation results in the overall cost of delivered electricity increasing for consumers.

2.13 Some parties submitted that the Authority had previously supported not allocating settlement residue to generators and allocating based on the residual charge.¹⁰ This appears to be a reference to the 2014 working paper, "Transmission pricing methodology: Use of LCE to offset transmission charges".¹¹ However, we note that:

- (a) in the 2014 working paper, the Authority did not say that LCE should not be allocated to generators. Rather it considered whether allocating LCE based on interconnection or DC assets raised risks of gaming by generators and of nodal price signals being muted
- (b) the 2014 working paper was written in the context of the proposed TPM at the time, which included an SPD charge rather than a benefit-based charge as it does now.

2.14 In 2014, the Authority expressed concern that allocating LCE based on a charge that varies with spot market outcomes (such as the SPD charge) may give rise to risks of gaming or nodal price signals being muted. However:

- (a) The risks of gaming under the Simple BB option have been thoroughly considered and discussed more recently in Appendix D of the August 2022 consultation paper. The Authority concluded that a fixed rebate would reduce incentives to exercise

¹⁰ Entrust, Transpower. Haast/Independent Retailers also made multiple references to the Authority previously supporting the point, but did not specify that it was the 2014 working paper.

¹¹ See [Transmission pricing methodology: Use of LCE to offset transmission charges - 2014 working paper \(ea.govt.nz\)](https://www.ea.govt.nz/transmission-pricing-methodology-use-of-lce-to-offset-transmission-charges-2014-working-paper)

market power for parties using a congested link, and that there are already other factors constraining the use of market power for parties that benefit from constrained links. Submissions did not challenge this analysis.

- (b) The risks of nodal price signals being muted under the Simple BB option are also minimal, as this option involves fixed allocations that are only updated every five years.
 - (c) As such, the Authority now considers the allocation of settlement residue to generators to be appropriate.
- 2.15 Some submitters preferred the wholesale market options.¹² Flick and Haast and the Independent Retailers argued that these options were more consistent with the SRAM principles and would avoid the issue of distributor pass-through. Having considered the submissions, the Authority does not agree that this option would be more consistent with the SRAM principles, particularly the principle of not undermining grid usage signals as discussed above in paragraph 2.7.¹³ We consider that this adverse impact on grid usage signals outweighs any practical difficulties that may arise from requiring distributor pass-through.
- 2.16 Other submitters preferred allocating settlement residue based on the TPM residual charge.¹⁴ This was not one of the main options that was considered in the August 2022 consultation paper, due to the Authority’s concerns that it had “similar drawbacks to the TPM option”, specifically by causing overpayments and undermining investment signals. As explained in the August 2022 consultation paper, if the residual charge was used as an allocator, “the gain or loss each party gets from a new [benefit-based investment (BBI)] would materially depend on their residual charge allocation, which is unrelated to their usage of the BBI”.¹⁵ We also consider this option to be inappropriate as it would allocate settlement residual rebates only to load customers, not to generators.
- 2.17 There was little engagement from submitters on the TPM charges option. Haast/the Independent Retailers and Meridian did not support this option. Transpower preferred it to the Simple BB option (on the basis that it was simpler, had fewer policy concerns and lower cost) but generally preferred the wholesale market options. The Authority notes that the ongoing cost and complexity of the Simple BB option are similar to the existing allocation methodology and considers that the one-off implementation and familiarisation costs are justified by the benefits of the Simple BB option (relative to the TPM charges option).
- 2.18 No submissions addressed outside options.
- 2.19 Horizon expressed a preference for the simplest possible option, due to its view that the type of allocation methodology will not “materially distort the operation of the market or influence investment decisions”.
- 2.20 The Authority acknowledges that many submitters are sceptical of the benefits that could arise from a well-designed allocation methodology – including because settlement residue is small relative to the wholesale electricity market, and because the

¹² Flick, Haast/Independent Retailers, Transpower

¹³ See paragraphs 4.17 to 4.22 of the August 2022 consultation paper

¹⁴ MEUG, Vector. Entrust supported this option if a TPM-based option is used, but its main concern is that settlement residue is not allocated to generators. Haast/Independent Retailers and Transpower supported this approach but preferred the wholesale market options.

¹⁵ See paragraph B.7 of the August 2022 consultation paper.

methodology options appear complex. These factors understandably cause doubt for some submitters as to whether allocation can deliver benefits in terms of retail costs or investment coordination.

- 2.21 On retail costs, we think it is reasonable to expect the benefits to become clearer over time. Retailers will find that locational price risk is softened, because there will be some correlation between high prices at a location and higher rebates at that location. As retailers gain confidence in that relationship, they will be able to spend less on hedging locational price risk and/or build lower risk premiums into retail tariffs.
- 2.22 On investment coordination, we expect parties will gain experience over time with the way that rebates partially shield existing usage from the nodal pricing impacts of congestion and improve the allocation of upgrade costs.¹⁶
- 2.23 Having considered all submissions, the Authority has decided that the Simple BB option is the most consistent with the SRAM principles and the Authority's statutory objective.

¹⁶ In contrast to the TPM charges option, for the Simple BB option the level of shielding is related to historical usage by each party. This means that congestion and upgrade costs fall most heavily on parties adding to grid congestion – including through investment in new generation capacity or inflexible demand.

3 Distributor pass-through

Our decision

- 3.1 The Authority has adopted the Code amendment on distributor pass-through of settlement residual rebates that was proposed in the August 2022 consultation paper (the “limited pass-through obligation” option), with the following amendments:
- (a) requiring distributors’ allocation methodologies to “give effect to”, rather than just “have regard to”, the purpose clause
 - (b) requiring distributors to pass through any settlement residual rebates on a monthly basis, rather than “at least annually”
 - (c) allowing the Authority to prescribe the form in which distributors must publish a breakdown of rebates passed through to customers
 - (d) clarifying that a distributor’s “customers” only include those that pay lines charges to the distributor directly (so that where end consumers contract for lines services via retailers, the rebate should be allocated to the retailer rather than to the end consumer).

What we proposed

- 3.2 The August 2022 consultation paper considered four main options for distributors’ treatment of settlement residual rebates:
- (a) status quo – rebates are unregulated revenue: distributors have full discretion as to whether rebates are passed through, distributed, or retained
 - (b) enhanced disclosure – as above, but distributors would be required to disclose their treatment of rebates (ie, their methodology, and the results of its application)
 - (c) limited pass-through obligation – enhanced disclosure, plus distributors required to pass rebates through to their customers, but with limited prescription as to how or when
 - (d) full pass-through obligation – as above, but with prescription as to how and when rebates are allocated and passed through.
- 3.3 The Authority expressed a preference for a limited pass-through obligation on the basis that this ensured that settlement residual rebates would be passed through to distributors’ customers (as opposed to the status quo or enhanced disclosure options) but avoided the unnecessary compliance costs and inflexibility that could result from the full pass-through obligation.¹⁷

Submitters’ views and our assessment

- 3.4 Most submitters agreed that distributor pass-through should be mandated to some degree.¹⁸
- 3.5 MEUG supported the status quo option on the basis that the Authority had provided “no evidence that distributors are allocating settlement residual income into unregulated (ie,

¹⁷ See paragraph 5.31 and 5.32 of the August 2022 consultation paper.

¹⁸ Contact, ENA, ERANZ, Genesis, Haast/Independent Retailers, Horizon, Mercury, Meridian, Northpower, Nova. Vector did not oppose mandatory pass-through obligation so long as it would still be able to rebate end users directly rather than through retailers.

not regulated by Part 4 of the Commerce Act) businesses.” It also argued that the Authority was being inconsistent by merely providing guidance for the pass-through of transmission costs but mandating the pass-through of settlement residual rebates. The Authority notes that analysis by Sapere¹⁹ indicates some distributors not passing rebates through to customers. We consider that Authority guidance will not be sufficient to ensure that they do so (regardless of the effectiveness of such guidance in the case of transmission charges pass-through).

- 3.6 Some distributors and associated parties supported the proposed “limited pass-through” option.²⁰ They agreed with the Authority’s position that this would provide greater flexibility and cost savings for distributors than the full pass-through option.
- 3.7 Retailers tended to favour tighter pass-through obligations.²¹ They submitted that any additional compliance costs would be minimal (where distributors were already passing through rebates) or warranted (where they were not). To maintain some flexibility for particular cases, some retailers suggested an exemption mechanism that would allow distributors to apply for permission to use a non-standard methodology.²²
- 3.8 The Authority agrees with the submissions by distributors that fully prescribing the pass-through methodology that distributors must use is inappropriate at this time (and considers an exemption mechanism would be unnecessary given the generic ability under section 11(1)(b) of the Electricity Industry Act 2010 for the Authority to exempt participants from obligations under the Code). Adopting a single, prescribed methodology would not allow distributors adequate flexibility to pass through rebates in a way that fits with their approach to transmission cost pass-through or distribution pricing more generally. However, we accept that some aspects of the pass-through requirements could be tightened without unreasonably limiting distributors’ flexibility or imposing unreasonable costs. These are discussed below.

Distributors’ methodologies must give effect to purpose

- 3.9 Meridian submitted that as currently drafted, the Code amendment may not achieve its intent of requiring distributors to pass through settlement residual rebates. The proposed drafting only requires distributors to “have regard to” the purpose clause.²³ Meridian submitted that this should be changed to “give effect to” to ensure that a distributor incorporates this purpose in their methodology, rather than potentially being able to “give [the purpose clause] its attention but not necessarily accept it”.
- 3.10 The Authority agrees that “giving effect” to the purpose of distributor pass-through is a reasonable obligation to require from distributors’ methodologies.

¹⁹ Commissioned by Mercury and supported by Genesis and Meridian in their March 2022 submissions.

²⁰ ENA, Horizon, Northpower, Vector (subject to footnote 18).

²¹ Contact, ERANZ, Genesis, Mercury, Meridian, Nova.

²² Contact, ERANZ, Nova.

²³ The purpose being “to allocate settlement residue to consumers ... in proportion to the transmission charges paid by those consumers ... in respect of each connection location”. See clause 12A.3(1) in the August 2022 consultation paper.

Distributors must pass through settlement residual rebates monthly

- 3.11 The proposed drafting as provided with the August 2022 consultation paper would have required distributors to pass through settlement residual rebates to their customers “at least annually”.²⁴
- 3.12 Some retailers submitted that this pass-through should instead be required on a monthly basis.²⁵ Genesis argued that allowing distributors to hold rebates for up to a year provides them with the benefit of being able to use this money interest-free for up to a year. On the other hand, some distributors supported the annual requirement. ENA noted it “would allow EDBs flexibility in choice of pass-through method” and Northpower noted it would pragmatically balance cost and efficiency.
- 3.13 On balance, the Authority considers that requiring monthly pass-through is reasonable, including because, even though it may require changes by some distributors, it delivers benefits because:
- (a) Transpower allocates rebates on a monthly basis and distributors bill retailers on a monthly basis. Requiring monthly pass-through would align all these cycles
 - (b) wholesale purchasers are billed on a monthly basis. Requiring monthly pass-through would mean timely mitigation of volatility for retailers, as they would receive higher settlement residual rebates within two months of paying higher nodal transport costs due to congestion
 - (c) it would reduce the amount of accumulated settlement residual rebates held by distributors. This addresses Genesis’ concern about distributors benefiting from interest-free funds, but would also avoid complexity for distributors when dealing with changes in retailer market shares over the course of a year.
- 3.14 The Authority notes that distributors will still have flexibility as to their pass-through methodology in terms of how to allocate settlement residual rebates to their customers – this change only requires them to do so more frequently than they might otherwise choose.

The Authority may prescribe the form of annual disclosure

- 3.15 The Authority’s draft Code amendment further proposed requiring distributors to publish²⁶ their allocation methodology (and rationale for this methodology). They would also need to annually publish a breakdown of such payments by location and type of customer.²⁷
- 3.16 Some generator-retailers submitted that distributors should be required to disclose to customers the breakdown of the rebates passed through to them.²⁸ Northpower submitted that they did not object to this requirement but noted that disclosure complexity should be “commensurate with the payments made and allocation approach taken”. Horizon agreed that it was reasonable to require distributors to disclose their allocation methodologies to the Authority, but that the Authority needs to “work with the industry to develop and deliver education material to consumers on the use and

²⁴ See proposed clause 12A.3(2) in the August 2022 consultation paper.

²⁵ ERANZ, Genesis, Mercury, Nova.

²⁶ “Publish” is defined in clause 1.1(1) of the Code as “to make the information available to the public, at no cost, on a website maintained by, or on behalf of, the participant”.

²⁷ See proposed clause 12A.3(5) in the August 2022 consultation paper.

²⁸ Mercury, Meridian, Nova.

allocation of LCE prior to any required disclosure of how EDBs are passing this onto consumers.”

- 3.17 The Authority considers that the disclosure requirements in the proposed Code amendment are generally appropriate. We consider that prior education material is not a high priority.
- 3.18 While the proposed Code amendment does not specify the form that the disclosure must take, we have made a minor amendment by allowing the Authority an option to prescribe the form of this disclosure. This would not change what information must be disclosed, but just the format in which it is presented if that would be desirable in the future.

Distributors may not pass-through rebates to end consumers directly

- 3.19 The proposed drafting consulted on would have required distributors to pass through settlement residual rebates to their “customers”. In clause 13A.3(5) it gives examples of types of customers as “retailer, direct generation customer, direct load customer”. However, the pass-through purpose clause refers to allocating rebates to “consumers (or retailers on behalf of consumers)”.²⁹
- 3.20 Entrust and Vector argued that distributors should be able to pass through settlement residual rebates to end consumers directly, rather than having to pay them to retailers. They argued that allowing direct allocation would be more cost effective, transparent and consistent with the SRAM principles. ENA and Northpower also expressed doubt that retail competition would be sufficient to ensure rebates would be fully passed through to consumers. On the other hand, some retailers expressed support for distributors being required to pay retailers and submitted that the drafting should be amended to clarify this.³⁰
- 3.21 The Authority does not agree that distributors should be able to pass settlement residual rebates directly to end consumers. We are concerned that allowing distributors to pass through rebates to end consumers directly would bypass the point in the supply chain where transmission and wholesale electricity charges (which include nodal transport charges) are united. This would leave retailers fully exposed to nodal transport charge volatility, with no access to offsetting rebates. As discussed in the March 2022 consultation paper, requiring pass-through to retailers “returns settlement residual rebates broadly to the parties who bear the cost of congestion (in particular, to wholesale purchasers of electricity) and broadly offsets monthly congestion charge volatility, ie, provides a partial offset of that volatility.”³¹
- 3.22 The Authority considers that the term “customers” should be more clearly defined as those that pay lines charges to the distributor directly. We have changed the drafting of the proposed amendment accordingly, similarly to the drafting proposed in Mercury’s submission.

²⁹ See proposed clause 12A.3(1) in the August 2022 consultation paper.

³⁰ Genesis, Mercury, Meridian. ERANZ also noted the importance of clarifying this provision, but did not express a clear preference as to their preferred definition of “customer”.

³¹ See paragraph 5.6 of the January 2022 consultation paper.

4 Other issues

Commencement date

- 4.1 The Authority has made some minor amendments to the Code amendment to clarify that the new provisions will come into effect following the implementation of the new TPM.
- 4.2 The first LCE under the new TPM will be generated during April 2023. Transpower will first allocate the associated settlement residual rebates to its customers in May 2023. We expect most distributors will first pass these rebates through to their customers in June 2023.

Enforceable debt provisions

- 4.3 The August 2022 consultation paper included a proposal to make a party's allocation of settlement residual rebates a debt recoverable in court.³² This would apply to settlement residual rebates payable by Transpower to its customers and payable by distributors to their customers.
- 4.4 Only four submissions addressed this issue. Some parties submitted that this provision was unnecessary as the Code's enforcement mechanisms should be sufficient.³³ Nova agreed that recipients of settlement residual rebates have enforceable rights but did not expressly support this clause.
- 4.5 Following submissions and further analysis, the Authority agrees that this proposed Code amendment is not necessary. Parties can still enforce this obligation through the Rulings Panel, which can make amounts due a debt enforceable through the courts.³⁴ The proposed provision would simply bypass the Rulings Panel process, which could lead to ambiguity as to whether the amount is actually "payable" or not. The Authority also considers that dealing with such disputes through the Code breach process will be administratively manageable for both the participants and the Authority.
- 4.6 Horizon suggested that the Authority instead provide guidance to inform participants that recovery through the courts was an option to recover unpaid settlement residual rebates. The Authority notes that while such unpaid settlement residual rebates are recoverable through the Courts, going through the Code breach process allows the Rulings Panel to make a determination on whether there is unpaid settlement residue and if so, how much there is.
- 4.7 As such, these provisions have been deleted from the proposed Code amendment.

Negative settlement residue

- 4.8 Some submitters raised the point that settlement residue can sometimes be negative for some customers at some locations.³⁵ In these cases, Transpower charges a customer a

³² See paragraph 4.33 and proposed clauses 12A.3(7) and 14.35A(5).

³³ ENA, Horizon, Northpower.

³⁴ Clause 89 of the Electricity Industry (Enforcement) Regulations 2010 note that "if the Rulings Panel finds, or the parties agree, during the course of any dispute resolution process, that money is due and payable under the Code, that finding or agreement creates an obligation to pay the amount agreed or determined" and "that amount is a debt due by the industry participant and is recoverable as such in court."

³⁵ Horizon, Northpower.

settlement residual figure rather than paying them a rebate. This can occur for reasons including the following:

- (a) to correct previous overpayments of settlement residual rebates
 - (b) as a result of the SPD model producing negative LCE in specific grid scenarios.³⁶
- 4.9 Horizon also submitted that when rebates are negative, distributors are unable to pass this cost through to their customers so must bear the cost themselves.
- 4.10 The Authority acknowledges these points raised in submissions and considers that further analysis should be done following this Code amendment to determine the extent of any remaining issue and potential solutions. In the interim, we confirm that distributors are not required to pass through negative settlement residue to their customers (as the pass-through requirement only applies to settlement residue that distributors are “paid”), so the Code amendment does not impose any obligations on distributors that they may be unable to fulfil. Further, distributors will be able to adjust payments of settlement residual rebates to account for previous overpayments or any previous under-recovery. So distributors would not need to bear the cost themselves.

³⁶ This can occur where marginal losses are less than average losses (such as where transformers have some fixed losses and are lightly loaded). It can also occur very rarely on unconstrained transmission lines due to very specific loop conditions. See Appendix B of [Loss and constraint excess payment: Method for determining customer share \(transpower.co.nz\)](#).

5 Regulatory statement

- 5.1 The August 2022 consultation paper included (in Chapter 6) a regulatory statement in accordance with section 39(1) and (2) of the Act.
- 5.2 The regulatory statement included in the August 2022 consultation paper:
- (a) noted that the objective of the proposed Code amendment is to provide for the replacement of Transpower’s existing method of allocating settlement residue, which will become obsolete with the new TPM, with a new SRAM, to be developed by Transpower, that is consistent with the Authority’s statutory objective
 - (b) provided an evaluation of the costs and benefits of the proposed Code amendment, finding that the benefits were expected to outweigh the costs
 - (c) explained that the Authority had identified viable alternative means of addressing the proposed Code amendments’ objectives, but concluded that none of the alternatives were likely to be as effective in meeting the Authority’s statutory objective as the proposed Code amendment
 - (d) summarised how the proposed Code amendment complied with section 32(1) of the Act, focussing on how it would improve efficiency by, at moderate cost, better matching the charges for transmission services to the cost of providing them without undermining grid usage signals or investment signals.³⁷
 - (e) documented the Authority’s consideration of the Code amendment principles.

Submitters’ views and our assessment

- 5.3 Only a few submissions engaged directly with the Authority’s regulatory statement or the issues it addresses.³⁸
- (a) Genesis submitted that a use of money interest calculation should be included in the cost-benefit analysis to account for distributors’ ability to retain settlement residual rebates for up to a year. The Authority has changed the proposed Code amendment so that distributors must pass rebates through monthly, so this potential disbenefit to consumers is mitigated.
 - (b) Horizon submitted that it does not expect the SRAM to have any measurable impact on investment decisions. The Authority explained the importance of transport revenues to coordinating grid investment (despite making up only a small percentage of traded wholesale electricity values) in paragraphs B.11 to B.13 of the August 2022 consultation paper – it continues to hold the views expressed in those paragraphs. Horizon also suggested that when costs and benefits are expected to be relatively low, the level of effort to quantify them should reflect this. The Authority considers that its assessment of cost and benefits is appropriate.
 - (c) Meridian submitted that the regulatory statement and cost-benefit analysis “needs to account for the costs to retailers of managing 29 different pass-through methods”. We note that the updated proposed amendments reduce this cost by tightening the requirements on distributors’ pass-through of settlement residue. Any remaining cost of understanding differences in methodology is likely to be no more than minor.

³⁷ Also see Table 3 on p.26-27 of the August 2022 Consultation paper.

³⁸ Genesis, Horizon, Meridian.

5.4 Overall, the Authority considers the regulatory statement in the August 2022 consultation paper is fit for purpose.

Impact of changes to the Code amendment

5.5 As noted above, while the Authority has largely adopted the Code amendment that was proposed in the August 2022 consultation paper, we have made some changes to the provisions relating to distributor pass-through in light of submissions. Specifically, the Authority decided to:

- (a) amend the clause requiring distributors to develop a pass-through methodology so that the methodology must “give effect to” the purpose of the pass-through obligations
- (b) require distributors to pass through settlement residual rebates on a monthly basis rather than an annual basis
- (c) allow the Authority the option to prescribe the form that distributor’s annual pass-through disclosure must take
- (d) clarify that a distributor’s customers does not include end consumers who pay for lines services through a retailer. The term “customer” was defined, and the term “consumer” in the purpose clause was replaced with the term “customer”.

5.6 The Authority has also made other changes to the proposed Code amendment following other issues raised by submitters. Specifically, the Authority has decided to remove the proposal to treat rebates payable under the Code as a debt enforceable through the courts.

5.7 The Authority has considered whether any of these amendments may have impacted on the assessment provided in the regulatory statement set out in the consultation paper. In our view, these amendments have only a minor impact.

Conclusion

5.8 Overall, the Authority is satisfied that it has met the requirements of a regulatory statement in section 39(2) of the Electricity Industry Act 2010, and that it has had proper regard for the Code amendment principles as required by the Authority’s Consultation Charter.

5.9 After carefully considering all submissions on the proposed Code amendment, the Authority considers the final Code amendment will deliver long-term benefits to consumers by promoting the efficiency limb of our statutory objective.

5.10 Specifically, the amendment will promote the efficient operation of the electricity industry and promote competition by providing for the development of a SRAM that reduces overpayment while supporting efficient incentives for grid usage and investment.

Appendix A Submissions received

A.1 The Authority received submissions on our consultation paper from the 15 parties listed in Table 1. Submissions are available on the Authority's website.³⁹

Table 1: List of submitters

<i>Submitter</i>	<i>Category</i>
Contact	Electricity generation and retailing
Electricity Networks Association (ENA)	Electricity distribution representation
Entrust	Electricity distribution shareholder
Electricity Retailers' Association of New Zealand (ERANZ)	Electricity retailing representation
Flick	Electricity retailing
Genesis	Electricity generation and retailing
Haast and Independent Retailers	Electricity retailing
Horizon Networks	Electricity distribution
Mercury	Electricity generation and retailing
Meridian	Electricity generation and retailing
Major Electricity Users' Group (MEUG)	Electricity consumer representation
Northpower	Electricity distribution
Nova	Electricity generation and retailing
Transpower	Electricity transmission
Vector	Electricity distribution

³⁹

<https://www.ea.govt.nz/development/work-programme/pricing-cost-allocation/settlement-residual-allocation-methodology-sram/consultation/#c19217>