



MAJOR ELECTRICITY USERS' GROUP

25 March 2014

Dr John Rampton
General Manager Market Design
Electricity Authority

By email to submissions@ea.govt.nz

Dear John

Working paper – TPM beneficiaries-pay options

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Authority working paper¹ "Transmission pricing methodology review: Beneficiaries-pay options" dated 21st January 2013. MEUG requested advice from NZIER on the working paper. A copy of that advice "Beneficiaries-pay options, Advice to MEUG regarding Electricity Authority Beneficiaries-pay options working paper (21 January 2014)" dated March 2014 is attached and should be read as part of the MEUG submission.
2. Members of MEUG have been consulted in the preparation of this submission. This submission is not confidential. Several MEUG members will also be making submissions.
3. In the key point summary of their report (pp i-ii), NZIER note:

"Analysis shows incidence of overall transmission charges is very sensitive to how residual charges are allocated – that is those charges not captured in a beneficiary-pays charge. It is hard to see how a full assessment of the B-P mechanism can be made independent of options for allocating the residual and how the moving parts all interact.

Specific comments are as follows:

- We are pleased that the EA has acknowledged the importance of demand response and intends taking account of demand elasticity and dispatchable demand. Both are good moves in the right direction by the EA, though some further refinement is needed.

¹ Document URL <http://www.ea.govt.nz/dmsdocument/17482> found at <http://www.ea.govt.nz/development/work-programme/transmission-distribution/transmission-pricing-review/consultations/#c7492>

- The EA approach to non-supply is sensible, in principle, and a considerable improvement upon a blanket value of \$3,000/MWh as proposed. Their revised approach has the potential benefit of causing prices for non-supply to be adjusted dynamically and thus to reflect the changing value of interconnection over time.
 - Charging based on net benefit has some merit. The EA should consider whether its concerns about inefficiencies from charging on net benefits are of much practical consequence.
 - Compensation for dis-benefits is, however, highly inefficient as it encourages inefficient production and investment.
 - We have considered an in-principle basis for charging embedded generation. It is clear that efficient charging of industrial cogeneration will need to be based on net injection (as suggested by the EA). Finding the most efficient charging basis for other embedded generation will be more challenging.
 - A GIT-based charge shifts (some) costs of transmission from obvious non-beneficiaries to a set of possible and probable beneficiaries. This is potentially an improvement on the status quo in terms of investment and dynamic efficiency. It will, however, come with costs associated with the fact that it is not well targeted. Whether it is an efficient TPM option is a matter of trade-offs and needs to be compared against alternative charging approaches or components of a transmission pricing methodology. The materiality of these considerations is, in part, an empirical matter. These issues should be considered in the context of cost-benefit-analysis of a full transmission pricing proposal.”
4. The TPM working papers to date on CBA², sunk costs³, ACOT⁴ and LCE⁵ have been relatively stand-alone subjects. That is relatively discrete compared to this working paper considering options to use beneficiaries-pay for interconnection and HVDC assets. Commenting on beneficiaries-pay options and the soon to be consulted on treatment of residual charges is complicated because the combinations of options and sub-elements within each option quickly multiply leading to significant analytical resources and time to evaluate. This problem is compounded by some design parameters either reinforcing or counter-acting other parameters.
5. Overlaying the challenges to focus analytical resources on the options in the paper are concerns by interested parties that near term impacts on Transpower’s customers and end customers in general can be estimated however there is no analysis or indication on how each option might be assessed for the long-term benefit of consumers. This is not a criticism of the working paper rather a comment on the importance that any proposed changes in the second consultation paper must be evidenced by a robust CBA. MEUG and other parties have made this point since the original October 2012 proposal. It is a bottom line for MEUG that is worth repeating.

² Cost benefit analysis working paper, 3rd September 2013

³ Sunk costs working paper, 8th October 2013

⁴ Avoided cost of transmission working paper, 19th November 2013

⁵ Loss and constraint excess working paper, 21st January 2014

6. MEUG appreciated the work of EA staff to discuss the paper with members, answer various questions and undertake model runs at MEUG's request. The Authority allowed 9 weeks for consultation and we have had to use all of that. From that experience and the discussion above on the complexity of the task MEUG suggest:
- a) Longer than 9 weeks may be needed for consultation on the residual paper and second consultation paper.
 - b) The Authority held a forum on 29th January 2014, a week after the consultation paper was published. That workshop clarified some initial issues. At that time some people were on annual leave and others couldn't attend as they were based outside of Wellington. A forum in Auckland would have been useful.

A second workshop part way through the consultation might also have been worthwhile. That could have focussed on specific matters, ie not to repeat the initial forum but to have a look at a smaller set of matters in detail.
 - c) Feedback from the beneficiaries-pay paper is likely to be an input to the Authority preparing the residual working paper. There may be value in having a post-beneficiaries-pay submissions workshop to discuss specific topics that the Authority may wish to tease out from submissions. This forum would not be an opportunity for parties to restate their submissions. The purpose would be to assist the Authority be efficient in understanding and testing new ideas or themes from submissions relevant to the Authority drafting the residual paper.
7. Stepping back and looking at the broader view MEUG note:
- a) Nothing in the working paper has altered MEUG's view that conceptually a beneficiaries-pay approach is better than the current administrative (in effect) flat-tax method. The challenge is to find an option that is implementable with demonstrable long-term benefits for consumers.
 - b) There has been in our view inefficient capital investment by Transpower either by building too early⁶, building gold-plated assets or failing to consider short term options until better information can be obtained to decide optimal project design and timing. Rhetoric about under-investment in the grid continues to be made by various commentators without evidence that service levels have declined. Poor capital investment decisions by Transpower in the past, albeit within the regulatory frameworks of the time, have made New Zealand less wealthy than we could have been. There are many solutions to ensure that behaviour is mitigated in the future. Amending the TPM charges for interconnection and HVDC assets for prospective and perhaps existing assets, to a beneficiaries-pay approach, is worth exploring. It must as noted above be evidenced by long-term benefits to consumers. Rearranging the TPM leading to wealth transfers without evidence of long-term benefits, particularly in the treatment of existing assets, must be avoided.

⁶ For example see the discussion on MEUG's view that Transpower decided to build NIGU even though it was clear that forecast demand growth had decreased relative to when NIGU was first proposed, refer MEUG to Commerce Commission, Cross-submission on NIGU Project Amendment issues paper, 31st January 2014, document URL <http://www.meug.co.nz/includes/download.aspx?ID=132827> found at <http://www.meug.co.nz/Site/submissions.aspx>

- c) In workably competitive markets businesses cannot charge for assets that provide no benefit. The same should apply to Transpower. The debate on the SPD approach has been complex but one benefit cannot be denied. That is the SPD method has allowed an assessment of the uneconomic portion of prior investment decisions. That value is in the residual. In the discussion on the GIT-plus-SPD option the Authority makes the observation (paragraph 8.33 (vii)):

“However, full allocation of costs to beneficiaries increases the chance that inefficient investments will ultimately be borne by the Transpower shareholder, and therefore socialised more efficiently across the general tax base, rather than just electricity consumers.”

The Authority is correct to identify an option for treatment of uneconomic assets is for Transpower's shareholders to bear the cost by writing down the assets. MEUG suggests this option is not only appropriate for the GIT-plus-SPD option but should also be considered for any beneficiaries-pay approach where a residual representing uneconomic asset values are identified. Requiring Transpower's shareholders to bear write-down of prior poor investment decisions is not trivial and may require appropriate amendments to the regulatory asset base Input Methodologies determined by the Commerce Commission. As with all options being considered by the Authority it would also need to pass a robust CBA to demonstrate net benefits for the long-term benefit of consumers were greater than other options.

8. We look forward to the Authority considering this submission and the specific process improvements suggested in paragraph 6 above.

Yours sincerely



Ralph Matthes
Executive Director

Attachment:

NZIER, Beneficiaries-pay options, Advice to MEUG regarding Electricity Authority Beneficiaries-pay options working paper (21 January 2014), March 2014